FOR-PROFIT, NON-PROFIT, AND HYBRID: THE GLOBAL EMERGENCE OF LEGALLY 'GOOD' CORPORATIONS AND THE CANADIAN EXPERIMENT

by

Carol Liao

LL.M., The University of British Columbia, 2010
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ABSTRACT

There are mounting expectations for corporations to play a role in overcoming barriers to sustainability and socio-economic development. The explosion of social enterprises in the last decade has spawned a new generation of alternative corporations. Legislators across the world are crafting new laws to meet growing demands from social entrepreneurs seeking legal infrastructure to house their social businesses. “Hybrid” corporations blend for-profit and non-profit legal characteristics in their design, enabling and, at times, requiring businesses to pursue dual economic and social mandates. Some hybrids have been met with relative success in their home nations, others have not. The emergence of hybrid corporations challenges the foundational principles of corporate law and shareholder wealth maximization, as well as the nature of the non-profit organization.

Corporate hybridity has received little scrutiny in scholarship to date as it is a relatively new institutional phenomenon. This dissertation situates hybrids within the broader context of neoclassical corporate legal theory. The underlying hypothesis is to test whether the creation of hybrids will contribute to the advancement of the social economy to a greater extent than if such entities did not exist. Part One provides historical background on the development and evolution of the shareholder primacy model of governance, both in theory and in practice, and whether there has been global convergence of this model. It explores some of the leading critiques and counter-hegemonic discourses to shareholder primacy and limitations to its reform, as well as the challenges facing the non-profit sector and resulting global emergence of hybrid legal structures. Part Two shifts the focus to Canada, a unique country to study corporate hybridity as some international hybrid forms have been adopted or are being considered. This critical juncture in Canadian corporate history serves as a live experiment on the utility of hybrids. Using qualitative

empirical data, this dissertation positions a Canadian model of corporate governance within the international dialogue, and provides early lessons on whether hybrids can serve as catalysts in growing the social economy. Implementation strategies are provided for both domestic and international legislators who are interested in creating new laws to support burgeoning social enterprises.

PREFACE

This dissertation is formatted in accordance with the regulations of the University of British Columbia and submitted in partial fulfillment of the requirements for a PhD degree awarded jointly by the University of British Columbia and the University of Toronto. Versions of this dissertation will exist in the institutional repositories of both institutions.

This dissertation is an accumulation of several years' work in the field of corporate law, legal theory, hybrid corporations, social enterprise law, and social innovation. Previous drafts of portions of this dissertation have appeared in the following publications:

> An earlier version of Sections 1.2 – 1.5 appeared in "Corporate Governance Reform for the 21st Century: A Critical Reassessment of the Shareholder Primacy Model" (2012) 43(2) Ottawa Law Review 187-232 (peer-reviewed).
>
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>
> Figure 1 will appear in "The Changing Face of the Non-Profit Sector: Social Enterprise Legislation in British Columbia" in Nick Mulé and Gloria DeSantis, eds., *The Shifting Terrain: Public Policy Advocacy in Canada* (Montreal: McGill-Queen's University Press, forthcoming 2017) (peer-reviewed).
>
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>
> An earlier version of Section 7.3 appeared in "Disruptive Innovation and the Global Emergence of Hybrid Legal Structures" (April 2014) 11:2 European Company Law 67-70 (peer-reviewed); University of Oslo Faculty of Law Research Paper No. 2014-16.
>
> An early stage framework of this dissertation formed the basis for my ideas in "The Next Stage of CSR for Canada: Transformational Corporate Governance, Hybrid Legal Structures, and the Growth of Social Enterprise" (2013) 9 McGill International Journal of Sustainable Development Law and Policy 53-85 (peer-reviewed); reprinted in the Canadian Law eJournal, Anita Anand, ed., Vol. 9, No. 40 (13 June 2013).

The fieldwork reported in Chapter 5 and Appendix B was covered by UBC Ethics Certificate number H12-03615, entitled "Robert Bertram Project."

Footnotes conform to the *Canadian Uniform Guide to Legal Citation* (McGill Guide), 8th ed. (Thomson/Carswell, 2014).

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GLOSSARY

AMF	Autorité des Marchés Financiers
AUM	Assets under management
BIS	UK Department for Business Innovation & Skills
BCE	*BCE Inc. v 1976 Debentureholders*
C3 or CCC	Community Contribution Company
CBSR	Canadian Business for Social Responsibility
CCGG	Canadian Coalition for Good Governance
CEO	Chief Executive Officer
CIC	Community Interest Company
CII	Council of Institutional Investors
CBCA	*Canada Business Corporations Act*
CRA	Canada Revenue Agency
CSA	Canadian Securities Administrators
CSGVP	Canada Survey of Giving, Volunteering and Participating
CSR	Corporate social responsibility
ESG	Environmental, Social, Governance
ESV	Enlightened Shareholder Value
EU	European Union
GDP	Gross domestic product
GFC	Global financial crisis
GSA	*Glass-Steagall Act*
ICA	International Cooperative Alliance

ICGN	International Corporate Governance Network
ISS	Institutional Shareholder Services Inc.
IRS	Internal Revenue Service
ITA	*Income Tax Act (Canada)*
L3C	Low-profit limited liability company
LLC	Limited liability company
M&A	Mergers and acquistiions
MI 61-101	Multilateral Instrument 61-101 *Protection of Minority Security Holders in Special Transactions*
MNE	Multinational enterprise
NIE	New institutional economics
NP 62-202	National Policy 62-202 *Take-Over Bids – Defensive Tactics*
NPO	Non-profit organization
NSGVP	National Survey of Giving, Volunteering and Participating
NSNVO	National Survey of Nonprofit and Voluntary Organizations
OECD	Organization for Economic and Cooperative Development
OSC	Ontario Securities Commission
PHS	Portland Hotel Society
PLR	Private letter ruling
PRI	Program-related investment
SCC	Supreme Court of Canada

SE LLC	Social Enterprise Limited Liability Company
SMB	Small and medium-sized business
SOX Act	*Sarbanes-Oxley Act of 2002*
SPC	Social purpose corporations
SRI	Socially Responsible Investment
TMX	TMX Group Ltd.
TSX	Toronto Stock Exchange
UK	United Kingdom
UN	United Nations
UN PRI	United Nations Principles of Responsible Investment
US	United States

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Before academia, I practised corporate law in New York. Now with three children, my doctoral studies drawing to a close, and my second year as an assistant professor at the University of Victoria Faculty of Law before me, I reflect on the path that got me here with some bewilderment. Much had to do with timing and sheer luck. More had to do with mentors that were willing to invest in my future, and family and friends that supported me.

I want to first thank my doctoral committee for their time, thoughtful feedback, and guidance throughout this dissertation project. I am very lucky to have had Professor Janis Sarra and Professor Anita Anand as my co-supervisors in this joint doctoral degree with the University of British Columbia and the University of Toronto. I offer my gratitude to Professor Sarra, who encouraged me to find my own voice as a scholar and has supported me for a countless number of years. I am grateful to Professor Anita Anand for all her insights and advice, and who, along with Professor Sarra, has been an inspiring example to me on how to excel as academic while remaining highly connected to industry and still very involved in family life. I give my sincere thanks to Professor Ian Lee for his astute reflections and particularly challenging and incisive questions that raised the caliber of my research. Finally, my deep gratitude goes to Professor Benjamin Richardson, whose continual involvement in my research and career has left an indelible mark and changed the course of my life. He is a world-class researcher, teacher, and changemaker, and I hope one day to be even half the scholar he is. His generosity to me over the years leaves me humbled, and I intend to pay it forward to my students.

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Justice Risa Levine, Professor Emeritus John Hogarth, Vickie Cammack, Coro Strandberg, Christie Stephenson, and Professor Beate Sjåfjell, for taking chances on me and opening doors for me over the years. My gratitude as well goes to Professor Jutta Brunnée and Professor Douglas Harris for their collaborative support in this unique joint doctoral degree across institutions. I would also like to thank my friends and colleagues at the University of Victoria Faculty of Law, who have been immensely supportive of my research and growth as a teacher and scholar.

Part Two of this dissertation addresses the current Canadian corporate governance landscape and its relevance to the implementation of hybrid corporate legal structures in Canada. I gratefully acknowledge the following Canadian senior legal practitioners who kindly and generously contributed their time and expertise to my findings in Part Two, particularly Chapter 5: William M. Ainley, Davies Ward Phillips & Vineberg LLP; Rita C. Andreone, Q.C., Lawson Lundell LLP; Jeff Barnes, Borden Ladner Gervais LLP; Noralee Bradley, Osler, Hoskin & Harcourt LLP; William J. Braithwaite, Stikeman Elliot LLP; Terrence Burgoyne, Osler, Hoskin & Harcourt LLP; Rob Collins, Blakes, Cassels & Graydon LLP; Douglas G. Copland, Borden Ladner Gervais LLP; Dallas L. Droppo, Blakes, Cassels & Graydon LLP; Aaron S. Emes, Torys LLP; Jean Fraser, Osler, Hoskin & Harcourt LLP; Sharon C. Geraghty, Torys LLP; Mitchell H. Gropper, Q.C., Farris, Vaughn, Wills & Murphy LLP; Stephen Halperin, Goodmans LLP; Carol Hansell, Hansell LLP; Doug H. Hopkins, Boughton Law Corporation; Michael L. Lee, Lawson Lundell LLP; Robert Lehodey, Q.C., Osler, Hoskin & Harcourt LLP; Jon Levin, Fasken Martineau DuMoulin LLP; Andrew J. MacDougall, Osler, Hoskin & Harcourt LLP; R. Hector MacKay-Dunn, Q.C., Farris, Vaughn, Wills & Murphy LLP; Margaret C. McNee, McMillan LLP; D. Shawn McReynolds, Davies Ward Phillips & Vineberg LLP; William K. Orr, Fasken

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DEDICATION

To my mom, Susan Liao

陳淑玲

INTRODUCTION

An ongoing environmental crisis, an escalating demand for greater worldwide sustainability, and an imperative to strengthen the social economy have pushed public funds to their limits. Climate change, ecosystem collapse, unemployment/underemployment, biodiversity loss, fiscal crises – in 2015, these were named as some of the most significant long-term risks to the world by the World Economic Forum.[1] Rising socio-economic inequality has led to the world's richest 85 people having as much wealth as 3.5 million of the poorest.[2] Increasingly complex economic, societal, geopolitical, environmental, and technological challenges have accelerated the search for new and sustaining relationships to bind our global community.

The laws and principles controlling our human organization have wide application to our treatment of these challenges, yet corporate law traditionally has not been viewed as a useful tool to advance the *social* economy, as any contributions from corporations have always been excluded from estimations of the social economy's size and scope.[3] The social economy has been labeled in a variety of ways, such as the third sector, not-for-profit sector, alternative economy, and voluntary sector, but generally, it can be seen as a "robust organizing framework" that mobilizes economic resources towards the social and economic needs of individuals and communities.[4] The importance of the social economy is profound, but as an essentially contested concept, quantifying its significance has been difficult to do without drawing controversies over

[1] World Economic Forum, "2015 Global Risks Report," online: World Economic Forum <http://reports.weforum.org/global-risks-2015/executive-summary/>.

[2] Laura Shin, "The 85 Richest People in the World Have as Much Wealth as 3.5 Billion Poorest," online: Forbes <www.forbes.com>.

[3] See Jorge Sousa & Evelyn Hamdon, "Preliminary Profile of the Size and Scope of the Social Economy in Alberta and British Columbia" (14 September 2010) B.C.–Alberta Social Economy Research Alliance, online: <http://auspace.athabascau.ca>.

[4] *Ibid.*

its interpretation. Nevertheless, there is consensus that strengthening and expanding the social economy is critical in overcoming local and global challenges to socio-economic development and sustainability.[5] Our global awareness of the risks at hand has resulted in mounting expectations for corporations to transform, innovate, and play a role in lessening the risks.[6] Now more than ever, there is a pressing need to reap the benefits of sustainable governance from the private sector.

The concept of "shareholder primacy" is deeply rooted within the Anglo-American corporation's organizational design – pursuing anything other than shareholder wealth is tantamount to bad governance.[7] For a long while this meant putting shareholder interests first, and ignoring the negative externalities that came with increasing share value. Social gains that occurred as a result of corporate actions were regarded as ancillary or subordinate to the primary goal of profit-making.[8] It was not until the turbulent financial times of the 1980s that thinking began to change. The unpredictable economic environment led to the rise of reactionary business models specifically addressing the interests of non-shareholder stakeholders. The development of stakeholder theory and inclusion of stakeholders in corporate decision making – such as employees, consumers, creditors, community, and the environment – became good strategic management for increasing share value, and thus it did not work against the shareholder wealth

[5] See e.g., Frank Moulaert & Oana Ailenei, "Social Economy, Third Sector and Solidarity Relations: A Conceptual Synthesis from History to Present" (2005) 42 Urban Studies 2037; Laurie Mook, Jack Quarter, & Sherida Ryan, eds., *Researching the Social Economy* (Toronto: University of Toronto Press, 2010).

[6] See e.g., David A Lubin & Daniel C Esty, "The Sustainability Imperative" (May 2010) Harvard Business Review 2.

[7] Adolf Berle & Gardiner Means, *The Modern Corporation and Private Property,* Revised ed (New York: Harcourt Brace and World, 1967).

[8] See e.g., Milton Friedman, "The Social Responsibility of Business is to Increase its Profits" *The New York Times Magazine* (13 September 1970).

maximization norm.

In the 1990s, the scholarly discussion in vogue within corporate legal circles was whether there had been global convergence to the shareholder primacy model. This discussion reached its pinnacle in 2001, with Henry Hansmann and Reinier Kraakman's provocative work, "The End of History for Corporate Law," which persuasively argued that the shareholder primacy model of governance was here to stay and other alternative models of governance had been tried and had failed. The corporate accounting scandals of 2001-2002 subsequent to Hansmann and Kraakman's article, and the global financial crisis that began in 2008, shook the corporate world but added little ammunition to those who disagreed with Hansmann and Kraakman's position.

The rapid growth of corporate social responsibility (CSR) in recent decades has been viewed by some as an effective tool in tempering some of the negative externalities arising from shareholder primacy. The period when CSR only referred to corporate philanthropic donations has long passed. Contemporary CSR is intimately intertwined with the 'green' movement, and the cross-sector expansion of CSR is growing increasingly apparent on the global stage. Academic scholarship has become saturated with CSR-focused research, a topic that spans several disciplines (including business, political science, economics, law, sociology, and environmental studies), and appears in various theories and approaches within those disciplines (such as institutionalism, law and economics, law and society, and organizational behaviour, to name a few). A parallel trend can be found in the rise of the socially responsible investing (SRI) movement, where holders of capital look beyond share value metrics and consider other variables such as ESG (environmental, social, and governance) factors in their investing decisions. The movement has made considerable inroads in the last decade at reorienting investors toward long-term outlooks and greater sustainability.[9]

Nevertheless, while developments in the CSR and SRI movements may be viewed as worthwhile by some leaders seeking corporate reform, there are certain ideological and practical limitations that challenge any true reformation of the shareholder primacy model. Existing power imbalances and path dependence, entrenched ideologies, and the overwhelming pull of short-term market forces within our global capital system make transformative change in corporate behaviour particularly difficult.[10]

The main alternative legal structures to the corporation are charitable and non-profit organizations (NPOs).[11] NPOs are not required to pay income tax (and in addition, charities are able to issue tax receipts), so they have certain restrictions. In Canada, charities must fall within four defined heads of charity,[12] refrain from engaging in "political activities,"[13] among other things, and NPOs are required to be exclusively for "social welfare, civic improvement, pleasure, recreation, or any other purpose except profit."[14] However, they are not prohibited from engaging in "incidental" business activities, which means that an NPO can only make profit if it is by accident. This rule means little to no growth in capital to reinvest into the organization. NPOs get the bulk of their money through corporate, governmental, and other types of donations,

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[9] CSR and SRI are discussed in more detail in Chapter 2.

[10] A discussion on entrenched ideological beliefs and path dependence is found in Section 2.2.

[11] Charities are included in this category, as all charities are non-profits. Note that in Canada, the language is slightly different. Non-profit organizations exclude registered charities, and the proper terminology in capturing the entire tax-exempt public sector is "not-for-profit corporations."

[12] The four heads of charity are taken from the common law, specifically from *Commissioners for Special Purposes of Income Tax v. Pemsel* [1891] AC 531 (HL).

[13] *Income Tax Act* (Canada), ss. 149.1(6.1) and 149.1(6.2).

[14] *Ibid.* at para. 149(1)(l).

and have difficulty growing once their funding sources are tapped. Former American non-profit leader Dan Pallotta has argued that society's "economic apartheid" of for-profit and non-profit sectors "undermines our ability to eradicate great problems and, ironically, puts charity at a severe disadvantage to the for-profit sector at every level."[15] He calls this unfair economic divide in corporate law a serious moral issue. Yet allowing NPOs more access to capital and free market liberties may be viewed by some as only perpetuating a neoliberal agenda. Critics argue that welcoming profit elements into NPOs wanting to "do good" will only leave them vulnerable of being corrupted.

Doubts aside, new legal innovations are challenging the notion that corporations are best governed in pursuit of a singular objective, and that NPOs' profit-making abilities should be restricted. The next foreseeable stage in the CSR movement is in the reformation of existing laws and creation of new legal structures that not only enable, but require, CSR concepts to be embodied within corporate practices. CSR is getting a facelift in the private sector – mainstream companies are still catching onto CSR but the leaders at the forefront of the movement are transforming the concept into one of "social innovation" and the integration of business concepts with social activism. The growth of the "social enterprise" – a definition with no legal import in Anglo-American countries that refers to either a for-profit trying to "do good" or an enterprising non-profit – suggests a shift in the business landscape. Social enterprises are not fitting within the drawn lines of the for-profit / non-profit divide, and legislators are beginning to craft new corporate entities to meet growing demands from social entrepreneurs seeking infrastructure to house their social businesses.

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[15] Dan Pallotta, *Uncharitable: How Restraints on Non-Profits Undermines Our Potential* (London: Tufts University Press, 2010) at 9.

A new generation of alternative corporations is emerging on the horizon. “Hybrid” corporations are corporate legal entities that blend for-profit and non-profit legal characteristics in their design requiring businesses to pursue dual economic and social mandates. Each hybrid contains features that may be particularly attractive for those currently situated in either the for-profit or non-profit sectors. Legal entities such as the benefit corporation and low profit limited liability company in the United States (US), and the community interest company in the United Kingdom (UK), are some alternative models for businesses that elect to have governing infrastructure support their social value output in addition to profit. Other countries, such as Australia, Belgium, Greece, Denmark, Japan, South Korea, and Israel, to name a few, are also in the early stages of developing hybrids. Some of these hybrids have been met with relative success in their home nations, others have not. Restrictions on dividends, obligations on directors to consider community interests, and community-purpose asset locks are only some of the unique governing features.[16] Conceptual boundaries surrounding the social economy are being tested as hybrid corporations begin to grow in recognition. The emergence of corporate hybrids questions the foundational principles of corporate law, and whether mainstream legal institutions will need to adapt in order to accommodate greater demands for sustainability and social innovation. How are hybrids meaningfully different, if at all? The answers to those questions test age old arguments on the purpose of the firm and the nature of the non-profit.

In Canada, as more entrepreneurs express the desire to concurrently pursue economic and social mandates within their companies, legislators have struggled to keep up with the pace

[16] These hybrids are described in more detail in Chapter 4.

of innovation.[17] Canadian legislators are contemplating the adoption of hybrid corporations into its laws, and indeed the process has already begun in a few provinces. The creation by the BC government of the community contribution company (C3 or CCC) which became available to the public in July 2013,[18] and the community interest company in Nova Scotia which received Royal Assent December 2012 with enacted legislation still forthcoming,[19] suggests a movement to parallel international trends. Several Canadian provinces are now actively considering the implementation of hybrids into their corporate statutes, and the 2014 public consultation by Industry Canada on certain provisions within the *Canada Business Corporations Act* (*CBCA*)[20] has also included a request for comments on adopting a federal version of the BC C3 model.[21]

Corporate hybridity has received little scrutiny in academic scholarship to date, as it is a relatively new institutional phenomenon. This dissertation situates the new generation of hybrid legal structures within the broader context of Anglo-American neoclassical corporate legal theory, while pinpointing the theoretical tensions underlying the role of corporate law in socio-economic development. The underlying hypothesis is to test whether the creation of alternative corporate legal structures that account for the governance of social value will contribute to the advancement of the social economy to a greater extent than if such entities did not exist. Can, should, and if so, how do you transform the singular objective of shareholder wealth

[17] Josh Wingrove, "Marc and Craig Kielburger's Do-gooding Social Enterprise" (19 March 2010) *The Globe and Mail* 2 (Paul Martin, Canada's former Prime Minister, commented, "Government policy hasn't caught up…I think Canada is ready for it. I think Canada is looking for it").

[18] Bill 23 – 2012, *Finance Statutes Amendment Act*, online: <www.leg.bc.ca>.

[19] Nova Scotia Canada, Service Nova Scotia and Municipal Relations, "New Opportunities for Social Entrepreneurs' (28 November 2012), online: < http://novascotia.ca>.

[20] *Canada Business Corporations Act,* RSC, 1985, c C-44 [*CBCA*].

[21] Industry Canada, "Consultation on the *Canada Business Corporations Act*," online: <www.ic.gc.ca>. The deadline for comments was on 11 March 2014.

maximization in the corporate firm? What are the risks in inviting profit into the non-profit organization (an oxymoron in and of itself)? Why would an entrepreneur choose a hybrid form over existing alternatives? This dissertation aims to answer those questions and whether solutions can also be found through the improvement of existing corporate, non-profit, and/or tax laws.

There is a delicate interplay between corporate law and social policy, and it is evident that there are limitations in employing purely legal means to cause normative shifts in corporate culture. The emergence of hybrid corporations on the international stage suggests a unique sector of the social economy is beginning to form, but this assumption has not been tested. Canadian federal and provincial governments are responding to growing demands by establishing legal entities to govern businesses in the dual mission of profit and social value creation, with little assurance as to how these entities will fare. This dissertation examines newly implemented hybrids across nations and gauges the early successes and failures, while considering how the existence of hybrids is challenging traditional notions within corporate legal theory. The emergence of corporate hybrids highlights a global trend in corporate law toward a more stakeholder-based approach to management and increased expectations that corporations act as good global citizens. Canada is a unique country in which to study the emergence of corporate hybridity. This critical juncture in Canadian corporate history serves as a live experiment on the utility of hybrids. Corporate legal theory from a Canadian perspective is relatively limited, and this dissertation positions Canada within the international corporate law dialogue while assessing the overall effectiveness of emerging hybrids in contributing to the social economy. Implementation strategies are provided to future legislators, both domestic and international, who are interested in creating laws to support burgeoning social enterprises.

Part One of this dissertation lays the theoretical groundwork and justifications behind for the for-profit corporation and the non-profit organization, significant issues arising from historical and scholarly contexts, counter-hegemonic discourses in light of neoclassical corporate legal theory, and how tensions have signalled the rise in Anglo-American hybrid legal forms. Chapter 1 begins by identifying the tensions within the for-profit and non-profit arenas leading to the rise of social enterprises and early development of hybrids. The problem at hand is identified – transforming the singular objective of shareholder wealth maximization within corporate firms – and situated it within the context of existing literature. What was viewed as the original purpose of the corporation? How has the discourse evolved in the last several decades? The efficiency of shareholder primacy is questioned in light of the financial calamities that have plagued the first decade of the 21st century (particularly the corporate and accounting scandals of 2001-2002 and the global financial crisis), providing a timely outlook on how the model encourages corporate behaviour that perpetuates the likelihood of future crises. The chapter then modernizes the global convergence debate that dominated academic circles in the 1990s and posits that only partial convergence has occurred and it is unlikely there will ever be complete convergence to shareholder primacy. The findings in this chapter suggest that corporate legal theory is not stagnant but evolving alongside the evolution of scholarly thinking in reaction to real life events, and that it may be worthwhile to pursue both macro and micro reform efforts in corporate law to illicit social change.

Chapter 2 highlights debates that have spanned the decades on shareholder primacy in relation to stakeholder interests and social value, while addressing critiques and alternative approaches, particularly stakeholder theory and CSR, including the codification of CSR in the UK's 'enlightened shareholder value' and the SRI movement, progressive corporate law, and team production theory. Some formidable barriers facing reformation of the shareholder primacy model are addressed which, regardless of the validity of one's theoretical arguments, perpetuate the perceived economic viability and continued domination of this mainstream corporate model. These factors include entrenched ideological beliefs that have permeated the psyche of corporate governance practices in global capital markets, and path dependence. This then poses the interesting follow-up question, which is whether alternative corporate legal structures may provide a pragmatic parallel track to reform efforts of the shareholder primacy model of governance.

The NPO is invited into the conversation in Chapter 3. While scholarship on the for-profit corporation has been vast and at times unwieldy, economic scholarship on the non-profit arena has tended to be more constrained and focused. Neoclassical economists have viewed NPOs as addressing excess demands that government cannot provide. The nondistribution constraint has been viewed as a point of comfort for consumers. These theoretical analyses are layered with practical realities and challenges facing NPOs. The inability of NPOs to use the engine of the market to effectively disseminate their social goods and services has put those organizations at a severe disadvantage to the for-profit sector. The notable disadvantage has precipitated a significant increase of social enterprises arising from the non-profit sector. Countervailing pressures in the non-profit sector open the door to possibilities with alternative hybrid legal structures, but the risks that hybrids will divert scarce resources away from the sector, and/or serve to perpetuate a neoliberal agenda are significant issues to some NPO advocates and should be kept in mind by proponents of the hybrid form.

Part One concludes by advancing in Chapter 4 some international legislative innovations that have been offered to assist in solving the problems besetting the for-profit / non-profit divide, particularly the global development of hybrid corporations. The legal features of the UK community interest company, Canadian community contribution company, American low-profit limited liability company, B Corporation (privately regulated), and benefit corporation are addressed, as well as their relative success or failure in their home countries and projections as to why.

In Part Two, the focus shifts to Canada as a real time experiment of hybrid legislation. In particular, what are the essential factors that should be considered when determining whether to implement particular hybrid models within a jurisdiction? Early lessons are gleaned for both a Canadian and international audience. Canada's corporate legal development serves as a country-specific test against the hypothesis of this dissertation. Any nation considering the adoption of hybrid corporations into their own laws must conduct a thorough analysis of their existing corporate alternatives and how they function in corporate practice, so as to better project how the emergence of new alternative corporate models will affect the existing corporate landscape. Canada is a particularly useful example as two of its provinces have adopted a UK hybrid model, and there are other provinces that are contemplating the adoption of an American hybrid model. In Chapter 5, Canada's current model of corporate governance is identified using qualitative empirical data, particularly where the model differentiates from the descriptions in Chapter 1, if at all, to allow subsequent chapters to apply these findings to hybrid models currently being explored within the country. The analysis reveals an interesting counterpoint to assumptions that Canadian laws also adhere to a shareholder primacy model. These legal differences should be taken into account when considering what kind of hybrid 'alternative' is offered relative to the mainstream corporate model.

Chapter 6 offers a pragmatic look at the legal ramifications of implementing the

American benefit corporation in Canada given the information provided in Chapter 5 on Canada's current corporate model. Leaders in the hybrid movement must be informed on the status of existing corporate governance standards and norms, so that incoming hybrids can be tailored specifically to a jurisdiction's social and legal needs. The features of the benefit corporation are markedly similar to that of Canada's existing corporate laws, and therefore its implementation in Canada as an 'alternative' would only solidify misconceptions about Canada's corporate laws and further reinforce the idea that the purpose of the corporation is solely for profit-making purposes. If hybrids are to serve as a parallel track to reform, it is important that they do not thwarting ongoing reform efforts behind the mainstream corporate model in the meantime. Hybrid alternatives must offer legal features that reinforce dual mandates, beyond what is already permissible under Canadian laws. The latter half of the chapter outlines the challenges in fostering the development of existing and emerging hybrids, and argues that there is still considerable room for the creation of new innovative hybrids to enter the Canadian corporate landscape.

Finally, the puzzle pieces from earlier chapters are fitted together and Chapter 7 summarizes the collected evidence to conclude as to whether the creation of hybrids can contribute to the advancement of the social economy beyond the current status quo. An overall framework is provided for legislators and social innovators to assess whether a jurisdiction is well suited for the placement of new hybrids, and how to strategically implement such hybrids going forward. This dissertation concludes is that hybrid legal structures governing social value output may advance the social economy within a certain set of parameters, but there are several notable risks and legislators should proceed with caution. A nation must have a strong demand for an additional alternative corporate model from social entrepreneurs, which is justified due to the state of a nation's corporate laws and not from incorrect assumptions about those laws. In addition to a legal justification there must be an economic justification, and considerable governmental support in administering, regulating, promoting, and educating any new hybrid alternative that is made available to the public in order to ensure long-term success. Without the necessary support, every hybrid legal structure has a high chance of becoming dormant legislation that is ineffective in offering solutions to the pressing problems of our time, or worse, impede on other reform efforts in corporate law. On the flip side, if a hybrid form becomes widely utilized, policymakers need to consider whether such hybrids are at risk of funnelling resources away from or shrinking the non-profit sector, and if so, whether and how to prevent or circumvent such risks.

This dissertation identifies the early risks in blurring the lines between the for-profit and non-profit sectors, and carries hybrid corporate legal scholarship into the mix of for-profit and non-profit analysis on both a theoretical and practical level. If hybrid organizations do indeed carry the potential of advancing the social economy beyond existing laws, then it is critical to get it right and capitalize on that potential, while also continuing along existing pathways to reforming the mainstream corporate model. As we move ahead in the 21st century seeking solutions to combat, or at least delay, staggering social inequalities and impending environmental catastrophes, the efforts on the part of legislators to craft new corporate alternatives offer interesting new ways of utilizing corporations for the greater good, while also questioning the mainstream corporate form and its purpose, potential, and role in society for the future.

PART ONE: Corporate Legal Theory and the Rise of Legally 'Good' Corporations

CHAPTER 1: Anglo-American Corporate Legal Theory in Context

Corporate institutions have become one of the most powerful legal structures in Anglo-American society.[22] Good or bad, it is undeniable that corporations have permeated our everyday lives. Before one can embark on any discussion regarding "hybrid" alternatives, it is important to understand some of the historical justifications behind the corporation that have led to its present day impact. What is the purpose of the corporation? The answer to that question has been debated for decades by corporate legal scholars, economists, and others, and is critical in understanding how hybrids are expected to be situated within the existing corporate landscape.

This chapter begins by highlighting some of the dominant theoretical foundations of the modern corporation, starting with the work of economist Ronald Coase, and how others – most notably Michael Jensen, William H. Meckling, Eugene Fama, Frank Easterbook, and Daniel Fischel – have built upon Coase's work to further develop a neoclassical economic view of the firm. Next, some of the dominant corporate legal literature that developed around the same time as Coase's work is considered, specifically Adolf Berle and Gardiner Means' well-known analysis of the "separation of ownership and control" in corporate governance. The shareholder primacy model is regarded by some scholars as the dominant model that is here to stay, and one

[22] Kellye Testy provides a commanding description of this phenomenon, stating: "Start with a pervasive distrust of regulatory solutions to economic problems, together with a concomitant faith in the righteousness of private ordering. Add to that the privileged status of financial capital in corporate governance, which is reinforced by an obsessive focus by corporate managers and investment communities on short-term share price. All of that, combined with exponential growth in the transfer of technology and other products across national borders, have paved the way for corporations to rival the state, and certainly the church, in institutional power and influence." Kellye Testy, "Linking Progressive Corporate Law and Progressive Social Movements" (2002) 76 Tulane L Rev 1227 at 1228.

that all other models will eventually converge into.[23] But has there, in fact, been global convergence into the mainstream model? The answer to that question is considered after outlining the neoclassical justifications for the shareholder primacy model and prevailing legal and economic approaches to corporate law. In the face of financial calamities that have occurred in the 21st century, there have been changes in dominant perspectives which have started to lay the groundwork for alternative corporate models. The evidence suggests that full-fledged convergence will not occur, as jurisdiction-specific nuances prevent full-scale adoption despite the influence of the global markets. There is thus some room for varying types of corporate models to enter the corporate legal landscape, although significant barriers predict that the impact of these models will likely be smaller in scale.

1.1 Economic Efficiency and Nexus of Contracts

In 1937, Ronald Coase offered an economic explanation as to why individuals choose to form partnerships, companies, and other business entities rather than trading bilaterally through contracts on a market. The traditional economic theory of the time implied that, because the market is efficient and "works itself," it should always be cheaper to contract out than to hire.[24] Coase observed how outside the firm, price movements direct production, which is coordinated through a series of exchange transactions on the market. Within a firm, however, these market transactions are eliminated, and in place is the "entrepreneur–coordinator" who directs production, creating "islands of conscious power in this ocean of unconscious co-

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[23] Such as the viewpoint of Hansmann & Kraakman, *infra* note 102.

[24] Coase made this point citing the work of Sir Arthur Salter in DH Robertson, "Control of Industry" and Arnold Plant, "Trends in Business Administration" (1932) Economica 85.

operation like lumps of butter coagulating in a pail of buttermilk."[25] According to Coase, the main reason why it is profitable to establish a firm is because there is a cost of using the price mechanism. The most obvious cost is in discovering what the relevant prices are, but there are also costs of negotiating and concluding a separate contract for each exchange transaction taking place on the market, and other costs including "search and information costs, bargaining costs, keeping trade secrets, and policing and enforcement costs." [26] Contracts are not eliminated when there is a firm, but they are greatly reduced, suggesting that companies will arise when they can arrange to produce what they need internally and somehow avoid these costs. Thus, Coase's transaction costs theory contends that corporations exist to economize on the cost of coordinating economic activity.

There is a natural limit to what contractual relationships can be produced internally, however. Coase found that "decreasing returns to the entrepreneur function," including increasing overhead costs and increasing propensity for an overwhelmed manager to make mistakes in resource allocation are countervailing costs to the use of the corporate firm. Coase argued that the size of a firm (as measured by how many contractual relations are "internal" to the firm and how many are "external") is a result of finding an optimal balance between the competing tendencies of the costs outlined above. In general, making the firm larger will initially be advantageous, but the decreasing returns indicated above will eventually occur, preventing the firm from growing indefinitely.[27] Coase's analysis demonstrates how, when transaction costs are

[25] Ronald H Coase, "The Nature of the Firm" (1937) 4 Economica 386, quoting DH Robertson at 388.

[26] *Ibid.* at 390-391.

[27] Other things being equal, therefore, a firm will tend to be larger: (1) the less the costs of organizing and the slower these costs rise with an increase in the transactions organized; (2) the less likely the entrepreneur is to make mistakes and the smaller the increase in mistakes with an increase in the transactions organized; and (3) the greater the lowering (or the less the rise) in the supply price of factors of production to firms of larger size. *Ibid.* at 396-397.

positive, institutions matter and share the resultant market structure, conduct, and hence performance. Recognition of this gives some credence to the explanation as to why seemingly inefficient rights, rules, and institutions exist and are perpetuated. New institutional economics has incorporated this aspect of transaction costs theory into its formal analysis, arguing that since there are costs to establishing and enforcing property rights, individuals or groups will devote resources to securing the establishment of, or a chance in, property rights only when they perceive that the benefits from such a change will outweigh the costs.[28]

According to Coase, legal rules are only justified by reference to a cost-benefit analysis. If we lived in a world without transaction costs, people would bargain with one another to produce the most efficient distribution of resources, regardless of the initial allocation. However, many welfare-maximizing reallocations are often forgone because of the transaction costs involved in bargaining.[29] In cases like these with potentially high transaction costs, Coase believed the law should produce an outcome similar to what would result if the transaction costs were eliminated. Coined as the "Coase Theorem" by George Stigler,[30] the theorem guarantees not only the attainment of the efficient outcome but also that the efficient outcome will be reached in the most efficient fashion. The theorem is "frequently misunderstood" since the world assumed by the theorem bears little correspondence to the real world.[31] But it is a useful fiction that shows how, under certain conditions, the form of legal rules does not affect the allocation of

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[28] See e.g., Nicholas Mercuro & Steven Medema, *Economics and the Law: From Posner to Post-Modernism and Beyond*, 2nd Ed. (Princeton: Princeton University Press, 2004) at 241-283. More on NIE is discussed in Chapter 7.

[29] Ronald H Coase, "The Problem of Social Cost" (1960) 3 J. Law & Econ 1 at 7.

[30] George Stigler, *The Theory of Price*, 3rd ed (1966) at 113 ("The Coase theorem thus asserts that under perfect competition private and social costs will be equal.").

[31] Mercuro & Medema, *supra* note 28 at 113.

resources. The Coase Theorem and transaction costs theory supports the argument that efficiency should be the criterion for legal rule-making. Because in the real world there are costs of bargaining and information gathering, legal rules are justified to the extent of their ability to allocate rights to the most efficient right-bearer.

Coase notes that "all solutions have costs and there is no reason to suppose that government regulation is called for simply because the problem is not well handled by the market or the firm."[32] He suggests that, beyond being reciprocal in nature, externalities are also amenable to efficient resolution without tax or regulatory measures being imposed – at least if markets operate without frictions. This requires that the conditions be met. First, rights over the resources in question must be fully specified.[33] That is, some party must have legal control over those resources; if there are no rights over said resources or those rights are incompletely defined or unassigned, market-oriented solutions are all but precluded. Second, legal rights must be alienable: if rights cannot be exchanged, the processes are rendered inoperative.[34] The final assumption is that transaction costs, including the costs of acquiring information, are zero. When these conditions are met – that is, when the exchange or market process is frictionless – all that is necessary is that the government decide liability one way or the other, in effect granting one party the right to act or the other party the right to be free from the action of the first party. Once these rights are defined and assigned, the parties are then free to trade the rights, and will do so if it is in their self-interest – ultimately, to an efficient solution.

Coase argued that the law and regulation are not as important or effective at helping

[32] Coase, *supra* note 25 at 18.

[33] *Ibid.* at 19.

[34] *Ibid.*

people as lawyers and government planners believe.[35] Coase wanted a change of approach, to put the burden of proof for positive effects on a government that was intervening in the market, by analyzing the costs of action.[36] Thus, the "Coase lesson" as described by Nicholas Mercuro and Steven G. Medema, indicates that courts should structure rights in a way that minimizes the amount of resources used up so that society can use the "saved" resources for other, more highly valued activities.[37] It follows that if efficiency is considered an important value in determining the law, then in general, courts should attempt to assign rights in such a way as to minimize the sum of all costs associated with the externality, including transaction costs.

The economic logic that underpins the Coase lesson is that a wide range of benefits and costs can, and usually do, attend alternative assignments of rights. That is, no matter what one's view of the normative import of efficiency, law does have important efficiency implications, and these include the costs associated with transacting over rights. The logic of this reasoning is inherent in Coase's approach where he states:

> The problem which we face in dealing with actions which have harmful effects is not simply one of restraining those responsible for them. What has to be decided is whether the gain from preventing the harm is greater than the loss which would be suffered elsewhere as a result of stopping the action which produces the harm. In a world in which there are costs of rearranging the rights established by the legal system, the courts…are in effect, making a decision on the economic problem and determining how resources are to be employed.[38]

Coase also argued that "the courts are conscious of it" and that judges "often make, although not always in a very explicit fashion, a comparison between what would be gained and what would

[35] *Ibid.* at 17-18.

[36] *Ibid.* at 23.

[37] Mercuro & Medema, *supra* note 28 at 113.

[38] Coase, *supra* note 25 at 27-28.

be lost by preventing actions which have harmful effects."[39]

The influence of Coase's work has been profound – his two articles, "The Nature of the Firm" and "The Problem of Social Cost," are among some of the most cited articles in the history of economics and law.[40] Scholars of the "Chicago school" of law and economics have frequently used an Anglo-American view of neoclassical economic theory and efficiency analysis to explain and understand the development of law. Several notable scholars that built upon Coase's work and applied it in a corporate legal context include Michael Jensen and William H. Meckling, who went on to formulate the conception that the corporation as a "nexus of contracts," where shareholders are not the owners of the firm, but rather a party that has strong contractual claims against the firm.[41] Other economists followed suit. In their 1996 work *The Economic Structure of Corporate Law*, Frank Easterbrook and Daniel Fischel also contended that in economic terms, the corporation is simply a "'nexus of contracts' . . . a financing device . . . [that] is not otherwise distinctive."[42] They described how the rules and practices of corporate law mimicked the contractual provisions that parties would reach if they bargained about every contingency at zero cost and flawlessly enforced their agreements.[43] Since bargaining and enforcement are costly, corporate law provides the rules and an enforcement mechanism that governs relations among those who commit their capital to such ventures. Corporate law is thus considered to be a branch

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[39] *Ibid.* at 28.

[40] William M Landes & Sonia Lahr-Pastor, "Measuring Coase's Influence" 54 (2011) J of L & Econ S383.

[41] Michael C Jensen & William H Meckling, "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure" (1976) 3 J Fin Econ 305-312.

[42] *Ibid.* at 12.

[43] Frank H Easterbrook & Daniel R Fischel, *The Economic Structure of Corporate Law* (Cambridge: Harvard University Press, 1996).

of contract law; it is an economic structure – "contract law on a large scale" – and the relations of participants in a firm substitute for transactions in a market.[44]

Echoing Coase, one of the defining characteristics of the Chicago school of thought is its contention that legal rules and outcomes can be assessed on the basis of their efficiencies. Richard Posner, recognized as one of the foremost leading proponents[45] of the Chicago school, was one of the first to advance the efficiency hypothesis in detail.[46] While a host of various measures surround the concept of efficiency, Posner has pointed out that the common operating definition in economics is "nine times of out of ten" in reference to Kaldor-Hicks efficiency.[47] Under Kaldor-Hicks efficiency, an outcome is considered more efficient if the monetary value of society's resources is maximized. If the marginal willingness to pay by those who benefit from an action is equal to the marginal willingness to accept payment by those harmed, Kaldor-Hicks efficiency contends that all parties end up no worse off than before.[48] In this regard, a legal change can be said to be Kaldor-Hicks efficient "if the gains to the winners exceed the losses to the losers or, alternatively stated, if the wealth of society (as measured by willingness to pay) is increased."[49]

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[44] *Ibid.* at 10.

[45] See e.g., Mercuro & Medema, *supra* note 28 at 51 (stating, "The work of [Chicago law and economics] scholars, of whom Posner – as professor, scholar, and judge – is perhaps the foremost exponent, form the core of the Chicago approach").

[46] Other founding scholars of the Chicago school have been identified by many as Coase, Guido Calabresi, Henry Manne, and Gary Becker. See e.g. *ibid.* at 59-83.

[47] Richard Posner, *Economic Analysis of Law,* 6th ed (New York: Aspen Publishers, Inc., 2007) at 15.

[48] But this of course would only be the case if those harmed were paid directly or indirectly by those benefitting or their proxies. See also Mercuro & Medema, *supra* note 28 at 59-60 (providing examples of Kaldor-Hicks efficiency).

[49] Easterbrook & Fischel, *supra* note 43 at 59.

Easterbrook and Fischel's contract theme repeatedly emphasizes the underlying economic logic of corporate legal rules. Limited liability provides a low-cost prerequisite for the separation of risk-bearing from control.[50] Voting serves as the mechanism for disciplining management in the market for control.[51] The fiduciary principle manages potentially high monitoring costs,[52] while the business judgment rule limits the costs of liability as a governance mechanism.[53] Corporate control transactions (going private or hostile takeovers) "move assets to higher valued uses."[54] State competition for the legal domiciles of corporations leads toward optimal legal arrangements.[55] Easterbrook and Fischel state their position straightforwardly: "[C]orporate law should contain the terms people would have negotiated, were the costs of negotiating at arm's length for every contingency sufficiently low…[and] corporate law almost always conforms to this model."[56]

Easterbrook and Fischel point out that corporate law determines the internal governance arrangements among members of a firm, and they argue that few (if any) third party effects or other problems undermine the utility of the law.[57] They note that the corporation-as-contract view fails to explain the ease with which management can unilaterally change the contract.[58] The

[50] *Ibid.* at 41.

[51] *Ibid.* at 67-68.

[52] *Ibid.* at 92.

[53] *Ibid.* at 94.

[54] *Ibid.* at 113.

[55] *Ibid.* at 215.

[56] *Ibid.* at 15.

[57] *Ibid.* at 17.

[58] *Ibid.* at 33-34.

law deals poorly with end-period problems that arise in areas such as limited liability[59] and tender offers.[60] Voting's collective action problems make it possible for management to ratify wealth-reducing activities.[61] They recognized, however, that their theme of legal efficiency may conflict with their criticism of takeover law: "Current law on takeovers reflects infatuation with gain sharing at the expense of wealth…It reflects a devotion to intrinsic value that has as much empirical support as the proposition that hurricanes are caused by witches."[62] They suggest that state antitakeover statutes prove an exception to the normal efficiency of state competition in law because legislators tend to behave opportunistically with respect to takeovers.[63] Thus, they admit some exceptions to the efficiency of the corporate legal structure.

It is important at this juncture to make a few comments as to the Coase Theorem, its application, and the legacy of the Coase's work. As noted earlier, the Coase Theorem is frequently misunderstood as it bears little resemblance to real world issues. While several economists such as those named in this section went on to flesh out Coase's research, the theorem also became "transformed into an icon of the political right" and was "used to justify a hands-off approach to big business on the part of politicians, regulatory agencies, and judges, leaving pollution and other economic problems to the corrective powers of the free market." [64] This was not as Coase intended – on the contrary, in fact. After receiving the Nobel Prize in

[59] *Ibid.* at 51.

[60] *Ibid.* at 169.

[61] *Ibid.* at 81.

[62] *Ibid.* at 209.

[63] *Ibid.* at 219-222.

[64] John Cassidy, "Ronald Coase and the Misuse of Economics," online: The New Yorker <http://www.newyorker.com>.

1991, Coase reflected on how his theorem was meant to serve "as a stepping stone on the way to an analysis of the economy with positive transaction costs."[65] The world in which Coase imagined where affected parties can come together, with all relevant information at hand, and reach a voluntary agreement at zero cost, is – as described by Coase – "a very unrealistic assumption"[66] and "quite unimaginable."[67] The misapplication of Coase's Theorem as a tool to align with conservative *laissez-faire* market values while ignoring negative externalities, has been described by pundits as both "ironic" and "tragic,"[68] as well as "vulgar,"[69] among other things.

To Coase, it was important to acknowledge that the efficiency of the economic system "depends to a very considerable extent on how…organisations conduct their affairs, particularly, of course, the modern corporation. As these institutional arrangements determine to a large extent what is produced, what we have is a very incomplete theory."[70] It is critical, therefore, that before one dismisses or embraces the Coase Theorem based on one's left or right wing tendencies, the theorem is regarded in the context that Coase intended – which is as a mental exercise existing within a set of parameters inconceivable in real life. In that vein, one should

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[65] Ronald Coase, "The Institutional Structure of Production," Nobel Prize Lecture (9 December 1991), online: Nobel Prize <www.nobelprize.org> [Coase, "Nobel"].

[66] Coase, *supra* note 29 at 15.

[67] EconTalk Episode with Ronald Coase, "Coase on Externalities, the Firm, and the State of Economics," 12 May 2012, online: Library of Economics and Liberty <www.econtalk.org>, stating: "I never liked the Coase Theorem…I don't like it because it's a proposition about a system in which there were no transaction costs. It's a system which couldn't exist. And therefore it's quite unimaginable."

[68] Cassidy, *supra* note 64.

[69] Timothy B Lee, "The Coase Theorem is Widely Cited in Economics. Ronald Coase Hated It." (4 September 2013) *The Washington Post*, online: <www.washingtonpost.com>.

[70] Coase, "Nobel," *supra* note 65.

also consider Coase's advice for future research: "let us study the world of positive transaction costs."[71]

1.2 Shareholder Primacy and the Separation of Ownership and Control

At around the same time as when Coase wrote "The Nature of the Firm" (which, interestingly, had little to no influence until 30 to 40 years after it was published[72]), the theoretical framework on the governing structure within the corporation was also taking shape. The 1932 book by Berle and Gardiner Means, *The Modern Corporation and Private Property,* was the first to identify a new major development in corporate law – the concept of a "separation of ownership and control" between shareholders and management.[73] Berle and Means described how public corporations were beginning to be comprised of two factions: controlling managers, considered the new "princes" of the social institution, and passive shareholders, the only residual claimants to the company's net assets.[74] This book is noted by many scholars as perhaps the single most influential book in corporate legal history. In the ensuing decades, there was a growth of theoretical principles and usage of terms that reinforced the concept of the Berle-Means corporation. Berle, in particular, has been named as the forefather of the shareholder primacy model of the corporation, but this has not been without some slight disagreement among corporate scholars.[75] In a later article, Berle outlined how management's authority was to be

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[71] *Ibid.*

[72] Ronald Coase, "The Nature of the Firm: Influence" in Oliver Williamson and Sidney Vinter, eds, *The Nature of the Firm: Origins, Evolution, and Development* (Oxford: Oxford University Press, 1993) at 61.

[73] Berle & Means, *supra* note 7.

[74] *Ibid* at 116.

[75] See William Bratton & Michael Wachter, "Shareholder Primacy's Corporatist Origins: Adolf Berle and 'The Modern Corporation'" (2008) 34 J Corp L 99.

exercised for the benefit of the corporation's shareholders. According to Berle, "all powers granted to a corporation or to the management of a corporation, or to any group within the corporation . . . [are] at all times exercisable only for the ratable benefit of all the shareholders as their interest appears."[76] Interestingly enough, in 1962 Berle conceded that he was wrong in limiting corporate actions to those solely for the benefit of shareholders, as corporations at the time seemed freely engaging in acts of philanthropy with little pushback from shareholders.[77]

While Berle and Means' division between ownership and control connotes a separation of interests that almost compels government oversight, the corporation-as-contract view sees a separation of functions that private contracts fully coordinate. To those who question market efficiency, Easterbrook and Fischel argue that no other social institution appears superior[78] and that "[t]he long run will arrive eventually."[79] Easterbrook and Fischel saw a separation as between "risk-bearing" and control[80] as opposed to Berle and Means' separation of ownership and control.

Jensen and Meckling note that the separation of ownership and control and the managerial revolution remained subjects of interests and occasionally some controversy, but much of the steam left the debate with the post-WWII expansion of the Western economies, the sustained increase in international trade, and the unchecked growth of the multinational

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[76] Berle, "Corporate Powers," *supra* note 239 at 1049.

[77] Adolf Berle, "Modern Functions of the Corporate System," (1962) 62 Columbia L Rev 433.

[78] Easterbrook & Fischel, *supra* note 43 at 19.

[79] *Ibid.* at 21.

[80] *Ibid.* at 11.

corporations.[81] Meanwhile, neoclassical economics "has attempted to develop a theory of resource allocation based on market exchange, and neglected the economic analysis of the productive sphere of the economy."[82] They reflected on how a number of later schools of economic thought broke further from the economic ideal of neoclassical economics than the "market imperfections" approach, and attempted explanations for economic governance based on a new understanding of economic activity and resource allocation. Jensen and Meckling addressed how among these new economic theories of the firm, agency theory became the dominant force in the theoretical understanding of corporate governance in the last decades of the 20th century.[83]

Jensen and Meckling argue agency theory rests upon this contractual view of the firm. The essence of the agency problem is the separation of management and finance. Managers raise funds from investors to put them to productive use or to cash out their holdings in the firm. Financiers need the managers' specialized human capital to generate returns on their funds. In principle the financiers and managers sign a contract that specifies what the managers do with the funds, and how the returns are divided between them and the financiers. The trouble is future contingencies are hard to foresee and complete contracts are infeasible. The managers and financiers have to allocate residual control rights – the rights to make decisions not foreseen in the contract. Managers end up with substantial residual control rights, and therefore discretion over how to allocate investors funds. From this point of view much of the subject of corporate governance concerns the constraints that managers put upon themselves, or that investors put on

[81] Jensen & Meckling, *supra* note 41.

[82] Mercuro & Medema, *supra* note 28.

[83] Jensen & Meckling, *supra* note 41.

managers, to reduce misallocation and thus to induce investors to provide more funds.

Jensen and Meckling pose the following question: "Why, given the existence of positive costs of agency relationship, do we find the usual corporate form of organisation with widely diffuse ownership so widely prevalent?"[84] The agency view suggests that shareholders are the 'principals' in whose interest the corporation should be run even though they rely on others for the actual running of the corporation. Eugene Fama and Jensen propose the separation of decision making and risk-bearing functions observed in the large corporation occurs in other organizations such as large professional partnerships, financial mutual, and non-profits.[85]

It is claimed shareholders have the right to residual claims because they are the residual risk bearers. As equity investors, the suggestion is that shareholders are the only economic actors who make an investment in the corporation without any contractual guarantee of a specific return. As 'residual claimants,' shareholders bear the risk of the corporation making a profit or loss, and have an interest in the allocation of corporate resources to make the largest residual possible. Since other stakeholders in the corporation will receive the returns for which they have contracted, the maximization of shareholder value results in superior economic performance, not only to the particular corporation, but for the economy as a whole. Fama and Jensen argued that shareholders are better equipped to bear risk than managers or workers, because they are not tied to the firms in which they hold shares.[86] Shareholders can diversify their investment portfolios to minimize risk. This separation of management and residual risk bearing in the corporation allows optimal risk allocation in the corporate economy.

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[84] *Ibid.* at 330.

[85] Eugene Fama & Michael Jensen, "Separation of Ownership and Control" (1983) 26 J L Econ. 301 at 309.

[86] *Ibid.*

An alternative theoretical approach that developed subsequent to transaction costs theory and agency theory is property rights theory, pioneered by Sanford Grossman and Oliver Hart in 1986, which adds an important dimension to analyses on firm structure.[87] While Adolf Berle and others[88] had noted the importance of property rights within the firm well before Grossman and Hart's work, the subject of property rights "received renewed attention following [Grossman and Hart's] assessment that property rights over assets can be used to define boundaries of firms."[89] Property rights theory "has common intellectual antecedents with transaction costs theory and agency theory," but it is conceptually different in its focus on the incentives of owners of assets to invest or exert effort.[90] As described by Ilya Segal and Michael D. Whinston,

> Property rights over an asset can be defined as a bundle of decision rights involving the asset (also called entitlements in the legal literature), which provide rights to take certain actions ("rights of access") and to prevent others from taking certain actions ("rights of exclusion"), including the right to take the profit generated by use of the asset and to prevent others from doing so, often called "profit rights" or "cash flow rights" in the literature.[91]

Property rights thus confer the residual rights of control to the owner of an asset. The owner is entitled to the use and benefits of the asset except insofar as he or she has contractually agreed to limits on those rights. Since it is impossible to contract specifically on certain future decisions

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[87] Sanford J. Grossman and Oliver D. Hart, "The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration" (1986) 94(4) J of Pol Econ 691; see also Oliver Hart & John Moore, "Property Rights and the Nature of the Firm" (1999) 98(6) J of Pol Econ 1119; Oliver Hart, *Firms, Contracts, and Financial Structure* (Oxford University Press, 1995).

[88] See e.g. Adolf Berle, *Power Without Property: A New Development in American Political Economy* (1959).

[89] Ilya Segal & Michael D. Whinston, "Property Rights" in R. Gibbons and J. Roberts, eds., Handbook of Organizational Economics (Princeton University Press, 2012).

[90] Jongwook Kim & Joseph T. Mahoney, "Property Rights Theory, Transaction Costs Theory, and Agency Theory: An Organizational Economics Approach to Strategic Management" (2005) 26 Manage Decis Econ 223 at 236.

[91] Segal & Whinston, supra note 89.

and renegotiations will inevitably take place, parties have insufficient incentives and contracts should be regarded are incomplete units of analysis in studying the firm. In this way, property rights matter very much, because they determine future bargaining positions.[92] The theory offers a "complementary organizational economics approach that informs analysis of both institutions and governance within the discipline of strategic management" which emphasizes the concept of residual control rights.[93]

The key notion behind property rights theory is that it derives the optimal allocation of ownership rights to assets in the economy to maximize social welfare.[94] Hart and John Moore examined a model of optimal property rights based on the assumption of positive bargaining externalities,[95] and scholars have noted how "the allocation of property rights can matter even in the absence of noncontractible actions/investments, when these rights affect the efficiency of agreements reached by the parties when their bargaining falls short of the perfectly efficient Coasian ideal."[96] The rich analysis that has developed from property rights theory, using sophisticated mathematical data, has influenced a broadened thinking of firm incentives and the

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[92] Patrick W Schmitz, "Bargaining Position, Bargaining Power, and the Property Rights Approach" (2013) 119(1) Economics Letters 28.

[93] Kim & Mahoney, *supra* note 90 at 237.

[94] Nevertheless, in practice, complications often arise within the concept of property rights within a firm. Segal & Whinston note:

> First, these rights of ownership are not always bundled together. For example, some stockholders of a firm may own a share of its profits, but may not have the right to vote on the use of the firm's assets. Similarly, an individual may possess the right to use an asset, such as a community garden or lake, but may not have the right to exclude others from doing so. Lastly, in some cases an owner may not possess the right to transfer his ownership rights to others, as with the prohibition against slavery. In addition, property rights are in practice often held collectively. For example, no single shareholder in a firm may be able to use the firm's assets as he sees fit. Yet, a majority of the shareholders, should they reach an agreement, can do so. Segal & Whinston, supra note 90 at ftn. 2.

[95] Hart & Moore, *supra* note 87.

[96] Segal & Whinston, *supra* note 89.

allocation of risks and resources within the business and economics fields.[97]

The common thread woven through transaction cost theory, agency theory, and property rights theory is dissatisfaction with neoclassical economics' treatment of firm behaviour. "Unitization" refers to private contractual arrangements to reduce economic losses associated with common pool extraction. Kim and Mahoney note the main differing features of the three theories:

> Agency theory is not concerned with the process of how a unitization agreement actually comes about. That is, agency theory focuses on the principal– agent relationship once a team production setting, with principal–agent relationship, is put in place. But why unitization (despite its potential for aggregate economic gain) is formed, or even more important, why it will not be formed, falls outside the analytical framework of agency theory. Second, both agency and transaction cost concepts of market frictions can be largely subsumed under the property rights concept of (negative) externalities.[98]

Kim and Mahoney note that "this dissatisfaction [by property rights theorists] has been channeled productively in the development of organizational economics theory within strategic management to explain and provide predictions for important business phenomena."[99] In this way, property rights theory attempts a "stylized modeling of ownership and incentive structures," and offers important insights beyond transaction costs theory and agency theory toward the efficient formation of the governing structure within the firm, [100] and potential alternatives to the

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[97] This dissertation is limited in its analysis of property rights theory given its economic depth and reliance on other economic theories that are beyond the scope of this dissertation, however, readers are encouraged to read Grossman and Hart's seminal work and subsequent research, cited at *supra* note 87.

[98] Kim & Mahoney, *supra* note 90 at 236.

[99] *Ibid.*

[100] Note that both transaction costs theory and property rights theory offer explanations of what Bengt Holmstrom and John Roberts call the "boundaries of the firm" that offer unsatisfactory accounts of a large variety of observed practices. Bengt Holmstrom & John Roberts, "The Boundaries of the Firm Revisited" (1989) 12(4) J Econ Perspectives 73. Holmstrom and Roberts recognize that firms are "complex mechanisms" for coordinating incentives and motivating activities, thus their argument lies in the fact that approaches which "focus on one incentive problem that is solved by the use of a single instrument give much too limited a view of the nature of the firm, and one that is potentially misleading." *Ibid.* at 75.

firm.

Law and economics scholars have often used normative analysis to explain managerial conduct that does not easily operate within the expected efficiencies of the shareholder primacy model, suggesting that managers "engage in stewardship of the corporation influenced by norms that bridge the gap between efficiency-enhancing activity and duties of care and loyalty."[101] Henry Hansmann and Reinier Kraakman agreed that agency costs associated with divergent objectives between managers and shareholders are comparatively less, stating that the shareholder primacy model has "stronger incentives to reorganize along lines that are managerially coherent."[102] Their arguments cumulated into the position they held in 2001, where they argued that the basic law of corporate governance had already achieved a high degree of uniformity to the shareholder primacy model[103] and "continued convergence towards [this] single, standard model is likely."[104] Key normative principles in this consensus include:

(1) ultimate control over the corporation should rest with the shareholder class;

(2) managers should be charged with the obligation to manage the corporation in the interests of its shareholders;

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[101] Janis Sarra, "Oversight, Hindsight, and Foresight: Canadian Corporate Governance through the Lens of Global Capital Markets" in Janis Sarra, ed, *Corporate Governance in Global Capital Markets* (Vancouver: UBC Press, 2003) at 42. See also Eric Posner, "Law, Economics and Inefficient Norms" (1996) 144 U Pa L Rev. 1697 at 1699; and Melvin Eisenberg, "Corporate Law and Social Norms" (1999) Columbia L Rev 1253 at 1256.

[102] Henry Hansmann & Reinier Kraakman, "The End of History for Corporate Law" (2001) 89 Geo LJ 439 at 14.

[103] In general, there seems to be little contention in legal scholarship regarding Hansmann and Kraakman's definition of shareholder primacy. See e.g. *ibid*; Stephen Bainbridge, "Director Primacy: The Means and Ends of Corporate Governance" (2003) 97 Nw U L Rev. 547, 573 (describing two principles of shareholder primacy being the shareholder wealth maximization norm and the principle of ultimate shareholder control); Jill Fisch, "Measuring Efficiency in Corporate Law: The Role of Shareholder Primacy" (2006) 31 J Corp L 637 (defining it as "the objective of the corporation as maximization of shareholder wealth"); and Ian Lee, "Efficiency and Ethics in the Debate About Shareholder Primacy," 31 Del J Corp L 533 at 535 (defining it as "the view that managers' fiduciary duties require them to maximize the shareholders' wealth and preclude them from giving independent consideration to the interests of other constituencies").

[104] Hansmann & Kraakman, *supra* note 102 at 439.

(3) other corporate constituencies, such as creditors, employees, suppliers, and customers (which, together with shareholders, are included as "stakeholders") should have their interests protected through contractual or regulatory means rather than through participation in corporate governance;

(4) non-controlling shareholders should receive strong protection from the exploitation of controlling shareholders; and

(5) the market value of the publicly traded corporation's shares is the principal measure of its shareholders' interests.[105]

Pointing to the shareholder primacy model's assumed efficiencies and its historical economic domination, Hansmann and Kraakman contended that the ideological convergence of this model is unlikely to be undone, especially since "no important competitors to the standard model of corporate governance remain persuasive."[106] At the time, American confidence in the shareholder primacy model was at a peak. To Hansmann and Kraakman, the ideological convergence toward the model meant that general convergence in practice will eventually follow – thus signifying, for all intents and purposes, an "end of history for corporate law."

In line with transaction costs theory, economic efficiency was regarded as the main force behind Hansmann and Kraakman's presumption of the long-term international acceptance of the shareholder primacy model. Profit maximization, historical success, and international competitive advantage are all identified as factors that "made the virtues of [the shareholder primacy] model increasingly salient."[107] Applying the principles of neoclassical law and economics on a global market level, the singular objective of a higher share price within the shareholder primacy model (the "shareholder wealth maximization norm") is legitimized in

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[105] *Ibid.* at 440-441.

[106] *Ibid.* at 456.

[107] Hansmann & Kraakman, *supra* note 102 at 449.

theory, providing Adam Smith's necessary "invisible hand" of self-interest to promote efficient outcomes within the supply and demand of the free market.[108]

1.3 Three Perspectives Emerging After "End of History"

Hansmann and Kraakman's article was published in early 2001, prior to the fall of Enron Corporation (Enron) and a number of other corporate and accounting scandals that devastated the US financial markets and rippled throughout the globe in the latter half of 2001 through to 2002. Readers are advised to consult the extensive documentation and analysis of Enron's collapse that is available,[109] but in brief, Enron's bankruptcy resulted from unlawful transgressions by its managers, which included non-transparent financial reporting, mark-to-market accounting, and the creation of complex corporate structures for the sole purpose of concealing billions of dollars in debt.[110] Once this information was revealed to the public, the outrage expressed by investors, employees, pension holders, and politicians was palpable.[111] Following in rapid succession after the fall of Enron was a series of other American corporate and accounting scandals that brought down several other companies, including most notably

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[108] Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776) 1 Eighteenth Century Collections Online 1.1.2. at I.2.2.

[109] Notable scholarly works are included in these footnotes. Enron's collapse has also been retold in non-fiction books and movies. See e.g. Bethany McLean & Peter Elkind, *The Smartest Guys in the Room: The Amazing Rise and Scandalous Fall of Enron* (New York: Portfolio, 2004); Mimi Swartz with Sherron Watkins, *Power Failure: The Inside Story of the Collapse of Enron* (New York: Doubleday, 2003); *Enron: The Smartest Guys in the Room*, DVD: (New York: Magnolia Pictures, 2005); *Frontline: Bigger Than Enron*, 2002, DVD (Boston, MA: WGBH, 2009).

[110] For a helpful summary, see e.g. Douglas M Branson, "Enron—When all Systems Fail: Creative Destruction or Roadmap to Corporate Governance Reform?" (2003) 48:4 Villanova L Rev 989 at 997-1002 [Branson, "Systems Fail"].

[111] See e.g. Kevin Anderson, "The Enron Outrage Game," *BBC News* (26 February 2002) online: <http://www.bbc.com>.

WorldCom,[112] whose bankruptcy quickly replaced Enron's as the largest in history.[113] Its downfall was due in part to management falsely inflating revenues and underreporting costs.[114] Following Enron's collapse, there came to be several discussions from legal scholars on the appropriate governmental response to the scandals. Simon Deakin and Suzanne Konzelmann's short article entitled "Corporate Governance after Enron: An Age of Enlightenment?"[115] identifies three groups of opinion that developed after the scandals. The following analysis summarizes Deakin and Konzelmann's findings and significantly builds upon them by highlighting some of the more persuasive voices from legal scholarship at the time, and categorizing them within Deakin and Konzelmann's three groups.

The first group believed that Enron's collapse only confirmed the existing model was working and "might actually be a reason to be more confident about corporate America."[116] Enron was an "aberration," and an example of one bad board did not denote that all boards were

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[112] Other companies included Tyco International, Adelphia Communications, Peregrine Systems and Global Crossing.

[113] See Luisa Beltran, "WorldCom Files Largest Bankruptcy Ever," *CNN Money* (22 July 2002) online: <http://www.money.cnn.com> (which reports WorldCom's bankruptcy as the largest in the history of the United States with $107 billion in assets, dwarfing that of Enron, which listed $63.4 billion in assets when it filed for bankruptcy). At the time of this writing, the WorldCom bankruptcy is the third largest in history, after the bankruptcies of Lehman Brothers Holdings ($639 billion) and Washington Mutual ($328 billion). See also Research Center: Largest All-Time Bankruptcies, *20 Largest Public Company Bankruptcy Filings 1980–Present*, online: <http://www.bankruptcydata.com>.

[114] See Complaint (Securities Fraud), *Securities and Exchange Commission v Worldcom, Inc*, No 17588 (SDNY 2002), online: Securities and Exchange Commission <http://www.sec.gov> (which claims that WorldCom disguised its operating performance by using undisclosed and improper accounting that overstated its income by approximately $3 billion in 2001 and $797 million during the first quarter of 2002).

[115] Simon Deakin & Suzanne J Konzelmann, "Corporate Governance after Enron: An Age of Enlightenment?" in John Armour & Joseph A McCahery, eds, *After Enron: Improving Corporate Law and Modernising Securities Regulation in Europe and the US* (Oxford: Hart, 2006) at 155.

[116] "Another Scandal, Another Scare," *The Economist* (27 June 2002) online: <http://www.economist.com>. See also Deakin & Konzelmann, *supra* note 29 at 155.

ineffective governance mechanisms.[117] This group, echoing *laissez-faire* market principles, felt that "[m]arket sanctions, in the form of reputational damage to its senior managerial team and to its auditors … served as an effective disciplinary device."[118] William W. Bratton described this group as the "supporters of deregulation," who found Enron's collapse to be "an exemplar of free market success."[119] In this sense, "[i]f Enron was a house of cards, it was free market actors who blew it down, with a free market administration keeping its hands off."[120] Once discovered by the public, the false inflation of Enron's stock price came to an end, and its value within the financial markets quickly depreciated. Because of the swift market reactions to Enron's exposed activities, proponents of this first position believed there was little to be accomplished with wider reforms to the existing corporate model. Enron's bankruptcy, then, was a "triumph of capitalism."[121]

The second group acknowledged that both managerial and "gatekeeper"[122] failures had occurred, and pushed for reform specifically addressing the misdeeds of Enron's executives and its lack of proper corporate monitoring. This group focused on tightening securities regulation and improving the functioning of the shareholder primacy model, without challenging or

[117] See Branson, "Systems Fail," *supra* note 110. See also Douglas M Branson, "Enron is an Aberration," *USA TODAY* (1 March 2002) 9A.

[118] Deakin & Konzelmann, *supra* note 115 at 155.

[119] William W Bratton, "Enron and the Dark Side of Shareholder Value" (2002) 76:5 & 6 Tul L R 1275 at 1281.

[120] *Ibid.*

[121] Robert L Borosage, "Enron Conservatives," *The Nation* 274:4 (4 February 2002) 4, online: <http://www.thenation.com> (notes that then-Treasury Secretary Paul O'Neill called Enron's rise and fall a "triumph of capitalism" at 5).

[122] Gatekeepers are reputational intermediaries who provide verification and certification services to investors. The term "gatekeeper" is not simply an academic concept. See Securities and Exchange Commission (SEC), *Revision of the Commission's Auditor Independence Requirements*, 2000 SEC LEXIS 1389 (Securities Act Release No 7870 on June 30 2000), online: Securities and Exchange Commission <http://www.sec.gov> (where the SEC noted that "[t]he federal … laws … make independent auditors 'gatekeepers' to the public securities markets" at 5).

restructuring it. Governance failures were traced back to conflicts of interest on the part of board members and its auditors. Many pointed to the false comfort of an independent monitoring board. On paper, Enron had a board that was ideal in several respects; among other favourable qualities, the board was diverse, with only two of their 14 directors classified as insiders.[123] Corporate governance issues thus focused on maintaining sufficient director independence and accountability, as well as a subtle shifting of powers from managers back to shareholders. Leading the charge was the Council of Institutional Investors (CII), an organization that in 2002 represented institutional investors holding approximately $2 trillion in pension assets. This group provided a detailed list of accounting and corporate governance reform recommendations "to prevent future Enrons."[124]

Many of the CII recommendations, along with other recommendations from the second group, eventually coalesced and led to the creation of the *Sarbanes-Oxley Act of 2002*[125] (*SOX Act*). The *SOX Act* was enacted directly in response to the scandals and implemented several new rules and regulations to curtail unwanted corporate behaviour. In particular, it contained provisions addressing director and managerial accountability through financial disclosure,

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[123] Stuart L Gillan & John D Martin, "Financial Engineering, Corporate Governance, and the Collapse of Enron" (2002) [unpublished, archived at the Social Science Research Network] online: Social Science Research Network <http://ssrn.com>.

[124] Council of Institutional Investors, Press Release, "SWIB Joins Council of Institutional Investors Seeking Reforms to Prevent Future Enrons" (4 February 2002) online: State of Wisconsin Investment Board <http://www.swib.state.wi.us> (the SWIB's recommendations, which were largely adopted by the *SOX Act*, *infra* note 39, were as follows: (1) "[r]eform auditor independence standards by prohibiting auditors from providing any non-audit services to their audit clients;" (2) "[r]adically reform the oversight of auditors;" (3) "[r]equire enhanced disclosure of director links to companies;" (4) "[t]oughen the stock exchanges' listing standards on board independence and board composition;" (5) "[d]o not soften the SEC's stance on enforcement;" (6) "[r]estore integrity to the proxy voting system by eliminating the stock exchanges' 'broker may vote' rule;" and (7) "[m]eaningfully update disclosure requirements for financial and other critical information").

[125] *Sarbanes-Oxley Act of 2002*, Pub L No 107-204, 116 Stat 745 (2002) (codified at 15 USC §7201 (2002)) [*SOX Act*].

including the imposition of a duty to disclose "on a rapid and current basis such additional information concerning material changes in the financial condition or operations of the issuer, in plain English …;"[126] greater internal controls, such as stricter standards on the certification of annual and quarterly reports by top executives and a prohibition against share sales by corporate officers during pension blackouts;[127] auditor independence, such as rotating the auditor partner every five years;[128] as well as the addition of stricter criminal penalties for managers responsible for any violations.[129]

Deakin and Konzelmann called the perspective of the third group "a radically different explanation for Enron's fall."[130] While this group generally accepted and approved of the initiatives created by the *SOX Act*, the underlying belief was that these reform efforts did not go far enough in addressing the root of the problem. Deakin and Konzelmann noted that "[f]rom this [third] perspective, the fate of Enron is less important than the future of the business model which it came to represent …."[131] The group also believed that "[u]nless the regulatory framework is adjusted to make this model unattractive, it will only be a matter of time before the same approach is tried again."[132] The problems of Enron inherently grew from the principles embodied within the shareholder primacy model of the corporation. Members of the senior management of Enron were given stock options that motivated short-term stock appreciation,

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[126] *Ibid*, § 409(1).

[127] *Ibid*, § 306(a).

[128] *Ibid*, § 203.

[129] *Ibid*, § 802.

[130] Deakin & Konzelmann, *supra* note 115 at 156.

[131] *Ibid.*

[132] *Ibid.*

and their unethical practices exemplified the "dark side" of the shareholder wealth maximization norm.[133] Proponents of this third position felt that the model fostered an environment that created oversized incentives, which invited corruption. "[G]overnance standards … [had] declined, particularly those addressed to the numerology of shareholder value,"[134] and the artificial inflation of Enron's stock was revealed only during the downward cycle of a cyclical economy. Clearly, some argued, a reliable corporate governance model should be designed to catch wrongdoing before it causes serious financial damage to shareholders and other stakeholders; therefore, the multiple scandals in 2001 and 2002 only demonstrated how the existing model did not work.[135] Deakin and Konzelmann shared this stance, stating:

> We believe that this third interpretation of events goes to the heart of the matter …. If we are to take this view seriously, nothing less than a fundamental rethinking of corporate governance practices and procedures is required. Above all, corporate governance must no longer confine its analysis to the relationship between managers, boards and shareholders. The narrowness of this focus is a major contributing factor to the present round of corporate scandals of which Enron is the most emblematic.[136]

Other scholars, such as Janis Sarra, identified how the scandals signified a real need to reassess other models of corporate governance available throughout the world. When examining governance issues within the global markets shortly following Enron's bankruptcy, Sarra noted:

> Although some scholars have claimed that the development of global capital markets will lead to the inevitable triumph of the market-centred system of corporate governance prevalent in Anglo-American law, the recent failures of large, publicly traded corporations in the United States cast doubt on claims of the ultimate superiority of that system. When this doubt is coupled with the existence of other forms of corporate governance throughout the world, the need for closer examination of potential

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133 See Bratton, *supra* note 110 at 1284.

134 *Ibid* at 1284.

135 See e.g. Jeffrey N Gordon, "Governance Failures of the Enron Board and the New Information Order of Sarbanes-Oxley" (2003) [unpublished, archived at Columbia Law School, Center for Law and Economic Studies] online: Columbia Law School <www.law.columbia.edu>.

136 Deakin & Konzelmann, *supra* note 115 at 156.

alternatives or improvements in corporate governance becomes more evident.[137]

Still others, such as Cary Coglianese and Michael L. Michael, suggested that real corporate governance reform may only be found through the disentrenchment and reinvention of cultural norms, stating:

> If corporate scandals stem from the same kind of underlying cultural problems that some insist afflict politics, sports, and even religion, then the core challenge for public policy will be to find ways to engender nothing less than a fundamental cultural shift.[138]

These voices aligned with scholars that had been supporting "counter-hegemonic" discourses on the shareholder primacy model for some time.[139] However, voices from this third group supporting structural changes to the shareholder primacy model did not gain much traction on the pathway to reform after the scandals of 2001 and 2002. They were easily outnumbered by those leading the second group and the mainstream push for greater regulation of financial reporting and auditing practices. The discussion during that period surrounded the effectiveness of the *SOX Act* and the alteration of the rules to curtail unwanted human behaviour within existing governance structures, rather than the possibility of revamping the dominant corporate form.

1.4 Ascendancy of Behavioural Approaches

From a law and economics perspective, the scandals marked an interesting period. It is

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[137] Janis Sarra, "Introduction" in Janis Sarra, ed, *Corporate Governance in Global Capital Markets* (Vancouver: UBC Press, 2003) at xv.

[138] Cary Coglianese & Michael L Michael, *After the Scandals: Changing Relationships in Corporate Governance*, Regulatory Policy Program Report RPP-09 (Cambridge, MA: Mossavar-Rahmani Center for Business and Government, Harvard University, 2006) at 20, online: Harvard Kennedy School <http://hks.harvard.edu>.

[139] See e.g. Testy, *supra* note 22 at 1232-40 (for an overview of "counter-hegemonic" discourses). Testy describes "hegemonic" discourse as discussions surrounding the shareholder primacy and wealth maximization model, where "managers' highest duties are to shareholders and to maximizing their wealth; thus, shareholders must be preferred in the event that a conflict between corporate constituents emerges" at 1231). "Counter-hegemonic" discourse thus seeks to describe alternative visions of corporate law.

apparent from Posner's later writings that he firmly belonged within the first group of scholars supporting free market principles, and not within the second group calling for stricter market regulations to support the existing governance model, or the third group envisioning deep normative and structural reform. In Posner's 2007 edition of the *Economic Analysis of Law*, where he directly responded to the corporate events of 2001 and 2002, he stated:

> [F]raud has long been criminal, and the successful prosecution of the Enron executives suggests that adequate legal tools were in place to deal with such conduct before Sarbanes-Oxley…. As for the receipt by accounting firms of fees for consulting services, as well as for auditing, …[i]t should be enough to require the corporation to disclose to investors the terms of its relations with its auditors, and leave the investors to penalize a corporation by bidding down its stock price if they think the auditor has been 'bought.'[140]

Other advocates of the Chicago School generally echoed this sentiment. For example, Gary S. Becker, Nobel laureate and a prominent figure in the Chicago School, argued that if a fully deregulated energy market had been in place, "the Enron political scandal would have been largely avoided" since "[t]he company could not have gamed the system by encouraging politicians to deregulate as it favored."[141] While conceding that the scandal "indicate[d] the need for stricter guidelines on accounting and greater Internal Revenue Service," Becker pointed out that "stock markets have responded by punishing Enron severely for the company's transgressions …" and that "flexible prices and competition are far more effective ways to improve energy markets than allowing bureaucrats and politicians to determine the speed and direction of deregulation."[142]

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[140] Richard Posner, *Economic Analysis of Law*, 7th ed (New York: Aspen, 2007) at 452.

[141] Gary S Becker, "Enron Was Mostly Right About One Thing: Deregulation," *Business Week* (18 March 2002) 26, online: <http://www.businessweek.com>.

[142] *Ibid.*

Despite the firm stance by leading scholars in the Chicago School, this controversial period in corporate history provided opportunities for other strands within law and economics scholarship, particularly behavioural approaches, to broaden their audience. Objections to the depiction of human agents as rational actors within the field of law and economics, and especially the Chicago School, had frequently been voiced in the past by both its supporters and its critics.[143] The scandals exposed the startling need for greater quantitative and qualitative research surrounding human behaviour in modern finance, while also providing a golden opportunity to apply behavioural approaches to pressing legal issues.[144]

Schools were eagerly adopting behavioural approaches in response to the concept of the rational, self-interested actor by the Chicago School. Herbert A. Simon's notion of "bounded rationality," being "behavior that is *intendedly* rational, but only *limitedly* so …,"[145] and other approaches addressing limitations within human behaviour[146] were increasing in influence.[147] Robert Prentice, for example, noted how the scandals supported his continued attempts "to create

[143] See Mercuro & Medema, *supra* note 28 at 102-4. See also Christine Jolls, Cass R Sunstein & Richard Thaler, "A Behavioral Approach to Law and Economics" (1998) 50:5 Stan L Rev 1471 (which noted that "[o]bjections to the rational actor model in law and economics are almost as old as the field itself" at 1473).

[144] The field was undergoing a transformative period toward the wider acceptance of approaches extending beyond neoclassical economics, including offshoots that developed from the work of the Chicago School. See e.g. Mercuro & Medema, *supra* note 28 at 284-90 (which discusses, for example, Guido Calabresi's influence within what the authors call the New Haven School of law and economics).

[145] Herbert A Simon, *Administrative Behavior: A Study of Decision-Making Process in Administrative Organization*, 2d ed (New York: Macmillan, 1957) at xxiv [Simon, Administrative Behavior] [emphasis in the original]. See also Herbert A Simon, *Models of Man: Social and Rational, Mathematical Essays on Rational Human Behavior in a Social Setting* (New York: John Wiley & Sons, 1957) [Simon, Models of Man].

[146] See e.g. Jolls, Sunstein & Thaler, *supra* note 143.

[147] This is not to say behavioural law and economics approaches were not already developing prior to the scandals of 2001 and 2002, but rather, that the corporate and accounting scandals allowed them to take centre stage. There have been disagreements as to when and how behavioural economics began. See e.g. Hamid Hosseini, "The Arrival of Behavioral Economics: from Michigan or the Carnegie School in the 1950s and the Early 1960s?" (2003) 32:4 Journal of Socio-Economics at 391. But see Louis Uchitelle, "Following the Money, but Also the Mind: Some Economists Call Behaviour a Key," *The New York Times* (11 February 2001) online: <http://www.nytimes.com>.

more realistic policy prescriptions than have been derived from the Chicago School law and economics reasoning that has dominated the interdisciplinary approach to legal analysis ….”[148] As well, Donald Langevoort asserted that “[t]he ones with the explaining to do [following the Enron debacle] are the believers in market efficiency ….”[149] He contended that “behavioral finance is somewhat better positioned to test the real world impact of bias in market prices than research in more opaque economic settings,”[150] and went on to develop a constructive theory of behavioural securities regulation. It was clear that those pressing for more contextualized critiques to the mainstream Chicago School of law and economics now had the chance to capitalize on those corporate events.

Law and economics scholars that were adopting behavioural approaches around the time of the Enron scandal held, if anything, beliefs in line with the second group, which argued for greater transparency and accountability of directors and managers, and for stricter regulation following the scandals to support the shareholder primacy model. The work of behavioural law and economics scholars generally focused on ways in which the law could promote desired human behaviour within pre-existing structures. The field itself utilizes traditional economic tools and enhances them by providing a better understanding of human behaviour in a market-driven environment. While recognizing that there can be new and innovative prescriptions from these lines of inquiry, following the scandals, behavioural law and economics scholars tended to focus on economic improvements within the boundaries of securities regulation and on

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[148] Robert Prentice, “Enron: A Brief Behavioral Autopsy” (2003) 40:2 Am Bus LJ 417 at 419-20.

[149] Donald C Langevoort, “Taming the Animal Spirits of the Stock Markets: A Behavioural Approach to Securities Regulation” in John Armour & Joseph A McCahery, eds, *After Enron: Improving Corporate Law and Modernising Securities Regulation in Europe and the US* (Oxford: Hart, 2006) 65 at 66.

[150] *Ibid* at 67.

"prescriptions regarding how to make the legal system work better;"[151] not on challenging the very structures and institutions in which the law operated.[152] Behavioural law and economics served as a useful tool to expose the flaws within the existing model, but the approach was incapable of offering a meaningful alternative.

Nevertheless, the growing movement of behavioural approaches signaled a marked change in law and economics analysis. In a 1998 article, Christine Jolls, Cass R. Sunstein and Richard Thaler noted: "[t]hirty years from now we hope that there will be no such thing as behavioral economics. Instead we hope that economists and economically oriented lawyers will … transform economics into behavioral economics, and economic analysis of law into one of its most important branches."[153] Following the scandals, the study of behavioural effects on economics garnered greater strength and momentum from these market-immobilizing events. George A. Akerlof, for example, argued in his Nobel Lecture on December 8, 2001, a decade after Coase was the recipient and two months after news of the Enron scandal broke, that macroeconomics should be behavioural and that John Maynard Keynes' *General Theory* "was the progenitor of the modern behavioral finance view of asset markets."[154] The following year, the selection of Daniel Kahneman as the corecipient of the 2002 Nobel Prize in economic

[151] Jolls, Sunstein & Thaler, *supra* note 143 at 1546.

[152] See e.g. Prentice, *supra* note 148; Jolls, Sunstein & Thaler, *supra* note 143.

[153] *Ibid* at 1547.

[154] George A Akerlof, "Behavioral Macroeconomics and Macroeconomic Behavior" in Peter Englund, ed, *Nobel Lectures Including Presentation Speeches and Laureates' Biographies: Economic Sciences 2001-2005* (New Jersey: World Scientific, 2005) 19 at 37, online: Nobel Prize <http://nobelprize.org>.

sciences indicated to many "the ascendancy of behavioral economics."[155]

One would think the corporate and accounting scandals of 2001 and 2002 would leave an indelible mark against Hansmann and Kraakman's claim that the shareholder primacy model was the final resting place of the corporate form. Hansmann himself noted five years after his article with Kraakman that "[t]he most serious argument against the efficiency claim … is that the standard shareholder-oriented model involves too steep a tradeoff between material prosperity and social order …. It is from this perspective that the end of history claim is weakest."[156] It was apparent from the scandals that the human limitations of "bounded rationality, bounded will-power, and bounded self-interest"[157] resulted in the identification of the inherent flaws within the perceived transparencies and efficiencies in the financial market. Following those events, many felt a behavioural approach to law and economics offered a better way of addressing human weaknesses in regulatory design, but the approach contained few positive prescriptions for the development of an alternative, competing model. The burden continued to rest on lawmakers' abilities to adequately protect stakeholder interests through securities regulation, and not on the corporate governance model itself. The scandals were potentially damaging to the reputation of the shareholder primacy model, and certainly showed the weakness in relying on market principles to regulate corporate behaviour, but its continued survival only solidified Hansmann and Kraakman's argument that the model had lasting acceptance within American ideological thought.

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[155] Peter H Huang, "Regulating Irrational Exuberance and Anxiety in Securities Markets" in Francesco Parisi & Vernon L. Smith, eds, *The Law and Economics of Irrational Behaviour* (Stanford, CA: Stanford University Press, 2005) 501 at 502.

[156] Henry Hansmann, "How Close is the End of History?" (2006) 31:3 J Corp L 745 at 747-48.

[157] Jolls, Sunstein & Thaler, *supra* note 143 at 1476. See also Simon, *Administrative Behavior*, *supra* note 145 at xxiv-xxvii; Simon, *Models of Man*, *supra* note 145 at 196-206.

1.5 Perspectives in the Aftermath of the Global Financial Crisis

The three positions identified by Deakin and Konzelmann following the scandals of 2001-2002 should have contrasting notes in the aftermath of the global financial crisis (GFC). The scandals of 2001-2002 involved conduct by management that was clearly in violation of law, whereas the main factors leading to the GFC were due to corporate actions that were legally permissible,[158] thus the fault cannot be said to rest solely upon the unlawful actions of a few greedy executives.[159] The position of the first group, which held that market sanctions alone were effective disciplinary devices, cannot seriously be considered any longer due to the GFC.[160] In fact, the GFC may have destroyed the very premise on which this position rests. In its aftermath, there were countless normative arguments searching for blame as to who 'caused' the GFC and subsequent economic recession, leading to an interesting account as to where the theoretical differences lay amongst business scholars in pinpointing the location of "capitalism's fault lines."[161]

US President Barack Obama did not mince words, laying blame on "the perfect storm of irresponsibility and poor decision-making that stretched from Wall Street to Washington to Main

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[158] Corporate executives were questioned for conducting unlawful activity, such as CEO Ian McCarthy of Beazer Homes USA Inc., who was under SEC investigation for lying about borrowers' qualifications, see TIME Magazine, "25 People to Blame for the Financial Crisis", online: <http://www.time.com>. McCarthy was never criminally sanctioned.

[159] In Carol Liao, "Corporate Governance Reform for the 21st Century: A Critical Reassessment of the Shareholder Primacy Model" (2012) Ottawa L Rev 187, I examine two factors that contributed to the collapse of the US subprime mortgage market: the repeal of the Glass-Steagall Act and the originate-to-distribute model of lending. The examination reveals how the shareholder primacy model played a key role in the onslaught of the global financial crisis by incentivizing the obstruction of efficient regulation and encouraging corporate behaviour that perpetuates the likelihood of future crises.

[160] See Section 1.3 at ftns. 116-121.

[161] Borrowing from Jonathan Rauch, "Capitalism's Fault Lines" (14 May 2009) *The New York Times* BR11.

Street."[162] Paul Krugman, in his September 2009 article in *The New York Times,* "How Did the Economists Get It So Wrong?" blasted economists like Olivier Blanchard, now chief economist at the International Monetary Fund, for "clinging to the vision of capitalism as a perfect or near perfect truth."[163] Blanchard had written an article in 2008 declaring that "the state of macro[economics] is good" and, in a tone reminiscent to Hansmann and Kraakman's "End of History,"[164] argued that there had been a "convergence in vision and methodology" for macroeconomics.[165] Krugman in his critique writes, "[t]he renewed romance with the idealized market was, to be sure, partly a response to shifting political winds, partly a response to financial incentives," but ultimately

> this romanticized and sanitized vision of the economy led most economists to ignore all the things that can go wrong. They turned a blind eye to the limitations of human rationality that often lead to bubbles and busts; to the problems of institutions that run amok; to the imperfections of markets — especially financial markets — that can cause the economy's operating system to undergo sudden, unpredictable crashes; and to the dangers created when regulators don't believe in regulation.[166]

Richard Posner also sought to pinpoint the cause of the GFC, finding the large apportionment of blame laid upon capitalism to be misdirected. In his 2009 book examining the GFC and what Posner called "the descent into depression" he remarks on how "laissez-faire capitalism failed us," but posing the question upon himself as to who was more responsible, industry or government, Posner emphatically believed the responsibility lay with the

[162] *Ibid.*

[163] Paul Krugman, "How Did Economists Get It So Wrong?" *The New York Times* (2 September 2009) at MM36.

[164] Hansmann & Kraakman, *supra* note 102.

[165] Olivier Blanchard, "The State of Macro," (2008) National Bureau of Economic Research Working Paper 14259, online: <http://www.nber.org>.

[166] Krugman, *supra* note 163.

government. For Posner, "the government allowed the preconditions of depression to develop and wreak havoc with the economy"[167] and it was the government who provided "late, slow, indecisive, and poorly articulated" responses to the GFC.[168] Directing a pointed attack at Krugman, Posner stated that "the journalists and politicians, and some who should know better, like the distinguished macroeconomist Paul Krugman, are engaged in an orgy of recrimination against Wall Street. They have the wrong target. The responsibility for building the fences that prevent an economic collapse as a result of risky lending devolves on the government."[169]

Posner was careful in distancing himself from scholars that have applied behavioural analysis in the autopsy of blame. He insisted that those on Wall Street were acting rationally, calling media coverage of Wall Street greed and extravagance as "ignorant" and "silly", and rhetorically asking "What did reporters think businessmen were like?"[170] Posner was very skeptical that "readily avoidable mistakes, failures in rationality, or the intellectual deficiencies of financial managers whose IQs exceed my own were major factors in the economic collapse."[171] He insisted that blame rested on the lack of regulation by the government, and not the "rational" actions conducted by individuals which ultimately led to the GFC, stating:

> By having over a period of decades [deregulated banking and credit], the government inadvertently allowed the rational self-interested decisions of private actors – bankers, mortgage brokers, real estate salesmen, homeowners, and others – to bring on a financial crisis that the government was unable to prevent from molting into a

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[167] Richard Posner, *A Failure of Capitalism: The Crisis of '08 and the Descent into Depression* (Cambridge: Harvard University Press, 2009) at 236.

[168] *Ibid.*

[169] *Ibid.* at 285.

[170] *Ibid.* at xiii.

[171] *Ibid.* at 77.

depression. A profound failure of the market was abetted by governmental inaction.[172]

Posner's position is helpful in highlighting foundational arguments that supporters of the shareholder primacy model generally hold. First, Posner identified reckless behaviour – as clearly evidenced in the actions leading up to the GFC, such as the originate-to-distribute model of lending[173] – as rational, predictable human behaviour. The stylized normative ideal of self-interest as the epitome of good business requires strong regulation and other internal and external pressures to curtail inevitable wanton behaviours from producing social and environmental harms. Posner adheres to this position in his analysis – calling on the paucity of government regulation as a main culprit in the onset of the GFC. His support of greater regulation in the financial arena seems ignores the political-economic realities of powerful, immense, and unrelenting lobbying efforts by large institutions on American lawmakers whenever issues regarding their regulation and governance are at stake,[174] as well as "regulatory capture."[175] Lastly, Posner's position seems to be almost an about-face to the standard deregulatory position regarding the government's role which has traditionally been favoured by the Chicago school, including after the Enron scandal.[176] This inconsistency seems to frequent the analysis of those

[172] *Ibid.* at 242-243.

[173] The originate-to-distribute model of lending allowed financial institutions to reduce their capital charges and transfer the risks associated with securitized loans to a market hungry to buy them. The strategy worked as follows: (i) originate consumer mortgage loans; (ii) package the loans, in tranches, into mortgage-backed securities and collateralized debt obligations; (iii) create additional over-the-counter derivatives whose values are derived from the underlying loans; and (iv) distribute the repackaged securities to investors. Arthur Wilmarth, "The Dark Side of Universal Banking: Financial Conglomerates and the Origins of the Subprime Financial Crisis" (2009) 41 Conn L R 963.

[174] Public choice theorists have commented on the socially perverse effects of lobbying, see e.g. James D Gwartney and Richard E Wagner, "Public Choice and the Conduct of Representative Government" in James D Gwartney and Richard E Wagner, ed., *Public Choice and Constitutional Economics* (Greenwich: JAI Press, 1988) at 3-28.

[175] See *infra* ftns. 413 and 414.

[176] See for example, Becker, *supra* note 141, where Becker argued that Enron could not have gamed the system in a deregulated energy sector.

typically in strong deregulation stance held prior to events of financial turmoil.

Since writing his book detailing the GFC in 2009, Posner wrote another book, *The Crisis of Capitalist Democracy*, where he conceded that he and the Chicago school erroneously believed that "markets were perfect, which is to say self-regulating, and government regulation in them almost always made things worse."[177] He now believes the GFC showed that pure market competition "can cause people to take reckless and irrational risks, with short-term profit-maximizing behaviour jeopardizing society's long-term interests" (a point that one reviewer has noted, is "hardly a revelation").[178] He berates the three major CRAs of Moody's, S&P, and Fitch, arguing they should lose their quasi-official status for their role in perpetuating the GFC[179] and surprisingly suggests, among other things, that reinstating the *Banking Act of 1933*,[180] popularly known as the *Glass-Steagall Act* (*GSA*) is a viable and realistic solution.[181] As other schools of thought gain greater traction and forward trajectory in challenging the status quo, the Chicago school of law and economics may need to clarify its normative stance on regulatory policies in a post-GFC climate.

Still, Posner's strong reproach of governmental inaction during the GFC did not mean

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[177] Richard Posner, *The Crisis of Capitalist Democracy* (Cambridge: Harvard University Press, 2010).

[178] Don Tapscott, "Bubble Brains" *The Globe and Mail* (23 April 2010), online: <http://www.theglobeandmail.com>.

[179] Posner, *supra* note 177 at 349.

[180] *Banking Act of 1933*, 48 Stat. 162.

[181] *Ibid.* at 353-354. The *GSA* had restricted commercial banks from any involvement in the securities industry, thus creating a firewall between commercial banking and investment banking. On November 12, 1999, then-U.S. President Bill Clinton signed into law the *Gramm-Leach-Bliley Act* (otherwise known as the *Financial Services Modernization Act of 1999,* Pub L 106-102, 11 Stat 1338), which repealed some of the key elements of *GSA* so that banks could thereafter be affiliated with securities firms.

he shied away from recognizing the GFC was also "a failure of capitalism" and the unfettered market. Deakin and Konzelmann's first position examined in response to the scandals of 2001-2002 – being the belief that free market sanctions are sufficient in times of financial turmoil – is now on tenuous ground. It was almost simple to call Enron an aberration and leave things as-is. However, the GFC cannot be called an aberration, a market hiccup, or a normal "bubble" that burst. The $700 billion bailout and stimulus package by the US government has significantly limited the viability of that argument. The GFC has thus caused many belonging in the first group following the scandals of 2001-2002, including Posner, to strongly shift into the second group focused on improving corporate behaviour through the tightening of securities regulation.

It seems that at a minimum, the influence of American culture on the world is at least passively settled with the shareholder primacy model as it currently exists. Governments are responsible for adjusting legal rules to restrain certain incentives that guide the existing model. If corporate conduct causes negative ramifications to society without appropriate regulation to address it, the solution is to create reactionary law to address and prevent such specific conduct from recurring in the future. It suggests a cyclical pattern of disaster and reactionary lawmaking will always accompany the financial markets if the shareholder primacy model is here to stay and market forces are expected to police. This pattern is particularly concerning as innovative financial products are produced with a level of rapidity and complexity that has regulators struggling to keep up. It is apparent from our recent history (and we see how one does not have to reach too far into the past to prove this point again and again) that market forces cannot be relied upon to ensure corporations help to advance the social economy.

1.6 Global Convergence Debate

Hansmann has acknowledged that his article with Kraakman was written with the intention to provoke.[182] Yet, the question remains as to whether there has been global convergence in corporate governance norms. It is apparent from the wide array of articles addressing global convergence that the debate is far from settled. However, while convergence towards the Anglo-American shareholder primacy model was heavily deliberated in the late 1990s when the American economy was booming and the possibility of convergence seemed "irresistible,"[183] the force behind both sides seems to have lessened of late. This may be due to the economic times – the GFC, the European sovereign-debt crisis, a fluctuating global economy, the growth of multinational enterprises, and the emergence of China as the new economic superpower may have shifted the focus for legal scholars. This section explores the arguments within this debate and examines whether, given these changes in the global landscape, a temporary consensus regarding convergence is feasible and if so, whether this consensus is conducive to future reformation of shareholder primacy, and/or negates the relevance of new innovative corporate structures challenging the status quo.

1.6.1 Convergence is Likely

The globalization of capital markets, the growth of institutional investors, and increasing international competition have provided significant market pressures for the global convergence of governance norms toward the shareholder primacy model. Shareholding is increasing internationally, particularly due to the globalization of private finance and the privatization of public enterprise.[184] Domestic stock markets are being deregulated, which has

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[182] Hansmann, *supra* note 156 at 745.

[183] Thomas Clarke, ed., *Theories of Corporate Governance* (New York: Routledge, 2004) at 205.

[184] Michael Useem, "Corporate Leadership in a Globalizing Equity Market" (1998) 12 Acad Mgmt Exec 43 at 45-46.

typically entailed an easing of restrictions on foreign ownership of brokerage firms. This has resulted in cross-border stock exchange listings and the growth the cross-border financial diversification.[185] Because of increased international investor activism, there has been pressure to create global standards of corporate disclosure and governance. Michael Useem has noted that most financial experts prefer companies throughout the world to observe shareholder rights, maximize shareholder value, and provide adequate transparency and disclosure in their reporting of corporate activities.[186] Institutional investor activism has resulted in American and British international equity managers supporting efforts to create more uniform transnational disclosure policies, accounting principles, and governance practices. Ongoing dialogue among national executives and managerial transplants across nations has created an exchange of ideas and norms.[187] Hansmann and Kraakman as well have found that "…the persuasive power of the standard model has been amplified through its acceptance by a worldwide network of corporate intermediaries, including international law firms, the big five accounting firms, and the principal investment banks and consulting firms – a network whose rapidly expanding scale and scope give it exceptional influence in diffusing the standard model of shareholder-centered corporate governance."[188]

In response to the growth of institutional investor activism, several organizations have designed global governing principles, which include:

(1) the OECD Principles for Corporate Governance (OECD Principles), aimed at assisting

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[185] *Ibid* at 47-8.

[186] *Ibid* at 51.

[187] *Ibid* at 49-55.

[188] Hansmann & Kraakman, *supra* note 102 at 449.

governments improve the regulatory frameworks for corporate governance;[189]

(2) the World Bank framework for implementing good corporate governance practices in emerging market economies;[190]

(3) the International Corporate Governance Network's Global Corporate Governance Principles (ICGN Principles), which "are intended to be of general application around the world, irrespective of legislative background or listing rules";[191]

(4) the International Financial Reporting Standards, providing global accounting standards requiring transparent and comparable information in financial statements and other financial reporting;[192] and

(5) the United Nations Principles for Responsible Investing (UNPRI), with the goal of understanding the implications of sustainability for investors while supporting voluntary signatories to incorporate these issues into their investment decision making and ownership practices.[193]

Sarra has noted that the OECD Principles focus on four key themes: (1) shareholder rights and equitable treatment of shareholders; (2) disclosure and transparency to enhance accountability; (3) the role of other stakeholders; and (4) the responsibility of corporate boards.[194] These themes also resonate in the framework provided by the World Bank and the ICGN Principles, and the International Financial Reporting Standards help to bolster the disclosure and accountability component of those themes.

In its preamble, the World Bank argues for the adoption of globalized governance principles in developing market economies in order to combat poverty. It notes that:

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[189] OECD, "OECD Principles for Corporate Governance" (2004 edition), online: OECD <www.oecd.org>.

[190] World Bank, "Corporate Governance: A Framework for Implementation" (1999), online: Sovereign Global <www.sovereignglobal.com>.

[191] International Corporate Governance Network, "Global Corporate Governance Principles" (2009 edition), online: ICGN <www.icgn.org>.

[192] International Financial Reporting Standards (2011), online: IFRS <www.ifrs.org>

[193] Principles for Responsible Investing, online: <http://www.unpri.org/>.

[194] Janis Sarra, "Convergence versus Divergence, Global Corporate Governance at the Crossroads: Governance Norms, Capital Markets & OECD Principles for Corporate Governance" (2001) 33 Ottawa L Rev 177 at 208.

> [i]ncreasingly for developing and transition economies, a healthy and competitive corporate sector is fundamental for sustained and shared growth….[I]ndividual investors, funds, banks, and other financial institutions base their decisions not only on a company's outlook, but also on its reputation and its governance. It is this growing need to access financial resources, domestic and foreign, and to harness the power of the private sector for economic and social progress that has brought corporate governance into prominence the world over.[195]

Sarra as well has pointed to the growing acceptance that the adoption of key governing principles by nation states are a precursor to obtaining an enhanced flow of capital investment to their economies.[196] While the above listed organizations have not specifically addressed which governance structure they are modeling (and the OECD "has suggested that it has resisted endorsement of one type of corporate governance structure"), Sarra points out that "the [OECD] Principles are remarkably close to those that shape Anglo-American governance structures and theory."[197]

The opening up of domestic corporate governance norms and laws to global capital markets as well as "the mobility of capital, mergers, cross-listing on international stock exchanges, the move to international accounting standards, and the global transfer of both debt and equity" provide continual market pressure towards convergence.[198] These norms include "protection of foreign shareholder rights, greater financial disclosure, regulated securities and lending markets, effective director oversight, and judicial systems that enforce these rights."[199] Sounding the battlecall for supporters in many respects, Hansmann and Kraakman predict that

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[195] World Bank, *supra* note 190 at 2.

[196] Sarra, *supra* note 194 at 205.

[197] *Ibid.* at 222.

[198] *Ibid.* at 206.

[199] *Ibid.*

> as equity markets evolve in Europe and throughout the developed world, the ideological and competitive attractions of the model will become indisputable, even among legal academics. And as the goal of shareholder primacy becomes second nature even to politicians, convergence in most aspects of the law and practice of corporate governance is sure to follow.[200]

Useem contends that, while the convergence process may ebb and flow and be lengthy, given the accumulating assets and powers of the institutional holders and their movement onto the world stage, convergence "appears inevitable."[201] Within the pro-convergence camp, the question has focused on whether convergence will be 'formal' through the wholesale adoption of the Anglo-American shareholder primacy model in other nations, or a 'functional' convergence of best practices.[202] Regarding the possibility of functional convergence, John Braithwaite and Peter Drahos have offered insights from their empirical research on how "[g]lobalized rules and principles can be of consequence even if utterly detached from enforcement mechanisms."[203] As a substitute for state enforcement and the incorporation of norms, standards, principles, and rules into positive law, the key enforcement mechanism is in modeling.[204]

1.6.2 Convergence is Unlikely or Irrelevant

On the flip side, there are several arguments against the prediction of convergence. The first is due to path dependence, which is also discussed further in Chapter 2. In general, the view is that corporate governance systems are tightly coupled with path dependent regulatory laws

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[200] Hansmann & Kraakman, *supra* note 102 at 468.

[201] Useem, *supra* note 184 at 220.

[202] See e.g., John Coffee, "The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control" (2001) Yale LR 70.

[203] John Braithwaite & Peter Drahos, *Global Business Regulation* (Cambridge: Cambridge University Press, 2000) at 10.

[204] *Ibid.* at 10, 25.

that are unlikely to be modified in the near future. Corporate governance models cannot be seen in isolation from other institutional factors and normative underpinnings within nations. Legally, corporate law "is intimately related not only to social custom but also to other legal areas, such as banking, labor, tax, and competition law."[205] Sarra has outlined how path dependence shows how governance models are reflective of the historical, legal, and political frameworks in which they operate rather than a pull towards efficiency, all the while "reflecting enormous power inequities."[206] Mark Roe as well has pointed out that "the American governance structure is not inevitable" and that "we must consider the role of politics, history, and culture."[207] Political and economic interests are heavily intertwined with existing corporate structures, and given political dynamics, social movements, and other factors external to corporate law, convergence should not be assumed. Elites within nations will be unwilling to subvert their existing positions and path dependence will create "formidable pressures for continuity" of structures that have delivered efficiency in the past.[208]

In support of the path dependence argument, Douglas Branson has remarked that the "one size fits all" approach of convergence advocates is culturally and economically insensitive. He is critical of existing convergence scholarship which he feels is lacking in evidence and is "highly inbred" in that a few scholars in a handful of elite institutions cite one another's work

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[205] Mauro Guillén, "Corporate Governance and Globalization: Is There Convergence Across Countries?" (2000) 13 Advances Int'l Comp Mgmt 175 at 178.

[206] Sarra, *supra* note 194, citing Bebchuk and Roe at 48.

[207] Mark Roe, "Some Differences in Germany, Japan, and the United States" (1993) 102 Yale LJ 1927 at 1989, 1997.

[208] Martin Rhodes & Bastiaan van Apeldoom, "Capital Unbound? The Transformation of European Corporate Governance" (1998) 5 J of Eur Pub Pol 406 at 414.

almost exclusively, while ignoring other research.[209] He notes that value systems in China are still firmly based on post-Confucianism and tradition and "a high degree of abnegation of self and tolerance and patience for others," thus creating insurmountable barriers to the import of American corporate governance principles which require "a certain degree of confrontation and a high degree of individualistic behavior."[210] Ron Davis has also observed how "it seems logical that if culture informs corporate behaviour, then the convergence thesis is less compelling and may be restricted to those nations whose cultures are similar."[211] Branson points out that the dominant forms of ownership in the world remain family ownership and other forms of embedded capitalism in which the economy is perceived to be subservient to the society, rather than the opposite.

Branson goes further to suggest that the issue of global convergence is extraneous in the face of the more pressing problem of the century, being problems associated with the growth and regulation of the multinational enterprises (MNEs).[212] This issue has also been identified by Davis, who notes that MNEs are not currently held accountable for any harmful conduct in host nations that may result in human, political, and social rights harms and environmental degradation.[213] He finds that while there is potential for institutional investors to limit harmful externalities from these MNEs, there are problems associated with this type of control and a form

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[209] Douglas Branson, "The Very Uncertain Prospects of 'Global' Convergence in Corporate Governance" (2001) 34 Cornell Int'l LJ 321 at 325.

[210] *Ibid.* at 268.

[211] Ronald B Davis, "Fox in S-OX North, A Question of Fit: The Adoption of United States Market Solutions in Canada" (2004) 33 Stetson L Rev 955 at 957.

[212] Branson, *supra* note at 334.

[213] Ron Davis, "Investor Control of Multinational Enterprises: A Market for Corporate Governance Based on Justice and Fairness?" at Janis Sarra, ed, *Corporate Governance in Global Capital Markets* (Vancouver: UBC Press, 2003) at 131.

of public regulation is needed.[214] The OECD Guidelines for MNEs may be of significant help in that regard.[215] Branson contends that these problems associated with globalization are critical to address, and the "sheer power and size" of MNEs force the question as to whether the debate about convergence within nation states is now irrelevant.[216]

1.6.3 Considering the Empirical Evidence

Of course, the empirical evidence on convergence is important to consider in the debate. Unfortunately, cross-national studies are limited and also somewhat difficult to assess for a number of reasons. Mauro Guillén has commented that the key problem is the dearth of empirical indicators for relevant dimensions. He remarks that earlier studies "vary in terms of the range of indicators used, the nature of the indicator (quantitative or qualitative), and the number of countries included."[217] The most well-known empirical research on global corporate governance patterns is from the economists Rafael La Porta et al, who in a series of articles documented empirically the relationship between the law and economic growth, the development of markets, and the governance of firms. La Porta et al examined levels of legal protection for shareholders using detailed data from nearly 50 countries, under classifications of French, German, Scandinavian, and common law traditions. They found there was a correlation between strong legal protection for shareholder rights and dispersed shareholder ownership, as well as a correlation between weak protection and more concentrated ownership. They claimed their results showed that attributes found in the common law tradition, being strong legal protection

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214 *Ibid.* at 147-149.

215 OECD, *supra* note 189.

216 Branson, *supra* note 209 at 335.

217 Guillén, *supra* note 205 at 181.

and the resulting diffuse ownership, were more likely to foster an environment attractive to private-sector investment. If strong legal protection for shareholders is not present, then there were adverse consequences for financial development and growth.[218] While their work did not directly address the convergence debate, it provided support for later claims regarding the superiority of the shareholder primacy model within the common law tradition.

Guillén also produced longitudinal evidence from both advanced and newly industrialized countries using indicators that spoke to "the tenets of the globalization thesis about convergence in corporate governance, and to the legal, institutional, and political cases against convergence."[219] Following the classification of countries by La Porta et al in terms of legal tradition, Guillén's research found that the proportion of the world's stock of outward foreign investment accounted for by the Anglo-Saxon countries is falling, from 66 per cent in 1980 to just over 50 per cent in 1997. Meanwhile, the combined shares of countries influenced from German, French, or Scandinavian legal traditions have grown from 34 to 49 per cent over the same time period.[220]

He concluded that his research found "[c]orporate governance patterns continue to differ markedly across countries in spite of decades of economic globalization and 20 years of intense financial globalization."[221] Stemming from this finding, Guillén remarked that "…if there is convergence in corporate governance, it may not be on the shareholder-centered model

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218 Rafael La Porta, F Lopez-de-Silanes, A Shleifer, & RW Vishny (1998) "Law and Finance" (1998) 106 J Pol Econ 1113 at 1152.

219 Guillén, *supra* note 205 at 229.

220 *Ibid.* at 231; emphasis in original.

221 *Ibid.* at 223.

characteristic of the United Kingdom or the United States but rather on some kind of hybrid."[222] He found it safe to conclude that the wholesale convergence of corporate governance systems across countries is unlikely in the near future. Convergence along selected aspects or dimensions is more likely, although it has thus far affected only a handful of countries.[223]

A 2009 study was also conducted by Marina Martynova and Luc Renneboog, which provides a comprehensive comparative analysis of corporate governance regulatory systems and their evolution over the last 15 years in 30 European countries and the United States. To Martynova and Rennboog's knowledge, it is the first study to provide empirical research specifically addressing the convergence debate (but of course, note Guillén above). Their analysis is based on a database which comprises of the main changes in corporate governance regulations in the United States and all European countries between 1990 and 2005. The indices indicate how each country's laws address potential agency conflicts between corporate constituencies, particularly between (i) shareholder and managers; (ii) majority and minority shareholders; and (iii) shareholders and bondholders. In contrast to the ranking system by La Porta et al, they believe their indices reflect a broader scope of governance regulation reforms and their dynamics.[224]

Their results are revealing. Martynova and Rennboog found that "virtually every country from [their] sample has been involved in substantial changes in their corporate

[222] *Ibid.* at 231-250.

[223] *Ibid.* at 236.

[224] Marina Martynova & Luc Rennboog, "A Corporate Governance Index: Convergence and Diversity of National Corporate Governance Regulations" (2010) Tilburg University Discussion Paper Series No. 2010-17 at 22.

legislations since 1990."[225] Reforms related to increased transparency have been made to address agency problems between shareholders and managers, and the protection of minority shareholders from expropriation by a strong shareholder. They also found signs of increasing convergence by national corporate governance regulations towards a shareholder primacy model where the protection of minority shareholders is considered.[226] This led to their prediction that legislative amendments in countries with French and German legal traditions may bring about more diffused ownership in the foreseeable future.

Limited convergence was found in countries of Scandinavian tradition and former communist countries, which have mainly stakeholder-based systems that Martynova and Rennboog predict will be maintained. They found that "[o]ver the past 15 years, Scandinavian countries have substantially lagged other West European countries in terms of increasing the level of (minority) shareholder rights protection, such that their legal reforms may be insufficient to induce changes in corporate control."[227] Former communist countries, on the other hand, tended to favour greater minority shareholder protection. Nevertheless, since both Scandinavian and former communist countries altered creditor rights in cases of financial distress and bankruptcy, Martynova and Rennboog guessed that it may impede on their development of efficient equity markets and hence any convergence. They conclude by stating that countries of common law tradition still provide the highest quality of shareholder protection while many continental European countries have improved their legal system up to the standard set by the

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[225] *Ibid.* at 23.

[226] *Ibid.*

[227] *Ibid.*

Anglo-American model.[228]

Martynova and Renneboog's study only showed how there was convergence among the US and Europe, thus classifying their results as indications of "global" convergence is premature. Studies from Guillén, who built upon La Porta et al's work, as well focused only on countries that could be classified under Anglo-Saxon, French, German, and Scandinavian legal traditions. None of the empirical studies above included China in their analysis.

1.6.4 A Middle Ground

There seems to be some consensus within academic scholarship that the wholesale import of the Anglo-American model in developed countries is unlikely.[229] Equally so, there is no denying that there has been some level of convergence in governance principles within several countries in Europe and elsewhere. Thus, a middle ground of conceding to partial convergence seems a plausible temporary resting place in the debate; more detailed analysis within particular countries may allow for stronger positions one way or the other. While this may be sufficient to quell the debate for now, Christopher Nicholls has observed that "[t]he difficulty is that both convergence and nonconvergence stories can plausibly explain observed international developments to date, leaving those of us who are not content to substitute dogma for analysis in the uncomfortable position of not knowing in which direction public policy and law ought properly to be nudged."[230] Sarra has commented that "the principles of transparency,

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[228] *Ibid.* at 24.

[229] With the exception perhaps of Hansmann and Kraakman, *supra* note 102.

[230] Christopher C Nicholls, "Governance, Mergers and Acquisitions, and Global Capital Markets" in J. Sarra, ed., *Corporate Governance in Global Capital Markets* (UBC Press, 2003) at 89.

accountability, fairness and responsibility appear to have wide application,"[231] and makes the strong argument that path dependence and market convergence theory are not mutually exclusive.[232] Thus, a middle ground and "partial convergence" seems to be the most reasonable position to take on this debate at the present time and in the foreseeable future. This position most accurately reflects available data, while indirectly also proffers space for there to be reformation and change to the mainstream Anglo-American model. Partial convergence suggests that nations still have the capability to influence change within their jurisdictions, with the potential for international consequences depending on the circumstance. The argument that there has been an "end of history for corporate law" is not supported by the evidence, and there is merit in seeking more effectively designed corporate conduits to influence economic and social ordering for the betterment of society, however one may perceive that to be.

1.7 Shareholder Primacy Then and Now

The findings in this chapter offer important takeaways. We saw how economic efficiency and the nexus of contracts are viewed as justifications behind the existence of the corporate form. As to how one should regulate and govern the corporation given its purpose, recent financial crises have led to a general acceptance of integrating behavioural economic approaches into traditional neoclassical concepts. The defence of economic efficiency is weak when myopic corporate behaviour leads to widespread negative externalities that affect not only shareholders but the broader community. Finally, Anglo-American corporate legal theory is not stagnant, but develops alongside the evolution of scholarly thinking in reaction to real life events and circumstances.

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[231] Sarra, *supra* note 194 at 222.

[232] Sarra, *supra* note 101 at 48.

As for the claim that corporate law is at the end of its history, the empirical evidence suggests that it is unlikely there will ever be complete convergence into shareholder primacy. But there seems to have been international agreement that certain principles are ideal in the governing of corporations, which as noted include transparency, accountability, fairness, and responsibility.[233] Perhaps one day it may seem natural for 'sustainability' or 'social innovation' to reach that list of general principles idealized by the international community in the governing of corporations, just as 'fairness' and 'responsibility' have. Geographic, cultural, and other limitations that have prevented widespread convergence of these principles mean individual jurisdictions are well served by looking at their particular corporate legal offerings to ensure that these principles, and even more aspirational ones, reach would-be entrepreneurs in the governing and operation of their businesses.

The recent financial calamities that have plagued the first decade of the 21st century are only some examples of how the inner workings of shareholder primacy can lead to immensely flawed results.[234] And while the arguments and examples of large corporate scandals seem most relevant for public companies with diffused ownership and professional management, it is important to note that closely-held firms are certainly susceptible to scandal as well.[235] If the purpose of the corporate form is economic efficiency, then why do these profoundly inefficient results come about? At best, the corporate form can foster a place for dynamic, innovative ideas

[233] *Ibid.*

[234] See Liao, *supra* note 159.

[235] For example, the 2015 family-owned firm of Volkswagen Aktiengesellschaft (Volkswagen) was issued a notice of violation of the *Clean Air Act,* 42 U.S.C. §7401 et seq. (1970), by the US Environmental Protection Agency after it found that the company had intentionally programmed turbocharged direct injection diesel engines to activate certain emissions controls only during laboratory emissions testing. Volkswagen is controlled by the Piëch family with a significant stake held by the German state of Lower Saxony. See Guilbert Gates et al, "Explaining Volkswagen's Emission Scandal" *The New York Times* (12 September 2016), online: <www.nytimes.com>.

to grow – but this innovation can outpace regulation and that is where self-governance is critical. At worst, corporations enable the singular profit-making objective which perpetuates amoral and immoral behaviour, with the only real obligation being to operate within the confines of the law. This model of corporate governance needs to be reformed. Milton Friedman's famous 1970's position in *The New York Times* that the "social responsibility of business is to increase profits,"[236] has been labeled the "dumbest idea in the world"[237] with countless naysayers that have attacked and debunked the validity of his argument. Nevertheless, the mentality that corporations exist solely for its shareholders and/or that its sole purpose is to produce a profit is immensely difficult to shake. Chapter 2 looks at the some of the longstanding critiques and dominant counter-hegemonic voices that have appeared in the decades alongside the shareholder primacy model. These critiques have underscored some of the broader movements in CSR and SRI to reform the traditional corporate model, but the road to transformative corporate reform is particularly difficult given how entrenched certain ideological beliefs are within society. These ideologies and path dependence are identified as some of the significant barriers which justify the exploration of alternative legal means to illicit social change.

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[236] Friedman, *supra* note 8.

[237] Steve Denning, "Salesforce CEO Slams 'The Dumbest Idea in the World': Maximizing Share Value," Forbes (5 February 2015), online: Forbes <www.forbes.com>.

CHAPTER 2: Critiques to Shareholder Primacy and Limits to Reform

The shareholder primacy model of governance is not without its critics. While Henry Hansmann and Reinier Kraakman asserted in 2001 that corporate law has reached the end of its history, the fact is that unforeseeable events are generally not calculated in such theories. After the fall of Enron, scholars wondered if the catastrophic market events would "usher in a new age of enlightenment" to corporate governance reform.[238] Yet, the *ideological* entrenchment of the shareholder primacy model seems firmly implanted in Anglo-American culture, as its steadfast existence in history can attest. Section 2.1 explores some of the predominant counter-hegemonic critiques of shareholder primacy that have developed in the past several decades, particularly stakeholder theory and CSR, including the codification of CSR in the UK's 'enlightened shareholder value' and SRI movement, progressive corporate law, and team production theory. Section 2.2 lays out some of the specific challenges that are faced with reforming the shareholder primacy model, which, regardless of the validity of one's theoretical arguments, perpetuate the perceived economic viability and continued domination of this mainstream model. These factors include entrenched ideological beliefs that have permeated the psyche of corporate governance practices in global capital markets, and path dependence. This then poses the interesting follow-up question, which is whether alternative corporate legal structures may be able to offer a new method of tackling the problems generated from within the shareholder primacy model of governance.

2.1 Critiques to Shareholder Primacy

The 1931–1932 exchange in the *Harvard Law Review* between Adolf Berle and E.

[238] Deakin & Konzelmann, *supra* note 115 at 583.

Merrick Dodd is considered by many as the start of the ongoing debate between two views of the corporation: (1) shareholder primacy, in which management works for the best interests of the shareholders, and (2) CSR, where corporations should operate in a socially responsible manner.[239] Both scholars accepted the position that corporate directors act as trustees, however, Dodd argued for "a view of the business corporation as an economic institution which has a social service as well as a profit-making function," claiming to identify an emerging public consensus that corporations should operate as "good citizens."[240] Berle replied that discarding a specific duty to shareholders, without substituting a reasonably clear alternative mandate, would impart too much discretion to management and lead to vast, uncontrolled power with no reason to assume it would be used responsibly.[241]

A few decades later, Berle accepted that Dodd's position had at least temporarily prevailed, as he observed actual practice and common law decisions had over time accepted Dodd's general viewpoint against a stricter fiduciary duty.[242] David Millon describes how "by then it had been established in practice and in law that corporations were free to engage in philanthropy, despite objections that they were spending shareholders' money. There was no need to show that such expenditures were at least in the long run enhanc[ing] corporate profits."[243] Nevertheless, historical events would frequently create a push-and-pull over the

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[239] The debate began with Adolf Berle, "Corporate Powers as Powers in Trust" (1931) 44 Harv L Rev

[240] E Merrick Dodd, "For Whom are Corporate Managers Trustees?" (1932) 45 Harv L Rev 1145 at 1148

[241] Adolf Berle, "For Whom Corporate Managers Are Trustees: A Note" (1932) Harv L Rev 1365.

[242] Adolf Berle, *The 20th Century Capitalist Revolution* (1954) at 169.

[243] David Millon, "Berle and Dodd: Why Are We Still Talking about This?" (2010) 33 Seattle University LR 889.

(imagined or existing) dichotomy between the two sides.[244]

Some scholars have put forth the proposition that Berle and Dodd were ultimately concerned with different issues.[245] It seems common for Berle to inaccurately be labelled as an advocate of shareholder wealth maximization at the expense of all else.[246] But Berle, who has also been labelled as "progressive" by some scholars,[247] was perhaps focused on ensuring a meaningful alternative to the shareholder primacy model was available before he could in good conscience lend his support. His later works indicate his interest in containing the pervasive levels of power that could be effectuated through the corporate institution, rather than protecting the profit-maximizing function of the model.[248] Berle believed that "a power vacuum is always filled by a power holder" and thus, for Berle, the issue at hand was really about ensuring that those in power were properly and effectively regulated.[249] In his writings and predictions, Berle could not have known how accurately his perceptions of power would have played out decades

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244 See e.g. Fenner Stewart, "Better Socializing Corporate Governance: The Berle and Dodd Debate 75 Years Later" Paper presented at the annual meeting of The Law and Society Association, Berlin, Germany (25 July 2007), online: All Academic Research <www.allacademic.com>. Lynn Stout put it well by stating how after reading contemporary works on these issues, "one might be tempted to throw up one's hands and conclude that academics have not lent much more insight into this question since the original Berle-Dodd debate." Lynn A Stout, "Bad and Not-So-Bad Arguments for Shareholder Primacy" (2002) 75 S Cal L Rev 1189 at 1190.

245 See Millon, *supra* note 243 (pointing to public policy controversies generated by the hostile takeover boom of the 1980s as the true origins of the current debate). Others have suggested that that they ultimately shared the same viewpoint. See e.g. Fenner, *supra* note 244.

246 See Bratton & Wachter, *supra* note 75 (highlighting this common error).

247 See e.g. Lorraine Talbot, "Enumerating Old Themes? Berle the Progressive" (2010) 33 Seattle University LR 889; William Bratton, "Berle and Means Reconsidered at the Century's Turn" (2001) 26 J Corp L 3; Bratton & Wachter, *supra* note 75.

248 Berle, *supra* note 88 at 19. Interestingly, Berle has reflected upon how he felt *The Modern Corporation* "in no way broke new ground." For Berle, pointing out that corporations increasingly held large concentrations of power was not a new realization and he queried as to why the book had been received in the academic community as novel. He felt that he had been "describing a phenomenon with which everyone was familiar" and still thought this to be the case. *Ibid.* at 19–20.

249 Berle extended his theories on power in Adolf Berle, *Power* (1969), in which he describes the sources and limits of four manifestations of power: economic, political, judicial, and international.

later, as the combination of ineffective regulation, human frailty, the derivatives revolution, and amplified power were all key American factors contributing to the GFC.[250]

In the decades following the Berle-Dodd debate, various alternative theoretical models and approaches emerged in an attempt to highlight and counteract the problems associated with the modern corporation's focus on shareholder wealth maximization. These works generally consider how to improve and potentially redesign the corporate institution so that it "can assure that power is deployed in the service of individual and societal flourishing rather than against it."[251] This section explores some prevalent counter-hegemonic discourses of the last few decades, while recognizing that there are several additional alternative approaches and models available in scholarship that may or may not overlap with those described below.[252]

2.1.1 Stakeholder Theory and CSR

Since the Berle-Dodd exchange, the shareholder versus stakeholder debate in corporate law "has proven most fundamental and enduring."[253] The core question has been whether shareholder primacy should be invoked in all circumstances: "Does the firm exist only to increase shareholder wealth? Or, should managers also seek to serve the interests of employees,

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[250] Cristie Ford, "New Governance in the Teeth of Human Frailty: Lessons from Financial Regulation" (2010) Wisc L Rev 101.

[251] Testy, *supra* note 22 at 1228.

[252] Examples include systems theory or enterprise corporatism (George Teubner, "Enterprise Corporatism: New Industrial Policy and the 'Essence' of the Legal Person" (1988) American J of Comp L 36) and the communitarian approach (David Millon, "Communitarianism in Corporate Law: Foundations and Law Reform Strategies" in Lawrence Mitchell, ed, *Progressive Corporate Law: New Perspectives on Law, Culture and Society* (Westview Press, 1995)).

[253] Lynn A Stout, "New Thinking on 'Shareholder Primacy'" (2012) 2 Journal of Accounting, Economics, and Law – A Convivium (AEL) 1 at 2.

creditors, customers, and the broader society?"[254]

Business models specifically addressing stakeholder interests in for-profit corporations became prominent in the mid-1980s.[255] The motivation behind stakeholder management was to build a framework that would respond to the concerns of managers experiencing a business environment "buffeted by unprecedented levels of environmental turbulence and change." [256] A stakeholder approach sought to broaden the concept of strategic management beyond its traditional economic origins. The definition of stakeholder included "any group or individual who is affected by or can affect the achievement of an organization's objectives," thus including any person or entity that simply could assist in or benefit from a corporation's success.[257] As well, corporate legal scholars have gone on to define the term stakeholder perhaps more broadly, as "any individual or group on which the activities of the company have an impact," implying stakeholders include those that have been affected by any and all corporate actions, not just those that have been for the achievement of the organization's objectives.[258]

Stakeholder theory encouraged management to develop business strategies that invest in all stakeholder relationships that will help to ensure its long-term success. The theory places

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[254] Stout, *supra* note 244 at 1190.

[255] R Edward Freeman & John McVea, "A Stakeholder Approach to Strategic Management" in Michael A Hitt, R Edward Freeman & Jeffrey S Harrison, eds, *The Blackwell Handbook for Strategic Management* (Oxford: Blackwell Publishers Ltd, 2006) at chapter 6, para 3 (describing how its origins may have come from the Stanford Research Institute, now SRI International, in the 1960s).

[256] Freeman & McVea, *supra* note 255 at 189.

[257] R Edward Freeman, *Strategic Management: A Stakeholder Approach* (Cambridge: Cambridge University Press, 2010) at 46.

[258] Christine Mallin, *Corporate Governance* (Oxford: Oxford University Press, 2004) at 43. See Jean Jacques du Plessis, James McConvill & Mirko Bagaric, *Principles of Contemporary Corporate Governance* (New York: Cambridge University Press, 2005) at 16-28, for further detail on the definition of "stakeholder."

critical importance on developing an understanding of the actual stakeholders specific to the institution in question as, through this level of understanding, management can create strategies supported by all stakeholders to ensure the long-term survival of the institution. R. Edward Freeman and John McVea suggest that as the business world becomes increasingly tumultuous and interconnected, and "as the boundaries between firms, industries and our public and private lives become blurred, a stakeholder approach has more and more to tell us about both values and value creation."[259] The central task in the stakeholder approach to strategic management is "to manage and integrate the relationships and interests of shareholders, employees, customers, suppliers, communities and other groups in a way that ensures the long-term success of the firm."[260]

While the notion of stakeholder interests may have roots in a number of academic fields, much of the theoretical development behind stakeholder theory has been credited to work from Freeman and others at the Wharton School of Business at the University of Pennsylvania. The theory has also had its application stretched into several interdisciplinary fields such as corporate law, feminist ethics, and philosophy, among others. The "wide-ranging intuitive appeal" and avid adoption by several schools of thought led some of the early developers of the theory to decry "distortions" in its interpretation, with later works attempting to address the exact scope of the theory in response to both "explicit and implicit" criticism.[261] Proponents suggest that stakeholder theory "can reasonably remain agnostic" with regard to whether any changes the

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[259] Freeman & McVea, *supra* note 255 at 189.

[260] *Ibid.* at 192.

[261] Robert Phillips, R Edward Freeman & Andrew C Wicks, "What Stakeholder Theory is Not" (2000) 13:4 Bus Ethics Q 479.

governance model are required for it to work effectively.[262] The theory does not rule out the possibility, or even advantage, of having stakeholder representation on boards, for example, but these sorts of efforts "[are] not theoretically necessary or intrinsic to stakeholder theory *per se*."[263] Recognizing that the topic of stakeholder legislation "may be the knottiest log we herein hew,"[264] they insist that while discourse concerning the legal relationship between the corporation and its stakeholders is welcome, stakeholder theory does not require changes in the law to remain viable.

It is important to note that stakeholder theory tends to assume that managing firms in the interest of multiple stakeholders is indisputably better than managing in the best interests of shareholders only, but this presumes that the long-term survival of firms is also beneficial to society as a whole. However, it is important to consider instances where under the long-term success of a firm there is one long-term firm survivor which may not be socially beneficial. Jan Bena points out the example of a precious asset that could be very productive in delivering large gains to social welfare but is owned by a firm that is inefficiently managed, so these gains to the society are not realized. The firm might be managed well enough that it is not in fear of bankruptcy, and thus the precious asset is conserved in this unproductive use. Here, the long-term survival of the firm does not benefit society as a whole, and bankruptcies may be regarded as good things if such procedures allow those assets to be freed up and put to better use for the society in other organizations. Thus the application of stakeholder theory is limited in that its focus is rests solely on improving the survival of the firm and not necessarily the betterment of

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[262] *Ibid* at 491.

[263] *Ibid.*

[264] *Ibid.*

society.[265]

Despite its neutral position in improving social and environmental problems, stakeholder theory as a management approach is better at incorporatinfg environmental interests, and has become closely linked to the rapid development of CSR in recent decades. Contemporary CSR itself has become intimately intertwined with the "green" movement, and its growth has been evident on a global scale.[266] Despite the vast and ever-increasing body of literature on CSR, the prospect of defining CSR is not an easy one. In fact, there has been much work produced in academic scholarship that has specifically addressed the difficulties in determining the parameters of CSR.[267] Prakash Sethi commented that "the phrase 'corporate social responsibility' has been used in so many different contexts that it has lost all meaning."[268] Dirk Matten and Jeremy Moon explain:

> First…CSR is an 'essentially contested concept' being 'appraisive' (or, considered as valued); 'internally complex'; and having relatively open rules of application. Secondly, CSR is an umbrella term overlapping with some, and being synonymous with other, conceptions of business-society relations. Thirdly, it has clearly been a dynamic phenomenon.[269]

Freeman et al have noted that "[a]fter more than half a century of research and debate, there is not a single widely accepted definition of CSR," and provides a panoply of the numerous "ideas, concepts, and practical techniques" generated from CSR research, including corporate

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[265] Thank you to Professor Jan Bena for this point.

[266] See e.g. Douglas Branson, "Corporate Social Responsibility Redux" (2002) 76 Tulane L Rev 1207 (providing a historical summary of the CSR movement).

[267] See e.g. Andrew Crane et al, eds, *The Oxford Handbook of Corporate Social Responsibility* (Oxford: Oxford University Press, 2008); Dirk Matten & Jeremy Moon, "'Implicit' and 'Explicit' CSR: A Conceptual Framework for a Comparative Understanding of Corporate Social Responsibility" (2007) 33 Academy of Mgmt Rev 2 at 3.

[268] Prakash Sethi, "Dimensions of Corporate Social Performance: An Analytical Framework for Measurement and Analysis," 17:3 California Management Rev at 58.

[269] *Ibid.*

social performance[270]; corporate social responsiveness[271]; corporate citizenship[272]; corporate governance[273]; corporate accountability[274]; sustainability, triple bottom line[275]; and corporate social entrepreneurship[276]; among others.[277]

Ultimately, "[t]heories of corporate social responsibility cast a potentially broader net, emphasizing all of the social costs of corporate activity, and therefore embrace, for example, environmental or political concerns as well as stakeholder interests."[278] Scholars have pointed out that in the past several years "an array of stakeholders have turned to firms, rather than governments, to address enduring environmental problems including forest degradation, fisheries

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[270] AB Carroll, "A Three-Dimensional Conceptual Model of Corporate Social Performance," 4 (1979) Academy of Mgmt Rev 497; Steven L Wartick & Philip L Cochran, "The Evolution of Corporate Social Performance," (1985) 10 Academy of Mgmt Rev 758; Donna J Wood, "Corporate Social Performance Revisited (1991) 16 Academy of Mgmt Rev 691.

[271] Robert Ackerman, *The Social Challenge to Business* (Cambridge: Harvard University Press, 1975); Robert Ackerman & Raymond Bauer, eds*, Corporate Social Responsiveness: The Modern Dilemma* (Virginia: Reston Publishing Co, 1976); Sethi, *supra* note 268.

[272] DJ Wood & JM Logsdon, "Theorising Business Citizenship," in J Andriof & M McIntosh, eds, *Perspectives on Corporate* Citizenship (Sheffield: Greenleaf, 2001); S Waddock, "Parallel Universes: Companies, Academics and the Progress of Corporate Citizenship," (2004) 109 Business and Society Review 5.

[273] TM Jones, "Corporate Social Responsibility, Revisited, Redefined," (1980) 22(3) California Management Rev 59; R Edward Freeman, "Corporate Governance: A Stakeholder Interpretation," (1990) 19 J of Behavioral Econ 337; William M Evan & R Edward Freeman, "A Stakeholder Theory of the Modern Corporation: A Kantian Analysis," in *Ethical Theory and Business*, 4th ed, Tom L Beauchamp & Norman E Bowie, eds, (New Jersey: Prentice Hall, 1993).

[274] Simon Zadek, Peter Pruzan & Richard Evans, *Building Corporate Accountability: Emerging Practice in Social and Ethical Accounting, Auditing and Reporting* (UK: Routledge, 1997).

[275] John Elkington, "Towards the Sustainable Corporation: Win-Win-Win Business Strategies for Sustainable Development" (1994) 36 California Management Rev 90.

[276] James Austin, Howard Stevenson, and Jane Wei-Skillern, "Social and Commercial Entrepreneurship: Same, Different, or Both?" (2006) 30 Entrepreneurship Theory and Practice 1.

[277] R. Edward Freeman, Jeffery Harrison, Andrew C. Wicks, Bidhan L. Parmar, Simone de Colle, *Stakeholder Theory: The State of the Art* (Cambridge: Cambridge University Press, 2010) at 235.

[278] David Millon, "Communitarians, Contractarians, and the Crisis in Corporate Law" (1993) 50 Wash. and Lee L. Rev. 1373 at 1002.

depletion, mining destruction, and even climate change."[279] CSR has been readily adopted by environmental activists and supporters to take advantage of the enormous and integral role corporations play in the sustainable management of environment resources.

Matten and Moon contend that at the heart of CSR is the notion that it "reflects the social imperatives and the social consequences of business success."[280] Branson notes that one example of its staying power "may be the appearance in the legal periodicals of a steady stream of crossover articles dealing with environmental subjects and corporate responsibility."[281] Heal, for example, has taken his economic analysis of corporate social responsibility and how firms "internaliz[e] external costs, with a view to reducing the potential for conflict between themselves and other groups in society" through an environmental lens.[282]

Branson views the green movement as having three components: green advertising, green product manufacture and competition, and green management.[283] He notes that green advertising is driven, at times, by consumer preference rather than any strong corporate social responsibility mission.[284] Green product introductions and green product competition form a bridge between green advertising and green management. Green management is a broader topic, including "protection of the biosphere, sustainable use of natural resources, reduction and

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[279] Graeme Auld, Steven Bernstein, & Benjamin Cashore, "The New Corporate Social Responsibility" (2008) 33 Annu. Rev. Environ. Resour. 413 at 416.

[280] Matter & Moon, *supra* note 267 at 3.

[281] Branson, 'Redux,' *supra* note 266 at 1225.

[282] Geoffrey Heal, "Corporate Environmentalism: Doing Well by Being Green" (August 2007), online: Social Science Research Network <http://papers.ssrn.com>.

[283] Branson, 'Redux,' *supra* note 266 at 1222-1225.

[284] *Ibid.*

disposal of waste, wise uses of energy," while management is seen to have specific environmental responsibilities.[285] Green management can range from observance of environmental standards to actual subscription of private initiatives such as CERES Principles, which were created in 1989 following the Exxon Valdez crisis by the Coalition for Environmentally Responsible Economies, to provide broad environmental standards for evaluating corporate activity with the intention of helping organizations set environmentally sound business practices.[286] The recent increased visibility of SRI dedicated to environmental sustainability[287] and green investing in the capital markets (discussed further in Section 2.1.1.2 below), has resulted in many open-ended questions regarding the proper governance and regulation of these products going forward[288] and may also suggest progress toward new modes of good governance.

The period when CSR only referred to corporate philanthropic donations has passed, and the vast majority of scholars generally seem to agree that CSR on a whole, even as a confusing and disorganized movement, is a good thing. Branson has noted that the movement is "converging with, rather than diverging from, broader trends in corporate governance."[289] Few, if any, have challenged the theoretical merits behind the green movement and its important contributions to environmental sustainability. Indeed, it is important not to prematurely equate

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[285] *Ibid.*

[286] CERES, "CERES Principles" (as of July 2010), online: CERES <http://www.ceres.org>.

[287] See e.g. Wesley Cragg & Ben Richardson, "Being Virtuous and Prosperous: SRI's Conflicting Goals" (2009), online: Social Science Research Network <http://ssrn.com>.

[288] See e.g. Cragg & Richardson, *supra* note 287 (stating that "[t]o keep ethical investment ethical will likely require institutionalizing new norms and governance standards, in such domains as reforming fiduciary duties and the internal governance of financial organizations"); Heal, *supra* note 282 at 8-14.

[289] *Ibid.*

shareholder primacy to unfriendly social and environmental practices. Some scholars, for example, have supported increased shareholder democracy, pointing to examples where shareholders have advocated for sustainable reporting and other measures that have improved corporate actions, and certainly the SRI movement is a prime example of this practice.[290]

Nevertheless, empirical studies have shown that CSR trends have been consistent with theories of strategic CSR and rational, profit-seeking management decision-making.[291] 'Greenwashing' – where companies spend significantly more time and money on green advertising than on environmentally sound practices – is a real concern. The pure economic incentives driving CSR mean sustainable practices automatically lose out when those practices are not good for the financial bottom line. There are legitimate concerns that CSR may just become another commodity that businesses sell in the service of short-term shareholder wealth maximization, rather than act as a catalyst toward substantive change. While trends show that SRI is growing more relevant, studies indicate that the practice will not be reaching mainstream any time soon.[292] Only 23% of total assets under management (AUM) by institutional investors are from intrinsic investment strategies – such as low turnover, concentrated holdings, and pursuit of long-term value creation – as compared to the vast majority which use momentum or mechanical index strategies.[293] These and several other factors make the pressure on companies

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[290] See e.g. Janis Sarra, "Shareholders as Winners or Losers under the Amended Canada Business Corporations Act" (2003) 39 Can Bus LJ 52.

[291] See e.g. Donald Siegel & Donald Vitaliano, "An Empirical Analysis of the Strategic Use of Corporate Social Responsibility" (2007) 16 Journal of Economic and Management Strategy 773; Ronald Fisman, Geoffrey Heal and Vinay Nair, "A Model of Corporate Philanthropy" (2007) Columbia Business School Working Paper, online: <http://knowledge.wharton.upenn.edu>.

[292] Pricewaterhousecoopers, "Do Investors Care about Sustainability?" online: <www.pwc.com>.

[293] Dominic Barton & Mark Wiseman, "Focusing Capital on the Long Term" (January-February 2014) Harvard Business Review. Note that many studies assume ownership by institutional investors following passive investment strategies, such as mechanical index strategies, are not conducive to long-term value creation, but there are

to meet their quarterly earnings targets extremely intense. One study surveyed hundreds of CFOs and found that 55% of them indicated they would forego an attractive capital investment project today if the investment led them to even marginally miss their quarterly earnings targets.[294] Market forces essentially compel a company to look mainly at increasing share value, and short-term outlooks can easily overpower long term visions of sustainability when a company's shares are trading on the global capital markets.

It should be noted that sustainable practices are not the antithesis of shareholder primacy, they simply generate from financial motivations that at times overlap with sustainability and at other times do not. The issue, then, is whether it is sufficient to have shareholders act as the centrepiece of corporate interests with sustainability as a potential by-product. Stakeholder theory and CSR do shift away from concepts deemed to be inherent in shareholder primacy, but proponents from both fields who are motivated to pursue stakeholder-oriented management for the ultimate purpose of increasing shareholder wealth implies a strong adherence to the status quo. While both have been deemed effective in lessening some of the negative externalities from the private sector, thus far neither has proven to be a successful change agent to the shareholder primacy model, nor have proponents suggested they should be.

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counterarguments to this assumption. Passive investment strategies mean that the institutional investor cannot buy a firm's stock and sell it shortly after, for example after a short-term gain has been realized. Instead, such investment strategy allows the investor to sell a firm's stock only if the firm is removed from the index. Since equity purchases and sales are basically exogenously prescribed to passive investors, the only way the investors can increase their returns is to engage with firms' management to make them pursue long-term value creating strategies. This is in stark contrast to popular views. See e.g. Jan Bena et al, "Are Foreign Investors Locusts? The Long-Term Effects of Foreign Institutional Ownership, European Corporate Governance Institute (ECGI) – Finance Working Paper No. 468/2016.

[294] John R. Graham, Campbell R. Harvey & Shiva Rajgopal, "Value Destruction and Financial Reporting Decisions" (2006) 62 Financial Analysts Journal 27 (noting that 55% of CFOs would forego attractive capital investment project today if it meant even marginally missing quarterly targets).

2.1.1.1 Codified CSR: United Kingdom's Enlightened Shareholder Value

In 2006, the United Kingdom enacted the *Companies Act*[295] which introduced the concept of "enlightened shareholder value" (ESV) to their for-profit corporate model.[296] The core principle behind ESV is embodied in Section 172 of the *Companies Act*, which defines the fiduciary duties of directors as follows:

> A director [must act] in good faith . . . to promote the success of the company for the benefit of its members as a whole, and in doing so have regard to . . . (a) the likely consequences of any decision in the long term, (b) the interest of the company's employees, (c) the need to foster the company's business relationships with suppliers, customers and others, (d) the impact of the company's operations on the community and the environment, (e) the desirability of the company maintaining a reputation for high standards of business conduct, and (f) the need to act fairly as between members of the company.[297]

ESV recognizes the idea that corporations should pursue shareholder wealth with a long run orientation that seeks sustainable growth and profits based on responsible attention to the full range of relevant stakeholder interests. Similar to stakeholder-based approaches, ESV strives to expand beyond the short-term focus of increasing share price, particularly when such focus has the ability to produce negative effects for other stakeholders. Management's ultimate responsibility still lies with shareholders, but it is required to pursue that objective through the stakeholder parameters outlined in the statute.

American scholars have pointed to ESV an "emerging third way" in the classic

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[295] *Companies Act (2006*), C. 46. For the legislative history of UK reforms, see generally, Gordon Clark & Eric Knight, "Implications of the UK Companies Act 2006 for Institutional Investors and the Market for Corporate Social Responsibility" (2009) 11 U Pa J Bus & Employment L 1.

[296] *Ibid.* As one scholar pointed out, "American corporate law scholars and policy makers have not infrequently drawn inspiration from regulatory innovations in the United Kingdom." Virginia Harper Ho "'Enlightened Shareholder Value: Corporate Governance Beyond the Shareholder-Stakeholder Divide" (2010) 36 J Corp L 59.

[297] *Companies Act, supra* note 307 at s. 172.

shareholder v. stakeholder debate.[298] Beyond the specific mandate of Section 172, Cynthia Williams and John Conley have described ESV as a broader conceptual transformation in the UK that explicitly shifts the focus of corporations to longer term interests of extended stakeholder constituencies. Millon also sees ESV as serving as both a legal and normative approach to management that can significantly alter core tenets of the shareholder primacy model.[299] By broadening the range of interests attended to by management to include important stakeholder considerations, ESV does have the potential to produce social benefits. In this way, ESV might realistically be characterized as an alternative to short term shareholder primacy as well as an effective legal base to justify strategic styles of management based on stakeholder theory. Since laws in other countries such as the US have not reflected an ESV-style mandate to redefine management responsibility and corporate purpose, Millon has suggested that extra-legal pressures can have that effect instead. He believes that if concerned private actors apply pressure, public opinion about socially acceptable behaviour may drive management to rethinking its role. The result may be "a richer, more socially-oriented notion of the corporate objective, shaped by public opinion, which could arguably occur without public intervention through law."[300] However, since ESV is still about shareholder value, this objective imposes a limit on how far corporations are likely willing to go. It is doubtful that market-driven ESV will itself be sufficient to produce a commitment to long-run sustainability. Millon has pointed out, "[c]ertainly this approach to management will not necessarily result in corporations 'doing the

[298] Cynthia Williams & John Conley, "An Emerging Third Way? The Erosion of the Anglo-American Shareholder Value Construct" (2005) 38 Cornell Int'l LJ 493 at 495, 499-523.

[299] David Millon, "Enlightened Shareholder Value, Social Responsibility, and the Redefinition of Corporate Purpose Without Law" (June 2010), online: Social Science Research Network <http://www.ssrn.com>.

[300] *Ibid.* at 5.

right thing' where that would be costly to shareholders."[301]

What impact has the implementation of ESV had in the UK? Nine years after its implementation, the task of quantifying the value of ESV to changing corporate governance is daunting to say the least. Shortly prior to the enactment of ESV, Joan Loughrey, Andrew Keay, and Luca Cerioni reviewed the comments of large commercial law firms and found that a significant majority felt the provision would only increase the procedural aspects of a board's decision-making.[302] More troubling, a survey in 2008 concerning directors' awareness and understanding of the new directors' duties found that 81% of those directors were unaware of the changes implemented under s. 172 on ESV.[303] Another study which interviewed various stakeholders including executives and other management found that only 17% felt s. 172 would affect how they operated, with follow up interviews suggesting "they were of the opinion that they were doing what the legislation requires already and had no need to make changes."[304] Whether ESV truly is a "third way" in the shareholder v. stakeholder debate still remains an open question. Gail Henderson has pointed out that ESV only acts as a limit on the maximization of shareholder value rather than any significant alteration to the model, and "one of the most ardent defenders of shareholder primacy has acknowledged the duty to 'make as much money as possible' is qualified by 'conform[ity] to the basic rules of the society, both those embodied in

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[301] *Ibid.* at 6.

[302] Joan Loughrey, Andrew Keay, and Luca Cerioni, "Legal Practitioners, Enlightened Shareholder Value and the Shaping of Corporate Governance" (2008) 8 J of Corp Legal Studies 79. Interestingly, Canadian practitioners made similar comments regarding the impact of *BCE.* See Chapter 5.1.3.1.

[303] Jordan Publishing, "Companies Act Still Causing Confusion," online: <www.thecompaniesact.co.uk> at 209, ftn. 27.

[304] Andrew Keay, *Enlightened Shareholder Value and Corporate Governance* (Routledge, 2013) at 210.

law and those embodied in ethical custom.'"[305] ESV is, in many ways, simply a codification of the business case for CSR. Andrew Keay, in his assessment of on the impact of ESV, notes that "one of the biggest obstacles to seeing ESV as a move to a true stakeholder approach is the fact that no stakeholder, other than a shareholder, has the right to enforce any breach by the directors of s. 172."[306] Indeed, scholars like Virginia Harper Ho states that "to no small degree, then, 'enlightened shareholder value' looks like the standard Anglo-American corporate governance model. As the name suggests it is grounded squarely within a shareholder-primacy paradigm."[307] Keay as well, in examining the empirical data, concludes that ESV "does not take the UK far, or at all, down the path of stakeholderism."[308]

2.1.1.2 Socially Responsible Investment

In the last decade there has been an accelerated increase of global participation within the socially responsible investment (SRI) movement. Benjamin Richardson notes that "while no authoritative definition exists,"[309] SRI can be seen as representing "a broad constellation of interests campaigning for socially, ethically, and environmentally responsible financing."[310] Like CSR, SRI has had numerous overlapping labels attach to this form of activity. For example, the Forum for Sustainable and Responsible Investment (formerly the US Social Investment Forum) (USSIF), a non-profit hub for the American SRI sector representing members with over $2

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[305] Friedman, supra note 8 at 51.

[306] *Ibid.* at 216.

[307] Ho, *supra* note 253.

[308] Keay, *supra* note 261 at 218.

[309] Benjamin J Richardson, *Socially Responsible Investment Law: Regulating the Unseen Polluters* (Oxford University Press, 2008) at 2.

[310] *Ibid.* at 1.

trillion in AUM, has attempted to redefine the acronym SRI to stand for "Sustainable, Responsible and Impact Investing," which they define as "an investment discipline that considers environmental, social and corporate governance (ESG) criteria to generate long-term competitive financial returns and positive societal impact."[311] Other labels, with some terms better known in different parts of the world such the popular "ethical investing"[312] also include "green investing," "impact investing," "mission-related investing," "sustainable investing," and "values-based investing," among others.[313]

Richardson notes that the two principal tactics behind the SRI movement are portfolio screening and corporate engagement.[314] Portfolio screening, meaning the act of "avoid[ing] or favour[ing] investing in certain industries or companies because of characteristics of their products or operations"[315] recognizes the power in the investor to uphold certain values of importance. These values can vary widely from the environment, to human rights and employee rights, to religious beliefs, consumer protection, animal rights, etc. "Community investing" falls under this form of portfolio screening, and is one of the fastest growing segments within SRI, with some $61.4 billion in AUM.[316] Here, investors purposefully direct capital to projects and infrastructure supporting communities that are underserved by more traditional financing,

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311 Forum for Sustainable and Responsible Investment, "SRI Basics," online: <http://www.ussif.org/sribasics>.

312 Sirkuu Hesten & Chris Mallin, "Are Ethical or Socially Responsible Investments Socially Responsible?" (2006) 66 Journal of Business Ethics 393 at 393-394.

313 Forum for Sustainable and Responsible Investment, *supra* note 311.

314 Benjamin J Richardson, "Financial Markets and Socially Responsible Investing" in Beate Sjåfjell and Benjamin J Richardson, eds, *Company Law and Sustainability: Legal Barriers and Opportunities* (Cambridge University Press, 2015) at 233.

315 *Ibid.*

316 Forum for Sustainable and Responsible Investment, "Community Investing," online: <http://www.ussif.org/communityinvesting>.

providing valuable community services such as healthcare, housing, education and childcare, while still generating a financial return.[317] Large corporations are beginning to expound their involvement in community investing, with Suncor Energy Inc.,[318] and Manulife Financial Corporation[319] as some prominent corporate examples that have publicly highlighted their community investment involvement and strategies.

The second tactic behind SRI as noted is corporate engagement, where SRI acts as a form of shareholder advocacy that "engage[s] with specific businesses so as to induce behavioural changes."[320] Operating under the benefit of a shareholder primacy model of governance, socially responsible investors are able to put pressure on corporations to act as good corporate citizens, while at the same time promoting long-term value and financial performance. The filing of shareholder resolutions in public companies, dialogue with management, media attention, and other forms of activist investor engagement are aimed at persuading and encouraging corporations to allocate activities to ESG purposes. Examples such as mutual fund companies like NEI Investments (operating three competitive funds – NEI Funds, Northwest Funds, and Ethical Funds),[321] and investor advisory firms such as Sustainalytics[322] subscribes to this form of SRI in addition to portfolio screening.

The growth of SRI may have gained some impetus from the 2006 launch of the United

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[317] Global Impact Investing Network, "Scaling U.S. Community Investing: The Investor-Product Interface" (October 2015), online: <https://thegiin.org> at 1.

[318] Suncor Energy Inc., "Community Investment," online: <http://www.suncor.com/community-investment>.

[319] Manulife Financial Corporation, "Community Investment," <http://www.manulife.com/>.

[320] Richardson, *supra* note 314.

[321] NEI Investments, online: <https://www.neiinvestments.com>.

[322] Sustainalytics, online: <http://www.sustainalytics.com>

Nations Principles of Responsible Investment (UNPRI), an initiative that "works to understand the investment implications of [ESG] factors and to support its international network of investor signatories in integrating these factors into their investment and ownership decisions."[323] The UNPRI is supported by, but not a part of, the United Nations (UN) and acts independently, encouraging investors to utilize SRI to "enhance returns and better manage risks."[324] The following are the statement and Principles of the UNPRI that signatories adhere to:

> As institutional investors we have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social, and corporate governance (ESG) issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, asset classes and through time). We also recognise that applying these Principles may better align investors with broader objectives of society. Therefore, where consistent with our fiduciary responsibilities, we commit to the following:
>
> (1) We will incorporate ESG issues into investment analysis and decision-making processes.
>
> (2) We will be active owners and incorporate ESG issues into our ownership policies and practices.
>
> (3) We will seek appropriate disclosure on ESG issues by the entities in which we invest.
>
> (4) We will promote acceptance and implementation of the Principles within the investment industry.
>
> (5) We will work together to enhance our effectiveness in implementing the Principles.
>
> (6) We will each report on our activities and progress towards implementing the Principles.[325]

To date, over 1,500 signatories have signed the UNPRI, with a significant increase in signatories

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[323] Principles of Responsible Investment, "About the PRI," online: <https://www.unpri.org>.

[324] *Ibid.*

[325] Principles of Responsible Investment, "What Are the Six Principles for Responsible Investment?," online: <https://www.unpri.org>.

having joined following the GFC.[326] These Principles are regarded as "voluntary and aspirational" and "are designed to be compatible with the investment styles of large, diversified, institutional investors that operate within a traditional fiduciary framework."[327] There is no regulation as to signatories' compliance of these Principles, although signatories do have an obligation to report on their responsible investment activities through the UNPRI Reporting Framework, which according to the UNPRI allows them to: (1) demonstrate to stakeholders and the public how they incorporate ESG issues; (2) understand where their organisation sits in relation to local and global peers; and (3) learn and develop year-on-year.[328]

The significance of the overall size of the SRI market is a somewhat subjective one as much depends on one's comparators and expectations. Some 2007 estimates put SRI at "below 10% of the capital markets of major economies,"[329] but the rapidity in which SRI has grown shows how quickly such numbers can change. While the UNPRI signatories boasts a representation of $45 trillion in AUM in 2015, another study by the USSIF found that from 2012 to 2014, SRI had a growth rate of over 76% increasing to $3.74 trillion in 2012 and 18% of the $36.8 trillion in total AUM tracked.[330] The USSIF also claims that "$6.57 trillion or more was invested using one or more SRI strategies," which accounts for "more than one out of every six

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[326] Christopher Butz & Olivier Ginguene, "Crisis Calls for Traditional ESG Investing" (3 May 2009) *The Financial Times*, online: < http://www.ft.com>. More on the global financial crisis is discussed in Section 1.5.

[327] Principles of Responsible Investment, "PRI in Person 8th Annual Conference: Conference Highlights," online: <http://unpri.org> at 24.

[328] Principles of Responsible Investment, "Reporting and Assessment," online: <https://www.unpri.org>.

[329] Richardson, *supra* note 309 at 2, citing Social Investment Forum (SIF), "2005 Report on Socially Responsible Investing Trends in the United States: A 10-Year Review (SIF, 2006); European Social Investment Forum (Eurosif), "Socially Responsible Investment among European Institutional Investors" (Eurosif, 2003); Corporate Monitor, "Sustainable Responsible Investment in Australia – 2005" (Ethical Investment Association, 2005) at ftn. 7.

[330] Principles of Responsible Investment, *supra* note 323.

dollars under professional management in the United States."[331] This rather inclusive accounting of "one or more" SRI strategies within a portfolio may suggest a marketplace that is broader than experienced in reality, although there are many other studies supporting the exponential growth of SRI worldwide and its impact.[332] Others have noted that CSR and SRI "have captured only a relatively small group of committed converts"[333] when compared to the sizable markets around the world. Still others, including Tessa Hebb et al have stated that "while it is a matter of debate if responsible investment and the PRI are already mainstream or will be in 2015, it seems fair to conclude that after 8 years responsible investment has attracted strong interest from investors, investment professionals, policy makers and the general public."[334]

The success of the SRI movement is not without its challenges which have been noted by several scholars and are only briefly mentioned here. Hebb et al have remarked that the movement's "most formidable challenge" is "moving from a short-term to a long(er)-term investment system, with an accompanying set of expectations and values" and "redefining risk and opportunity in terms far longer than half a decade, especially for resource- and climate change-related developments."[335] Richardson as well has noted a lack of sufficient market leverage and reliance on tame voluntary codes of conduct as some of significant barriers to SRI

[331] US SIF Foundation, "2014 Report on Sustainable and Responsible Investing Trends in the United States," online: <http://www.ussif.org>.

[332] See e.g., Luc Renneboog, Jenke ter Horst, & Chendi Zhang, "Socially Responsible Investments: Methodology, Risk Exposure and Performance" (June 2007) European Corporate Governance Institute at 3, 4.

[333] Benjamin J Richardson & Beate Sjåfjell, "Capitalism, the Sustainability Crisis, and the Limitations of Current Business Governance," in Beate Sjåfjell & Benjamin J Richardson, eds, *Company Law and Sustainability: Legal Barriers and Opportunities* (Cambridge University Press, 2015) at 2-3.

[334] Tessa Hebb et al, eds, *The Routledge Handbook for Responsible Investment* (Routledge, 2015) at 8.

[335] *Ibid.* at 8.

ever contributing significantly to environmental governance.[336] The reality of mandated disclosures is that they "sometimes entail vague, perfunctory statements that do not illuminate how SRI decisions are effected or their ultimate impacts" and "process standards have rarely extended to democratizing investment policy-making, which remains dominated by fund managers, investment consultants and other so-called experts."[337] Richardson has also pointed to fiduciary law being a significant obstacle to SRI, especially in institutional funds such as pension plans, which are governed on the assumption that obtaining greater financial returns is the only lawful objective of fund management.[338] Richardson and Beate Sjåfjell also note how "many in the SRI sector have been preoccupied with ad hoc or specific issues of corporate conduct, while giving insufficient attention to the structural and systemic dimensions of the financial economy that are also determinative of progress towards sustainability."[339] They have identified the risk that CSR and SRI movements attempt to "thwart stricter regulatory standards through pre-emptive action by market actors"[340] across the world.

Luc Renneboog et al note that "at the heart of the SRI movement is a fundamental question: is a firm's aim to maximize shareholder value or social value (defined as the sum of the value generated for all stakeholders)?"[341] The movement's impressive growth cannot be discounted, and it may establish itself as a major player in changing the financial landscape for

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[336] Richardson, *Socially Responsible Investment Law, supra* note 309, specifically 103-280 for detailed analysis on some of these challenges and obstacles facing SRI.

[337] Written remarks by Benjamin Richardson, "Reforming Finance Capitalism for Sustainability" for the Sustainable Companies Conference (December 2013), University of Oslo, Norway [draft with author].

[338] Benjamin J Richardson, *Fiduciary Law and Responsible Investing: In Nature's Trust* (Routledge, 2015).

[339] Richardson & Sjåfjell, *supra* note 333 at 18.

[340] *Ibid.* at 11.

[341] Renneboog et al, *supra* note 332.

generations to come. However, some of the barriers to SRI becoming the significant change agent are quite formidable and not substantially different than those facing CSR. The business case for SRI is intimately intertwined with its success, as Celine Louche and Hebb have remarked on how "a large part of SRI literature has focused on demonstrating the link between SRI and financial performance"[342] but "not all positive [ESG] changes can be argued simply from the perspective of the business case."[343] Louche and Hebb, in considering whether or not SRI makes a difference, are frank in their assessment that "to have broad societal impact, SRI requires significant new investment to be made over time…Failing that, it remains a small niche that allows individual investors to feel good about their investment without any significant impact on companies or indeed society at large."[344]

2.1.2 Progressive Corporate Law

Another stream of research critiquing shareholder primacy was aimed at promoting "progressive" corporate law, particularly in 1995 with the textbook edited by Lawrence E. Mitchell entitled *Progressive Corporate Law (New Perspectives on Law, Culture and Society)*.[345] The common thread among many of the contributors in *Progressive Corporate Law* is the rejection of the Berle-Means model and support for a more "communitarian" style view of corporations in society, including a focus on a corporation's moral obligations to society as a whole. It provided voices from several corporate legal scholars considering how for-profit

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342 Celine Louche & Tessa Hebb, eds., *Socially Responsible Investment in the 21st Century*: *Does it Make a Difference?* (Emerald, 2014) at 282.

343 *Ibid.* at 285.

344 *Ibid.*

345 Lawrence Mitchell, ed, *Progressive Corporate Law: New Perspectives on Law, Culture and Society* (Boulder: Westview Press, 1995).

companies and corporate law could be better designed to emphasize "responsibility, altruism, and unity within the corporate form and between the corporation and broader society."[346] Mitchell identified the common premise of progressive corporate law being the belief that "it was no longer reasonable (if it ever was) to treat the corporation as a purely private mechanism" and "to disregard the actual public character of the modern corporation simply is wilfully to disregard reality."[347] Quoting sociologist Alan Wolfe, Mitchell contends that progressive corporate law serves to improve or redesign the corporate form to account for the fact that "[c]orporations really are both private and public simultaneously…They are institutions that sometimes act as quasi-governments and, even when they do not, they take actions that affect every aspect of people's lives, including people who have no formal contractual relationship with them."[348]

Kellye Testy noted in 2004 that "[i]n the realm of corporate law, unlike perhaps other legal systems of ordering, a progressive vision is at an embryonic stage."[349] The term "progressive" is normatively vague, and its usage in a corporate law context requires clarification. The lack of a mutually accepted terminology, a collective voice, and common goals within progressive corporate law has amounted to disagreements on what constitutes success in corporate practice. While some scholars have attributed many counter-hegemonic discourses in

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[346] *Ibid.*

[347] *Ibid* at xiv.

[348] Alan Wolfe, "The Modern Corporation: Private Agent or Public Actor?" (1993) 50 Wash and Lee L Rev 1673, 1692.

[349] Kellye Testy, "Capitalism and Freedom – For Whom? Feminist Legal Theory and Progressive Corporate Law" (2004) 67 L and Contemp Probs 87.

corporate legal scholarship as progressive,[350] others describing similar progressive discourses have bifurcated their research from a progressive approach, implying that their positions should stand alone as separate work.[351] The conflicting descriptions create a puzzle as to how to categorically place progressive corporate law in the context of alternative discourses. Still others critiquing progressive corporate law have found the term "progressive" contentious, attributing it as "simply a code word used by the left to take advantage of the positive connotations associated by most Americans with the idea of progress."[352]

Further prescriptive parameters within progressive corporate law have been suggested by other scholars, such as Kent Greenfield and Testy, but continue to be initial stage ideas in the movement. Greenfield has described five progressive principles as being: (1) the ultimate purpose of corporations should be to serve the interests of society as a whole; (2) corporations are distinctively able to contribute to the societal good by creating financial prosperity; (3) corporate law should further principles one and two; (4) a corporation's wealth should be shared fairly among those who contribute to its creation; and (5) participatory, democratic corporate governance is the best way to ensure the sustainable creation and equitable distribution of corporate wealth.[353] Testy has contended that a progressive corporate law project should: (1) seek an increased dispersion of wealth in society; (2) seek measures that reduce all forms of

[350] See e.g. Testy, *supra* note 22 (hinting at several discourses as falling under the purview of progressive corporate law).

[351] See Ronald Columbo, "Ownership, Limited: Reconciling Traditional and Progressive Corporate Law via an Aristotelian Understanding of Ownership" (2008) 34 J of Corp L 1; see also Margaret Blair & Lynn Stout, "A Team Production Theory of Corporate Law" (1999) 85 Va L Rev 248 at ftn 83.

[352] Stephen Bainbridge, "Community and Statism: A Conservative Contractarian Critique of Progressive Corporate Law Scholarship" (1997) 82 Cornell L Rev 856 at ftn 1.

[353] Kent Greenfield, "New Principles for Corporate Law" (2005) 1 Hastings Bus LJ 87.

subordination and discrimination; (3) be consistent with environmental justice movements; and (4) seek to enhance social democracy.[354]

The challenge of progressive corporate legal scholarship continues to be the struggle toward agreed upon normative goals, and concentrated efforts in reaching those goals. Voices advocating seemingly progressive projects tend to be disparate and, other than a few exceptions within the 1995 book, fairly individual. For example, some scholars point out that if the objective of serving the interest of society as a whole means to maximize the sum of the value generated for all firm's stakeholders, such an objective may be inconsistent with fairness when the benefit is not equally distributed.[355] These and other concerns weaken communitarian arguments driving progressive corporate law, and only raise further questions in terms of implementation. The inability to produce a common terminology created a significant stumbling block to internal organization and cohesion. Nevertheless, commonalities noted by Mitchell may exist. As Dalia Tsuk Mitchell proposes, progressive corporate law may be perceived as "twentieth-century corporate law scholarship that criticizes the shareholder primacy vision of corporate law and

[354] Testy, *supra* note 350 at 1244.

[355] Specifically, there may be instances when the betterment of society might be most signficant when the split in benefits is unfair. Jan Bena makes this point:

> Consider the following example, where the corporation with three stakeholders A, B, and C faces an investment decision to put resources into project P1 or P2. Under Project P1, the social value is 4 and it can only be split as follows: 0 for A, 2 for B, and 2 for C. Under Project P2, the social value is 2 and it can be split as follows: 0.5 for A, 1 for B, and 0.5 for C. Project P1 is thus socially efficient (since 4>2), but "unfair" to stakeholder A as A gets 0. Shall the society (through corporate governance mechanisms) make the corporation adopt project P1 or P2?

In his view, it is impossible for directors to generally make good decisions in these circumstances as (i) the key insight of social choice theory is that it is impossible to aggregate preferences of individuals, and (ii) there are different concepts of fairness and the society would have to agree on what concept of fairness to use. But see the oppression remedy discussed in Section 5.1.4.

views corporations as institutions with public obligations."[356]

Progressive corporate law may be appropriately described as a field focused structural reform where, "[i]nstead of regulating the uses to which the tool is put, [progressive corporate law scholars] look to redesign the tool itself."[357] Progressive corporate scholars commonly argue that changes in the law are required to make corporate directors take account of stakeholder interests. Rather than insisting there are ways in which corporate behaviour can be improved without disturbing the focus on shareholder wealth, this approach challenges the fundamental core of the shareholder primacy model. Progressive corporate law seems to push stakeholder interests to a new level, expanding the definition to the larger community and environment, and demanding public obligations of corporations be recognized both legally and normatively. Nevertheless, there has been little developed under the flag of "progressive corporate law" for some time now.

2.1.3 Team Production Theory

Margaret Blair and Lynn Stout's 1999 article entitled "A Team Production Theory of Corporate Law" was considered a departure from progressive corporate law because advocates of that approach "commonly argue that corporate directors do not take sufficiency account of nonshareholders' interests and that changes in the law are required to make this happen."[358] Blair and Stout's theory promotes a "mediating hierarch" approach to corporate governance rather than a principal-agent model. According to them, the public corporation is best viewed as a team

[356] Dalia Tsuk Mitchell, "Corporations Without Labour: The Politics of Progressive Corporate Law" (2003) 151 U Penn L Rev 1861at ftn 7.

[357] Mitchell, *supra* note 345 at xiv.

[358] Blair & Stout, *supra* note 351.

of shareholders, creditors, workers, managers and communities. In this sense, directors of public corporations do not maximize shareholder value but instead resolve competing claims that various "stakeholders" might have to the collective residual product of the corporation's activities.

Blair and Stout took issue with the shareholder primacy model's misleading view of ownership. They adopted their ideas of vesting allocational authority in an independent third party from Armen Alchian and Harold Demsetz's work on economic organization[359] as well as Raghuram Rajan and Luigi Zingales' work on team production.[360] In their "mediating hierarch" approach, the perception is that "directors should be viewed as disinterested trustees charged with faithfully representing the interests not just of shareholders, but of all team members."[361] The public corporation is best viewed as a team of "shareholders, managers, rank and file employees, and possibly other groups, such as creditors."[362] Team members are required to forego significant rights to the legal entity created by incorporation, including property rights over the team's mutual output and team inputs such as financial and human capital. In other words, corporate assets belong not to shareholders but to the corporation.[363] In this sense, directors of public corporations do not maximize shareholder value but instead resolve competing claims that various stakeholders may have to the collective residual product of the

[359] Armen Alchian & Harold Demsetz, "Production, Information Costs, and Economic Organization" (1972) 62 The American Economic Review 777.

[360] Raghuram A Rajan & Luigi Zingales, "Power in a Theory of a Firm" (1998) 113 The Quarterly Journal of Economics 387.

[361] Blair & Stout, *supra* note 66 at 286.

[362] *Ibid* at 253.

[363] *Ibid* at 250-251.

corporation's activities.[364]

Blair and Stout argue that the primary job of the board of directors of a public corporation is not to act as agents who "ruthlessly pursue shareholders' interests at the expense of employees, creditors, or other team members."[365] Rather, the directors are trustees for the corporation itself – mediating hierarchs whose job is to balance team members' competing interests in a fashion that keeps everyone happy enough for the productive coalition stays together.[366] The corporate team gives up control rights to a third party board that makes no firm-specific investment itself and is composed of outsiders to the actual productive activity.[367] The board is, however, given control over the team's assets, as well as the right to allocate output among team members, fire individual members, or even break up the team. In return, the board is rewarded with a nominal share of the team's output. As a result, the outsider directors have an incentive to choose an efficient and productive team and team members feel they can now safely invest in the corporation.[368]

The work spawned a variety of reactions from American and Canadian scholars. Testy, for example, called the team production theory a "[s]uperior normative theory of what corporate

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[364] Relying on Rajan and Zingales' research, Blair and Stout give credence to the propositions that (1) team members will only want to be part of a team if by doing so they can share in the economic surplus generated by team production, and (2) team members intuitively understand that it will be difficult to convince others to invest firm-specific resources in team production if shirking and "rent-seeking" go uncontrolled (*ibid* at 274). Blair and Stout describe rent-seeking as "situations where individuals expend time, money, and other resources competing for a fixed amount of wealth, in effect squabbling with each other over the size of their individual pieces of a fixed group pie" (*ibid* at 249). Thus, team members realize that it is in their own self-interest to create a higher authority that can limit this behaviour among team members. The team forms because the members perceive that each will obtain more from the cooperative enterprise than from individual action (*ibid* at 264-271).

[365] *Ibid* at 280.

[366] *Ibid* at 280-81.

[367] *Ibid* at 274.

[368] *Ibid.*

governance should be once unyoked from slavish devotion to shareholder interests" which "holds promise."[369] Robert Yalden, who classifies Blair and Stout's team production as a "pluralist model," acknowledges that it is "messy" in that "it does not provide directors with a simple goal and easily observable measure of stock price."[370] Stephen Bainbridge, who has championed the "director primacy" model, has not explicitly supported team production but his work resonates with a similar premise.[371] He argues that control is not really vested in the shareholders or the managers, but the directors because they have the ultimate say in controversial decisions of the corporation. Where Bainbridge differentiates from Blair and Stout is his insistence that the corporation should be regarded simply as a vehicle for the board of directors to use; director primacy, he argues, ultimately contributes to an efficient method of corporate governance. Bainbridge finds that the central problem in corporate governance is the tension between accountability and authority – with his director primacy model, there is no question that it is the directors that have the authority and therefore will be the ones held accountable for corporate actions.

There have been critics of both team production and director primacy. Millon has pointed out that decision-making regarding the allocation of resources then becomes "a matter of power rather than principle."[372] Jeffrey MacIntosh has argued that the team production model is

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[369] Testy, *supra* note 350 at 1234; see also M Kuykendall, *Assessment And Evaluation: Retheorizing The Evolving Rules of Director Liability*, 8 J L & Pol 1, 39-44 (1999).

[370] Robert Yalden, "Competing Theories of the Corporation and Their Role in Canadian Business Law" in Anita I Anand & William F Flanagan, eds, *The Corporation in the 21st Century* (2002) Papers Presented at the Queen's Annual Business Law Symposium.

[371] Bainbridge, *supra* note 103.

[372] David Millon, "New Game Plan or Business as Usual? A Critique of the Team Production Model of Corporate Law" (2000) 86 Va L Rev 1001 at 1026.

“internally contradictory” in its view that directors are to “(a) make decision that fairly balance the interests of different corporate constituents, and (b) aim to maximize the *total* value of the corporation and not merely shareholder wealth,” noting that these two propositions cannot stand together.[373] MacIntosh’s argument seems merely academic. Certainly, properly trained and thoughtful directors are capable of balancing the interests of various stakeholders while keeping in mind the bigger picture that their fiduciary duties are, in the case of Canada, to the best interests of the corporation. Other scholars commented that, by allowing directors to look beyond shareholder interests, “directors who are told to be loyal to many constituencies are too likely to prove loyal to none.”[374] The stakeholder excuse then can be used by directors to usurp control for ulterior motives.[375] Advocates of shareholder primacy have argued that directors would have free reign to serve their own interests without being held accountable to anyone.[376] Many have also asserted that shareholders require a privileged status, and the ability to challenge directors whenever they fail to maximize shareholder gain.[377]

In response to criticism of greater director control, some advocates of stakeholder interests have also downplayed the risk that directors will inevitably run amok unless held to strict standards of accountability to shareholders. Lawrence Mitchell, for example, has argued that, in general, it is appropriate to trust directors to act in good faith, taking all stakeholder

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[373] Jeffery MacIntosh, “The End of Corporate Existence: Should Boards Act as Mediating Hierarchs? A Comment on Yalden” in Anand & Flanagan, *supra* note 370.

[374] David A Skeel Jr, “Icarus and American Corporate Regulation” (2005) 61 Business Lawyer 155 at 176.

[375] George W Dent Jr, “Academics in Wonderland: The Team Production and Director Primacy Models of Corporate Governance”, online: (2007) 7:21 Case Research Paper Series in Legal Studies <http://papers.ssrn.com>.

[376] Nell Minow, “Shareholders, Stakeholders, and Boards of Directors” (1991) 21 Stetson L Rev 197; James J Hanks Jr, “Playing With Fire: Nonshareholder Constituency Statutes in the 1990s” (1991) 21 Stetson L Rev 97.

[377] See e.g. Easterbrook & Fischel, *supra* note 43; Jensen & Meckling, *supra* note 41.

interests into account.[378] He has pointed out, for one thing, that shareholders will still enjoy a positive return on their investment. For another, he has argued that the obsession with holding managers strictly accountable to shareholders is actually counterproductive. It treats managers as if they are "moral infants, incapable of living up to higher expectations" which ultimately encourages selfish, irresponsible behaviour on their part.[379] Giving boards discretionary power, on the other hand, "allows them to develop as morally mature decision-making bodies." [380] Furthermore, higher levels of moral maturity at the corporate helm are worth the risk that some managers may not rise to the occasion. Despite the fact that recent scholarly debates still include arguments that directors may become entrenched, or that boards must only focus on the singular objective of increasing shareholders' wealth for fear of confusion, etc., these arguments sound very dated in nations that have had considerable growth in director education and corporate governance norms. For example, as will be seen in Chapter 5, directors in Canada are highly cognizant of their fiduciary duties and the risks in deviating from those duties. Mitchell's point that directors should not be regarded as "moral infants" is a fair one – Canada is a notable example of a country with robust direction education programs administered by institutions such as the Institute of Corporate Directors and the Director's College, among others. To state rather simplistically, and almost dismissively, that directors will be incapable of putting other's interests before their own, or balancing a number of competing interests, only reveals one's preconceived notions on human nature and offers little to counter in favour of stakeholder theory or team production theory.

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[378] Lawrence Mitchell, "Cooperation and Constraint in the Modern Corporation: An Inquiry Into the Causes of Corporate Immorality" (1995) 73 Texas L Rev 477.

[379] Lawrence Mitchell, "The Board as a Path Toward Corporate Social Responsibility" in Doreen McBarnet, Aurora Voiculescu, and Tom Campbell, eds., *The New Corporation Accountability: Corporation Social Responsibility and the Law* (Cambridge: Cambridge University Press, 2007).

[380] *Ibid* at 537.

Whilst the team production theory is a useful alternative model for scholars to draw upon, there are other notable limitations to the theory. Blair and Stout's list of team members conspicuously excludes the broader community and environment as stakeholders. Directors and managers are no less obliged to consider eco-friendly corporate practices under team production theory than under the shareholder primacy model. Nevertheless, while shareholder primacy relies on its single corporate objective function, the team production model does align more favorably with sustainable practices by accounting for non-shareholder stakeholder interests, and recognizing corporate purposes beyond solely shareholder wealth maximization.

With some exceptions, there is an interesting parallel between stakeholder theory and team production theory, both in positive attributes which are very closely connected and in how each set of originators hold agnostic positions with respect to legal reform. Blair and Stout have also insisted that no changes to the law are required for their team production model to work effectively. To Blair and Stout, their work carries very different policy implications from the legal implications of progressive corporate law. They state, "[w]here progressives have argued that corporate law ought to be reformed to make directors more accountable to stakeholders, the mediating hierarchy approach suggests that directors should not be under direct control of either shareholders *or* other stakeholders."[381]

With due respect to Freeman, Blair, and Stout, a stakeholder-based form of governance requires a minimal level of legal backing when the interests among stakeholders do not align, particularly if shareholders are able to bring legal claims against directors for the fiduciary duties owed to them. For stakeholder theory and team production theory to be fully actualized, the law

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[381] *Ibid.* at 254.

must enable directors to consider stakeholder interests in corporate decision-making at a minimum. Given the entrenchment of ideological beliefs supporting shareholder primacy, which are discussed in the next section, there is a practical need for clarity in the law. Thus, despite the "agnostic" position of both advocates of stakeholder theory and team production theory, normative reform efforts are best achieved in partnership with legal reform and/or education. One cannot fully attain transformational change under an old infrastructure designed for the predecessor.

2.2 Limitations to Reforming the For-Profit Corporation

As seen from Section 2.1 above, for as long as the concept of shareholder primacy has existed in legal scholarship, there has been much research dedicated to critiquing many features inherent in the model.[382] With such an earnest desire to reform the existing model, why does it continue to thrive? The following discussion suggests that the resilience of the model depends not so much on the truth behind advocates' arguments, but whether beliefs supporting the model are widely-held and ideologically entrenched. Moreover, path dependence almost ensures the continued dominance of shareholder primacy for the foreseeable future.

2.2.1 Entrenched Ideological Beliefs

2.2.1.1 Shareholder Wealth Maximization Benefits Society

One reason for shareholder primacy's dominance is the common belief that the fundamental purpose of the corporation should be to maximize the wealth of its shareholders, which in turn will increase the wealth of society. This dogma has been at the core of modern

[382] See e.g. Joel Bakan, *The Corporation: The Pathological Pursuit of Profit and Power* (Free Press, 2004) (and the subsequent film documentary of the same name); Kent Greenfield, *The Failure of Corporate Law: Fundamental Flaws and Progressive Possibilities* (University of Chicago Press, 2006); Lynn Stout, *The Shareholder Value Myth: How Putting Shareholders First Hurts Investors Corporations and the Public* (Berrett Koehler Press, 2012).

economics since Adam Smith's *An Inquiry into the Nature and Causes of the Wealth of Nations*, where he famously opined: 'It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest."[383] Smith's concept of the "invisible hand" has resonated within the theoretical underpinnings of corporate law for some time now. It postulates that shareholders have powerful incentives to maximize the value of the firm and monitor corporate directors' and officers' conduct. Managers, as shareholders' agents, seek to maximize shareholder wealth through the increase of share value and dividend payments, which presumably includes ensuring that stakeholders are appeased[384] and ultimately translates into benefits to consumers and society as a whole. Advocates of shareholder primacy may point to improved consumer products and innovative research and development as some examples of societal benefits that are realised through the competitive drive for increased profit.[385] On the other hand, counterarguments have been made that expenditures such as research and development are vulnerable to cuts due to short-termism under the model.[386]

Many regard the singular pursuit of shareholder wealth maximization as necessary for the efficient management of the corporation. Jensen declares that "it is logically impossible to

[383] Smith, *supra* note 108.

[384] See e.g. Reinier Kraakman, et. al., *The Anatomy of Corporate Law: A Comparative and Functional Approach*, 2nd (Oxford University Press, 2009) at 61-6.

[385] See e.g. Christopher Elson, "Five Reasons to Support Shareholder Primacy," NACD Directorship Blog (15 April 2010), online: <www.directorship.com>; see also Angus Loten, "Can Firms Aim to Do Good if It Hurts Profit?" *The Wall Street Journal,* (11 April 2013) at B6, quoting Elson: "It's politically correct to suggest that a company benefit the public rather than its investors. But investors are the public."

[386] See e.g. Beate Sjåfjell, *Towards a Sustainable European Company Law* (UK: Kluwer Law International, 2009) at 339-340, where she discusses the argument of whether takeover concerns lead boards to "focus excessively on the short term and share price, leading … to insufficient resources being allocated to research and development," and cites inconclusive results found in W.N. Pugh & J.S. Jahera Jr, "State Antitakeover Legislation and Firm Financial Policy" (1997) 18 Managerial and Decision Economics 681; BH Hall, "The Effect of Takeover Activity on Corporate Research and Development," in AJ Auerbach , ed, *Corporate Takeovers: Causes and Consequences* (Chicago: University of Chicago Press, 1988) at ftn 113; see also Lynn Stout, "The Problem of Corporate Purpose" (June 2012) 42 Issues in Governance Studies 1 at 11.

maximize in more than one dimension at the same time … The result will be confusion and a lack of purpose that will handicap the firm in its competition for survival."[387] He echoes Smith's concept, insisting that "200 years' worth of work in economics and finance indicate that social welfare is maximized when all firms in an economy attempt to maximize their own total firm value."[388] Others, such as Hansmann and Kraakman, believe stakeholders are sufficiently protected by contract law and regulation, thus "the maximization of the firm's value by its shareholders complements the interests of those other participants rather than competing with them."[389]

The underlying force behind the presumption is economic efficiency. Christopher Nicholls has observed that "[t]he shareholder primacy norm is much beloved by law and economics scholars, financial economists, and dogmatic conservatives generally."[390] Hansmann and Kraakman have pointed to the standard model's many notable economic advantages, some of which they list as "access to equity capital at lower cost (including, conspicuously, start-up capital), more aggressive development of new product markets … and more rapid abandonment of inefficient investments."[391] Daniel Fischel notes that the public company "… is a type of firm that facilitates the organization of production which is particularly effective when a large amount of capital is required."[392] Common concerns surrounding efficiency and wealth maximization

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[387] Michael Jensen, "Value Maximization, Stakeholder Theory, and the Corporate Objective Function" (2001) 14 J of Applied Corp Fin 8 at 10-11.

[388] *Ibid* at 11.

[389] Hansmann & Kraakman, *supra* note 102 at 449.

[390] Nicholls, *supra* note 230 at 90.

[391] *Ibid* at 450-51.

[392] Daniel R Fischel, "The Corporate Governance Movement" (1982) 35 Vanderbilt L Rev 1259 at 1262.

typically relate to agency costs associated with divergent objectives between managers and shareholders and reducing those costs, not whether the model itself is efficient.[393] Efficiency within the shareholder primacy model is largely accepted as a norm within scholarly articles; improving efficiency within the model has been the preferred focus. Consequently, the broader question about whether the ultimate purpose of such "efficient" business activity is socially valuable and environmentally sustainable is hardly entertained.

The convenience of calculating efficiency based on the normative view of shareholder wealth vis-à-vis share price is that it "frequently externalizes particular costs of corporate activity such as environmental or consumer harms."[394] Thus, corporations may choose to be unhampered by externalities such as social and environmental consequences, and allow others to bear external costs that are not reflected in share or bond prices. Corporations are then only beholden to externalities that are regarded as serious enough to be protected (and adequately enforced) by external regulatory means, without having to comprehend the negative impact their collective actions have on the environment beyond those regulations.[395] The ability for corporations to ignore these negative effects simplifies questions of accountability and corporate purpose, providing a unified and measurable way to calculate success in the pursuit of corporate objectives without complicating factors of difficult-to-measure externalities, which perpetuate

[393] See e.g. Fama & Jensen, *supra* note 85; Jensen & Meckling, *supra* note 41.

[394] Sarra, *supra* note 101 at 41.

[395] In fact, the most severe environmental consequences are often regarded as force majeure and are unprotected by the law. There have also been movements in European Union (EU) law attempting to counteract negative externalities. See e.g. Directive 2002/96/EC, O.J. 2002 (L 27/24-39) (regarding waste electrical and electronic equipment).

the continuance of the model.[396]

2.2.1.2 Stakeholder Interests Adequately Protected by Law and Market Forces

The singular objective of shareholder wealth maximization does not necessarily mean that non-shareholder stakeholders are ignored in the process of corporate decision-making. Rather, for many proponents it means that stakeholder interests are important to consider, but only in the context of pursuing increased shareholder wealth. A cognate perspective is that stakeholder interests are best protected through separate public regulation, such as pollution control legislation, labour regulation and human rights standards, rather than through corporations that supposedly tend to lack the expertise, resources or legitimacy to address such problems.

Stakeholder theory, as discussed above in Section 2.1.1, has received broad, enthusiastic acceptance by corporate legal scholars on both sides of the shareholder versus stakeholder debate. For those believing corporations should have the singular objective of shareholder wealth maximization, the theory supports that belief by its claim that incorporating stakeholder interests simply furthers that cause.[397] Where it does not, shareholder interests prevail. For those believing that managers should seek to serve the interests of other stakeholders – including ensuring sustainable practices within a corporation – stakeholder theory also appeases on many fronts. While the economic incentives propelling CSR are regarded by many as a drawback of the

[396] For a detailed discussion on issues related to the internalization of externalities, such as costs associated with negative environmental effects, see Beate Sjåfjell, "Internalizing Externalities in EU Law: Why Neither Corporate Governance Nor Corporate Social Responsibility Provides the Answers" (2008) 40 George Washington International LR 977 at 987-1007.

[397] See Jensen, *supra* note 387. Consider as well Neil Gunningham, Robert A Kagan & Dorothy Thornton, "Social License and Environmental Protection: Why Businesses Go Beyond Compliance" (2004) 29 L & Social Inquiry 308 (suggesting that corporations are limited by a social license that at times requires them to perform above regulatory compliance standards).

movement, there is a question as to whether these arguments are more academic in nature, rather than of practical concern. As more studies show how long-term economic benefits are often realized from CSR practices, CSR advocates are motivated to trumpet those economic benefits over environmental concerns in order to garner the attention of profit-focused managers. Nevertheless, ensuring that a long-term perspective is actualized by corporate boards and management is difficult, as market forces and pressures tend to keep short-term interests a high priority. Law and economics scholars have frequently pointed out that when exposing the hidden agenda behind CSR, the shareholder primacy model is ultimately revealed.[398] Since CSR is able to co-exist alongside shareholder primacy – despite significant temporal challenges that heavily favour short-termism[399] – there tends to be little desire to reform the model in order to incorporate stakeholder interests beyond what companies are already driven to do from the market.

2.2.1.3 Shareholder Primacy is Superior to Alternatives

Fischel states that the relevant comparison for alternative models is not between "the ideal and the real" but between different institutional arrangements, and that it is a form of nirvana fallacy to conclude that the structure of corporate law should be changed because existing institutional arrangements are imperfect.[400] The proper comparison should be between the costs and benefits of existing arrangements, and echoing *laissez-faire* market principles, "[s]ince corporations are products of voluntary contractual agreements, a strong presumption

[398] Gary Becker & Richard Posner, "Do Corporations Have a Social Responsibility Beyond Stockholder Value?" The Becker Posner Blog (24 July 2005), online: <www.becker-posner-blog.com>.

[399] See e.g. Francois Brochet, George Serafeim & Maria Loumioti, "Short-termism: Don't Blame the Investors" (June 2012) Harvard Business Review 1 (providing empirical research that suggests the issue of short-termism isn't limited to investors, but is a fixation of management as well, and is rooted in corporate culture).

[400] Fischel, *supra* note 392 at 1272.

exists in favor of the superiority of existing arrangements."[401] Hansmann and Kraakman have also argued that alternative governance models – identified by them as manager-oriented, labour-oriented and state-oriented – have already been tried and have failed.[402] They describe the manager-oriented model as one that existed between the 1930s and the 1960s in the US; the labour-oriented model as one that peaked in Germany in the 1970s; and the state-oriented model as one most extensively realised in France and Japan post-World War II. They contend that "[a] simple comparison across countries adhering to different models – at least in very recent years – lends credence to the view that adherence to the standard model promotes better economic outcomes … The main examples include, of course, the strong performance of the American economy in comparison with the weaker economic performance of the German, Japanese, and French economies."[403]

Hansmann followed up his thoughts on shareholder primacy's superiority over other national models in 2006, noting that Japan and Germany have begun to adopt governance features that are similar to the American model, which "is the most attractive social ideal for the organization of large-scale enterprise."[404] The lack of a strong oppositional consensus on what consists of a better alternative to the shareholder primacy model only helps to bolster the belief that the existing model is superior. The most concerted reforms to date have focused on the relatively benign 'enlightened shareholder value' model, as found in the UK *Companies Act* (discussed in Section 2.1.1.1), and recent jurisprudence of the Supreme Court of Canada (SCC)

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[401] *Ibid.*

[402] Hansmann and Kraakman, *supra* note 102 at 443-47.

[403] *Ibid.* at 450.

[404] Hansmann, *supra* note 156 at 746.

(discussed in Section 5.1.3.1).[405] Other than these modest countervailing pressures toward enlightened shareholder value, there is little to no collective contrary support pushing for the adoption of another nation's model.

In addition, while Fischel makes the fair point that it is premature to compare *theoretical* alternatives against the existing model, there is no consensus on a theoretical alternative to shareholder primacy in any case. As seen in Section 2.1 of this chapter, various alternative theoretical models and approaches have emerged in legal scholarship as a critique to the modern corporation's focus on shareholder wealth maximization. Each theoretical model carries its own views on what corporate rules and structures should prevail, how value is measured, and whose rights should be protected, which may also cause problems for the entry of new theoretical models to take hold. For example, there is considerable difficulty in conceptualizing a form of stakeholder theory within an alternative corporate legal framework, as its usage has become "an umbrella for so many different theories and arguments, with so many express or implied foundations."[406] Any attempts at countervailing models incorporating elements of the theory "may unjustifiably be associated with [prior foundations] as soon as the term is employed."[407] While scholarly criticisms against the shareholder primacy model have been widely available, disagreements on the measure of success and the way forward have made concentrated efforts to reform the current model difficult to sustain. The shareholder primacy model will endure as the superior model if there continues to be a lack of consensus or at least strong support for a better theoretical alternative.

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[405] *Peoples Department Stores Inc. (Trustee of) v. Wise*, [2004] 3 S.C.R. 461 [*Peoples*]; *BCE Inc. v. 1976 Debentureholders*, [2008] 3 S.C.R. 560 [*BCE*].

[406] Thomas Donaldson & Lee E Preston, "The Stakeholder Theory of the Corporation: Concepts, Evidence, and Implications" (1995) 20 Academy of Mgmt Rev 73.

[407] *Ibid.*

2.2.2 Path Dependence

While path dependence theory is generally used as an argument against the likelihood of wholesale global convergence, it also inversely explains why the shareholder primacy model will continue to have a dominant hold on norms and laws, despite its inefficiencies. Lucian Bebchuk and Mark Roe identify two sources of path dependence. The first is structure-driven path dependence, where corporate structures within an economy at any time are influenced by the corporate structures it previously had.[408] The second is rules-driven path dependence, which arises from the effect that initial structures have on subsequent structures through their effect on the legal rules governing corporations.[409] Exploring the efficiency analysis behind these two sources of path dependence, Bebchuk and Roe point out how the measure of a model's efficiency relative to alternatives is subject to "sunk adaptive costs, complementarities, negative externalities, endowment effects, or multiple optima."[410] A movement away from shareholder primacy into another model of governance would incorporate several costs. A helpful example is imagining costs associated for a country with no public transportation system adopting the Vancouver SkyTrain as opposed to the city of London changing its existing Underground Tube. Adaptations may be costlier than starting from scratch. Complementarities and network externalities, as well, mean that shifting from the shareholder primacy model to an alternative would have ripple effects on those most familiar with the existing model – requiring investment from those players to acquire new techniques an anticipation of a new model. Complex regulation is already formed to address the needs of the model; new structures would require

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[408] Lucian Bebchuk & Mark Roe, "A Theory of Path Dependence in Corporate Ownership and Governance" (1999) 52 Stanford Law Review 127 at 139.

[409] *Ibid.* at 153.

[410] *Ibid.* at 139.

modifications that are costly and inefficient. Achieving an efficient control structure may also be difficult because of the endowment effect in human behaviour. An example given by Bebchuk and Roe is a supposed shift of control from those governed by American-style managers to European-style concentrated family-owners. Sellers may not find agreement with those willing to buy due to their overvaluation of the asset's prior value given existing control structures, thereby creating inefficiencies.[411]

Thus, shareholder primacy may persist due to players who have the motivation and power to prevent any changes to existing power arrangements. Holders of power are unmotivated to relinquish their power (be it under the guise of ownership or control) even in scenarios where doing so would increase the total value of the corporation. Corporate insiders have the power to prevent the loss of their economic power since their position as controlling shareholders permits them to block changes in the firm's control structure simply by refusing to sell their shares. Their position also permits them to block changes in governance by selecting the firm's directors. This concentration of power also extends itself to aspects of rules-driven path dependence. Bebchuk and Roe note that "legal rules are often the product of political processes, which combine public-regarding features with interest group politics … [t]hus, the corporate rules that actually will be chosen and maintained might depend on the relative strength of the relevant interest group."[412] In particular, the concept of "regulatory capture" exposes how power dynamics are intimately intertwined with rules-driven path dependence.[413] Regulatory agencies come to be dominated by

[411] *Ibid* at 141.

[412] Bebchuk & Roe, *supra* note 408 at 157.

[413] George Stigler is often cited as one of the main developers of capture theory. See George Stigler, "The Theory of Economic Regulation" (1971) 2 Bell Journal of Economics and Management Science 3 at 3 ("… as a rule, regulation is acquired by the industry and is designed and operated primarily for its benefits"); George Stigler, "Can

the very industries they were charged with regulating, and eventually act in ways that benefit the industries they are to regulate, rather than the public.[414] Those holding economic and/or political power can and likely will obstruct attempts to establish rules that may compromise their position, inhibiting the development of efficient regulation.

Politically, Roe has documented the relevance of political determinants to corporate governance. He finds that there is considerably more to governance reform than creating proper legal institutions, as "technical reforms have sometimes had little effect unless and until the underlying political reality changed."[415] Culturally, the creation of property rights and the norms that accompany it mean that Anglo-American governance theory seeks to "protect a particular hierarchy of property."[416] Empirical research has suggested that traditional notions of property rights have influenced most private law.[417] These norms run parallel to those found within the shareholder primacy model, and it is likely that a serious destabilising effect may be necessary to upset any of those pre-existing norms. Nevertheless, while there may be a "broad disquiet" among several nations, Hansmann taps into cultural reasoning for support, noting that "it may be fine for Americans, who are intensely individualistic and place an exceptionally strong value on personal liberty."[418] The cultural context may also hold true regarding the belief that the

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Regulatory Agencies Protect the Consumer?" in George Stigler, *The Citizen and the State: Essays on Regulation* (University of Chicago Press, 1975) at 183.

[414] An often cited example of regulatory capture is regarding the catastrophic 2010 Deepwater Horizon Oil Spill, and the regulatory agency responsible for off-shore drilling, the Minerals Management Service. See Gerald O'Driscoll, "The Gulf Spill, the Financial Crisis, and Government Failure" (14 June 2010) *The Wall Street Journal*, A17.

[415] Mark Roe, *Political Determinants of Corporate Governance* (Oxford University Press, 2003), 202.

[416] Sarra, *supra* note 101 at 41.

[417] Braithwaite & Drahos, *supra* note 203.

[418] *Ibid.*

shareholder primacy model is superior to alternative models. It is difficult to gauge the tenacity of this belief in international culture, but ethnocentrism may play a significant role in perpetuating the shareholder wealth maximization norm in nations possessing this cultural mentality.

2.3 Critiques, Challenges, and Barriers

Counter-hegemonic discourse was not absent during the development and dominance of shareholder primacy in legal scholarship. Critiques and challenges to the mainstream model of governance have led to the development of CSR, SRI, enlightened shareholder value in the UK, and other business approaches that have encouraged corporations to look beyond share value metrics and consider all stakeholders and the broader community when conducting their activities, if anything, to improve their bottom line. Of course, it is immensely difficulty to achieve these objectives. Products or services that seem socially desirable for some are not desirable for others, therefore, how do we know that products and services a given company is providing are leading to greater social good? Who will judge it? The business case for CSR has its limitations, but it is a powerful and compelling argument that has been an attractive for many companies to integrate into their business strategies. SRI equally has been starting to appear on the radar for financial institutions in a manner that suggests more SRI products will emerge on the horizon.

There are, of course, two sides to a story in assessing the state of corporate behaviour in the private sector in relation to the law, sustainability, and innovation. One story is depressing – the operating norm has justified selfish human behaviour and privileged the basest human vices. The other is somewhat uplifting – there is momentum in reforming the status quo on a number of fronts to allow for greater impact on the social economy and social change. In either case, it seems unlikely that shareholder primacy, in all its nuanced forms and guises, is leaving anytime soon. Shareholder primacy's continued dominance depends very much on path dependence and the resilience of all of the reasons provided in the above Section 2.2.1. Support for Smith's invisible hand is on safe ground. The force of competition motivates efficient positions, and the Anglo-American cultural emphasis on free market capitalism in an era of multinational enterprises and global markets supports the endurance of shareholder primacy for the foreseeable future, despite occasional unpleasant challenges such as from the Occupy Movement.[419] How, then, do reformers champion progressive ideals when beliefs supporting the mainstream model are so ingrained in the psyche of corporate power? Critiques of shareholder primacy and reform efforts must continue, but there are additional avenues that should not be ignored. Chapter 3 considers the non-profit sector and Chapter 4 addresses several alternative models that have, or are in the process of, recalibrating efficiency within their design and integrating sustainable practices into corporate governance in a manner beyond the incremental changes that have occurred in corporate law in recent decades.

[419] "Occupy movement," *The Guardian,* online: <www.guardian.co.uk/world/occupy-movement>.

CHAPTER 3: The Non-Profit Dilemma

The lion's share of Anglo-American scholarship devoted to improving the corporation tends to focus on corporate law and shareholder primacy, when there is considerable merit in taking a step back and inquiring how the non-profit organization fares in the picture. Is the NPO meant to be the antithesis of the for-profit corporation? What can be learned from the NPO structure? As seen in Chapters 1 and 2, neoclassical law and economics scholars regard the purpose of the corporation as one of reducing the costs of using the price mechanism, increasing profits, and being economically efficient. The purpose of the NPO, on the other hand, may be viewed as being for any purpose *other than* profit-making. There has been a split within the law – differing corporate legal vehicles exist to separate the mission of creating economic and social value, and this social construct is beginning to be challenged by the new onslaught of corporate hybrids that are appearing on the international stage.

Statistics can provide quite different snapshots of the non-profit sector, in that its size sounds considerable within Anglo-American nations until compared with each nation's business sector, which then dwarfs it. Canada, for example, has the second largest non-profit sector relative to population size in the world, accounting for 8.1% of the total gross domestic product (GDP) in Canada in 2009[420] and approximately $35.9 billion dollars.[421] While these numbers seem impressive, in comparison, Canadian businesses accounted for almost $1 trillion in GDP in 2005, with small and medium-sized businesses at $536.5 billion, or 54.3%, of business-sector

[420] Cynthia Haggar-Guenette & Mingyu Yu, Satellite Account of Nonprofit Institutions and Volunteering (Statistics Canada, 2009). Interestingly, the top 1% in the Canadian non-profit sector accounts for 59% of the total size, and in contrast, the bottom 42% account for 1% of the total.

[421] Statistics Canada, "Canada's Non-Profit Sector in Macro-Economic Terms," online: <http://www.statcan.gc.ca/>.

GDP, and large businesses at $451.9 billion, or 45.7%, of business-sector GDP.[422] Small or large, significant or not – much lies in the eyes of the beholder and conflicting views on the purpose of the non-profit sector, the needs that the sector is aiming to serve, and whether the sector has far more potential to improve communities than present day or not. These variant views, which tend to fall into neoclassical/neoliberal positions and those counter-hegemonic to those views, inevitably spill into viewpoints on the purpose, utility, and/or necessity of implementing hybrid legislation within a nation's laws.

This chapter examines the economic analysis behind the NPO in Anglo-American frameworks, as well as modern day tensions that have arisen within the non-profit sector. In particular, a variety of challenges that have arisen within the sector are examined, which include tax rules that inhibit profit-seeking, financial impediments and decreasing donations, and increasing administrative burdens associated with, among other things, compliance requirements. Many NPOs have been forced to seek out new funding sources in order to remain financially viable and maintain a strong voice within public policy advocacy. The inability of NPOs to fully use the engine of the market to disseminate their social goods and services has put those organizations at a severe disadvantage when compared to the for-profit sector. But is the disadvantage justified given certain tax and other advantages? The economic and socio-legal constraints put upon NPOs have precipitated a significant increase of "social enterprises" arising from the sector, which in turn has contributed to the emergence of hybrid legal structures. The NPO structure is not working for social entrepreneurs eager to utilize capital to make a difference within society. For example, Mark Zuckerberg, the Chief Executive Officer (CEO) of Facebook, Inc., and his wife, Priscilla Chan, in their 2015 announcement to donate 99% of their

[422] *Ibid.*

Facebook shares to charity, elected to use an American limited liability company (LLC) as the legal vehicle of choice – not an NPO because of the significant limitations it held in making a social impact.[423] These limitations belie an inherent contradiction in the non-profit model. If one of the purposes behind the non-profit sector is to operate as an organizing framework for advancing the social economy, why do so many social entrepreneurs with that goal in mind avoid the NPO structure? Whether or not one views this as a problem, there are three possible actions: (1) do nothing; (2) reform non-profit laws to better meet the potential for social entrepreneurship; and/or (3) look outside the non-profit sector for ways to foster an increase of social businesses overall. Note that while option (1) is mutually exclusive, options (2) and (3) are not. These latter options do not negate the possible value hybrids may have in advancing the social economy beyond the current status quo of the non-profit sector. Nevertheless, understanding the tensions within the non-profit sector is critical to understanding how hybrids may be designed to address economic disadvantages and stimulate increased activities that promote social good.

3.1 The Nature of the Non-Profit Firm

While the theoretical premise behind the nature of the for-profit firm in neoclassical law and economics has been developing for decades, the formation of an economic theory behind the nature of NPOs began decades later. Since there are multiple motivations behind the creation of NPOs, it is possible for a happy coexistence among several theoretical lines of inquiry. In the 1970s, economists began positing a "public goods" theory, outlining how NPOs serve as private

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[423] Vindu Goel & Nick Wingfield, "Mark Zuckerberg Vows to Donate 99% of His Facebook to Charity" *The New York Times* (1 December 2015), online: <www.nytimes.com>.

producers of public goods. Burton Weisbrod's 1975 "pathbreaking" [424] work explained how governmental entities provided public goods to the point of satisfying the median voter.[425] Because of this, there will always be a residual unsatisfied demand for public goods by those voters that are in need of, or prefer, goods that are greater than the median. NPOs satisfy this residual demand by offering public goods in addition to those provided by government, thus correcting a form of both "government failure" and "market failure."[426]

Henry Hansmann expanded on the market failure concept by developing a "contract failure" theory in his seminal 1980 article, "The Role of the Nonprofit Enterprise," arguing that NPOs also arise as a response to issues of asymmetric information facing consumers.[427] He identified two problems with the public goods theory: (1) how does one explain the services provided by many NPOs that do not seem to be public goods but rather appear to be private ones?; and (2) how does one explain why an NPO rather than a for-profit corporation arises to fill an unsatisfied demand for public goods?[428] The qualities of a donor as compared to a customer are important to consider. The donor is purchasing a particular kind of good: (1) delivery of goods to a third party – such as donations to a third world country; or (2) collective consumption goods where the increment purchased by a single individual cannot be easily

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[424] As described by Richard Steinberg, "Economic Theories of Nonprofit Organization: An Evaluation" in W.W. Powell & Richard Steinberg, eds, *The Nonprofit Sector: A Research Handbook*, 2nd ed (Connecticut: Yale University Press, 2006)

[425] Burton A Weisbrod, "Toward a Theory of the Voluntary Non-Profit Sector in a Three-Sector Economy" in Edmund Phelps, ed, *Altruism, Morality, and Economic Theory* (New York: Russell Sage, 1975).

[426] *Ibid.*

[427] Henry Hansmann, "The Role of the Nonprofit Enterprise" (1980) 89 Yale LJ 835.

[428] Henry Hansmann, "Economic Theories of Nonprofit Organizations" in WW Powell, ed, *The Nonprofit Sector: A Research Handbook* (New Haven: Yale University Press, 1987) at 27.

discerned – such as donations to a public radio station.[429] With respect to third party goods, Hansmann explains how:

> [t]he difficulty is that the purchaser (donor), who has no contact with the intended beneficiaries, has little or no ability to determine whether the firm performs the service at all, much less whether the firm performs it well. In such circumstances, a proprietary firm might well succumb to the temptation to provide less or worse service than was promised. The NPO, owing to the nondistribution constraint,[430] offers the individual some additional assurance that her payment is in fact being used to provide the services she wishes to purchase.[431]

While Hansmann has identified the nondistribution constraint as the main financial difference between for-profit corporations and NPOs, it is important to note that there are other factors at play. In addition to the nondistribution constraint, NPOs also cannot raise capital through the selling of shares. This means little to no start-up capital without government funding or other financial means. Once an NPO is established, then a "commercial NPO," meaning an NPO that derives most, if not all, of its income from the sale of goods and services, would have different funding challenges as compared to a "donative NPO."[432]

Hansmann acknowledges that his contract failure theory is more controversial in the case of commercial NPOs. He contends that these NPOs are effective when new markets and emerging industries are suffering from problems of asymmetric information, as their nondistribution constraint offers a form of consumer and fiduciary protection.[433] Contract failure

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[429] *Ibid.* at 30.

[430] Hansmann calls the inability for NPOs to distribute the firm's net earnings as the "nondistribution constraint." *Ibid.* at 28.

[431] *Ibid.* at 29.

[432] Burton A Weisbrod, *To Profit or Not to Profit: The Commercial Transformation of the Nonprofit Sector* (New York: Cambridge University Press, 1998).

[433] *Ibid.*

theory thus regards NPOs as a response to agency problems.[434] Eugene Fama and Michael Jensen have elaborated on, and somewhat challenged, Hansmann's argument that NPOs arise to address agency issues, suggesting instead that the proliferation of NPOs is tied more to the access of donor financing and the subsidies and other tax benefits attributed to such financing.[435] Their argument echoes that of Coase's observation that different tax treatments could bring into existence firms "which otherwise would have no *raison d'etre*."[436]

Other scholars, such as Avner Ben-Ner, further developed non-profit theory by arguing that NPOs may be established "when direct consumer control of firms enhances consumers' welfare relative to control through the market."[437] His study on the consumer control aspect of the NPO considers how such control assures that consumers will receive the NPOs' surplus, which is distributed as lower prices and/or larger quantities instead of dividends, and provides incentives for appeasing consumer demand and quality customer service.[438] Ben-Ner contends that his theoretical analysis supports Weisbrod's public goods theory as well as Hansmann's contract failure theory.

Hansmann found that the public goods theory was one that was complementary to contract failure theory, and in fact, can be viewed as a "special case" of the contract failure

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[434] Hansmann, *supra* note 428 at 31.

[435] Eugene Fama & Michael Jensen, "Agency Problems and Residual Claims" (1983) 26 Journal of Law and Economics 327 at 344.

[436] Coase, *supra* note 25 at 393.

[437] Avner Ben-Ner, "Non-Profit Organizations: Why Do They Exist in Market Economies" in Susan Rose-Ackerman, ed, *The Economics of Nonprofit Institutions* (New York: Oxford University Press, 1986) at 95.

[438] *Ibid.* at 110.

theory.[439] He deemed governmental regulation as more effective in addressing asymmetric information and validating the work of for-profit corporations than commercial NPOs. Since for-profits have particular economic advantages when compared to NPOs in addition to the nondistribution constraint, including better access to capital and what Hansmann deems as "better incentives for customer responsiveness and cost efficiency," he felt for-profits are likely to take over the industry in the long run with proper regulation.[440] NPOs remain, however, because "once established, [NPOs] tend to become embedded and do not quickly leave an industry, even after the conditions to which they initially responded have long disappeared."[441]

It is interesting to note Hansmann's presumption that NPOs are comparatively inefficient when set against for-profit corporations due to their nondistribution constraint. His position echoes a common sentiment held by economists.[442] Al Slivinski has noted how departures from profit maximization in economic analysis "oftentimes appear as 'market failures' due to 'agency problems,' which are cured by providing the proper financial incentives."[443] The assumption of relative inefficiency underscores decades of work in the field of NPOs and "follows from a [problematic] presumption that the profit motive is an important spur to efficiency."[444] A common argument in academic circles is whether neoclassical economic

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439 Hansmann, *supra* note 428 at 30.

440 Henry Hansmann, "The Economic Role of Commercial Nonprofits: The Evolution of the U.S. Savings Bank Industry" in Helmut Anheier & Wolfgang Seibel, eds, *The Third Sector: Comparative Studies of Nonprofit Organizations* (De Gruyter, 1989) at 75.

441 *Ibid.*

442 Armen Alchian and Harold Demetz embedded the belief in their seminal 1972 work by denoting how the non-profit sector is inherently subject to productive inefficiency due to their economic constraints. Alchian & Demsetz, *supra* note 359.

443 Al Slivinski, "Team Incentives and Organizational Form" (2002) 4:2 Journal of Public Economic Theory 185.

444 *Ibid.* at 186.

scholars tend to be over-reliant on efficiency mechanisms, leading to one-dimensional analysis. Slivinski points out that even if the profit motive presumption were correct, "it does not follow that other organizational forms and entrepreneurial/managerial motivations might not also induce an incentive for organizations to operate at low cost and provide high quality."[445] Richard Steinberg as well has noted how "the charitable behavior of donors and volunteers reminds economists that more complicated models are necessary, paying back the analyst with insights that go far beyond understanding charity."[446] It is critical that scholars recognize how NPOs "cannot be analyzed form the same starting point…[They] may indeed maximize their 'profits' (or financial surplus or endowment) under some circumstances. However, this is a result that must be shown and its significance must be interpreted anew."[447]

Slivinski has pointed out that corporations may themselves struggle with a significant number of incentive problems, citing moral hazard, opportunism, and adverse selection as some examples.[448] Why then, he asks, would one take a differing view of NPOs? The motivation behind those who found and/or manage NPOs (beyond the economics) may be unclear; there is no generally accepted assumption as to what that motivation is or should be. Considering the internal incentive structures within the non-profit sector, Slivinski recognized the existence of cost-differentials and focused on how incentives for members of a team can be provided to produce an efficient result. He shows how there is no inherent disadvantage in solving team incentive problems when compared to the corporation, but acknowledges that there is a great

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[445] *Ibid.*

[446] Steinberg, *supra* note 424 at 117.

[447] *Ibid.*

[448] Slivinski, *supra* note 443 at 186.

deal of work still to be done in determining the differences in for-profit and non-profit behaviour.[449] Multiple incentives are continuously at play in the non-profit sector, and NPOs may prove to be economically efficient in a manner that is calculated beyond monetary value. Motivations may remain somewhat of a mystery, as layers of self-interest, altruism, and morality are difficult to pin down within economic theory.

In 2006, Steinberg revisited the economic theories of NPOs, noting in particular Weisbrod's identification of the twin market and government failures to satisfy such market, and Hansmann's identification of contract failure as a meaningful component. Steinberg labelled their combination as an older set of theories that together comprise of an incomplete "three-failures" theory. He critiques how its sole focus on the demand side means a lack of explanation as to supply and why NPOs exist for consumers and donors – noting how "[u]nless we know why and when nonprofit organizations will be created, it is hard to assess whether they can play the roles we have discussed."[450] Another criticism is leveled at the fact that economists have an "excessive focus" on efficiency, and that while efficiency is important, "it leaves out much and the other sorts of roles that nonprofit organizations can play in a mixed-sector economy are ignored by this literature."[451] Steinberg argues for the development of "a more comprehensive and integrated theory."[452] Funding sources, access to capital, and why NPOs elect to become either donative or commercial are details in further need of clarity.

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[449] *Ibid.* at 206.

[450] *Ibid.* at 128.

[451] *Ibid.* at 128-129.

[452] David Mason, *Leading and Managing the Expressive Dimension: Harnessing the Hadden Power Source of the Nonprofit Sector* (San Francisco: Jossey Bass, 1996).

The theoretical components of the non-profit sector are still a few decades behind that of the for-profit sector in terms of development, and the commercial NPO remains the "great puzzle" of the non-profit sector today.[453] The existence of commercial NPOs seems somewhat incongruous to the view that there are economic justifications behind the split of corporations and NPOs into two distinct categories, one of which is excluded from the social economy and the other a main staple. The practical realities facing NPOs struggling to stay financially afloat while maintaining an independent voice in advocacy have spurned a great demand for legal and economic tools that enable NPOs to operate more like businesses, and become more financially self-reliant. An exploration into this phenomenon as to why NPOs are moving toward more commercial settings is examined in the next section.

3.2 Practical Realities: Financial Impediments and Advocacy Chill

Despite the significant role NPOs and charities play in communities and the social economy, the sector is subject to a number of challenges that affect its future vitality. Historically, the bulk of NPO and charitable funding has been through governmental, corporate, and other types of donations, and donative NPOs in particular have difficulty growing once their funding sources are tapped. It stands to reason that an NPO cannot be effective in its advocacy if it is struggling to keep its doors open. NPOs are under enormous pressure to maintain funding and influence. The considerable strain put upon NPOs and charities have led many within the sector to rethink their business plans in order to survive, continue to make a societal impact, and maintain their influence as advocates for social change. In Canada, registered charities have inherent limitations since, unlike NPOs, they are prohibited from engaging in "political activities" under ss. 149.1(6.1) and 149.1(6.2) of *Income Tax Act (Canada)* (*ITA*). The

[453] As described in Hansmann, *supra* note 74 at 16.

interpretation of "political activities" has historically been a considerable source of tension and in 2003 led to the issuance of Policy Statement CPS-022 from the Canada Revenue Agency (CRA) detailing the differences between political and charitable activities, with further updates in 2012. NPOs, on the other hand, are subject to s. 149(1)(1) of the *ITA* which requires that they are exclusively for "social welfare, civic improvement, pleasure, recreation, or any other purpose except profit." [454] NPOs are not, however, prohibited from engaging in "incidental" or "ancillary" business activities, which means that, formally, an NPO should only make a profit if it is by accident. In 2012, the CRA issued two technical interpretations that were in line with a more restrictive position on revenue generation, indicating that any NPO carrying on a business activity with the intent to make a profit beyond what is ancillary or incidental, or anything other than on a cost-recovery basis, would result in the disqualification of an NPO's net profits from tax exemption.[455] Followed strictly, this rule means little to no growth in capital to reinvest into the organization.

The plight of the non-profit sector is one that has been well-documented in the past. In 2000 and subsequent years, a series of Canadian reports have appeared which seek to expand the nation's understanding of the non-profit sector, including the National Survey of Nonprofit and Voluntary Organizations (NSNVO),[456] the National Survey of Giving, Volunteering and Participating (NSGVP) (now conducted every three years and renamed the Canada Survey of

[454] See para 149(1)(1) of the *Income Tax Act (Canada)* (ITA).

[455] CRA doc. no. 2012-0454251E5 and 2012-0468581E5.

[456] Voluntary Sector Initiative, "National Survey of Nonprofit and Voluntary Organizations," online: <www.vsi-isbc.org> [NSNVO].

Giving, Volunteering and Participating (CSGVP)),[457] and the Satellite Account of Nonprofit Institutions and Volunteering (Satellite Account),[458] as well as Canada's participation in the John Hopkins Comparative Nonprofit Sector Project (John Hopkins Project).[459] These reports revealed a very complex picture of non-profit sector development in Canada.

The NSNVO was the first large-scale national survey conducted on the non-profit and voluntary sector. Given the size of the project, it was split into two phases, with the first half released in 2003 based on nation-wide consultations, and the second half released in 2004 based on a survey of over 13,000 organizations. Along with the other reports, the NSNVO emphasized a collective problem that was already all too evident for those situated in the non-profit sector, being "substantial difficulties in obtaining the appropriate financial and human resources needed to deliver their programs and services to Canadians."[460]

Most participants in the NSNVO identified human capital as their greatest strength, as well as strengths in the area of planning and development.[461] By far the greatest challenges for the organizations surveyed were financial resource capacity issues. On average, governments provide 49% of organizations' funds, with 35% of reported revenue as earned income from non-

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[457] Michael H Hall, Larry McKeown, & Karen Roberts, "Caring Canadians, Involved Canadians: Highlights from the 2000 National Survey of Giving, Volunteering and Participating," Catalogue no. 71-542-XPE (Ottawa: Statistics Canada, 2001) [NSGVP].

[458] Malika Hamdad, Sophie Joyal and Catherine Van Rompaey, "Satellite Account of Nonprofit Institutions and Volunteering," Catalogue no. 13-015-XIE (Ottawa: Statistics Canada, 2004).

[459] Michael H Hall, et al, "The Canadian Non-Profit and Voluntary Sector in Comparative Perspective," John Hopkins Comparative Nonprofit Sector Project (Ottawa: Imagine Canada, 2005), online: <http://ccss.jhu.edu> [John Hopkins Project].

[460] Michael H Hall, et al, "The Capacity to Serve: A Qualitative Study of the Challenges Facing Canada's Nonprofit and Voluntary Organizations," Part 1 of the NSNVO, online: <http://sectorsource.ca> at vii.

[461] *Ibid.* at vii.

government sources, membership fees, and sales of goods and services, and 13% from gifts and donations from individuals, corporations and other organizations.[462] Organizations noted that a number of external factors such as "the impact of government downloading and cutbacks in government funding, a greater emphasis on project funding instead of core funding, increasing competition for scarce resources, and mandated collaborations with other organizations" were significant challenges to NPOs maintaining financial viability.[463] Organizations surveyed in the John Hopkins Project reported how government funding has become "more short-term, more competitive, and less predictable" with little funding available to support overall organizational capacity.[464] Moreover, the ability of NPOs to "identify and respond to needs earlier, more quickly, and often more innovatively than government" appeared to be eroding.[465] The NSNVO report stated that, "although the need for more money was often identified, organizations more frequently expressed a need for 'better money'":

> For participants, better money meant stable, longer-term funding that helps organizations plan and pay for core operating expenses, and gives them the autonomy to direct their services and programs to where they are most needed….Participants reported that their organizations have the most difficulty in dealing with the changing funding environment. Priorities of funders frequently change and funding is being increasingly restricted to direct program costs, making it difficult for organizations to pay for infrastructure, administration, and other organizational supports that they need to implement programs.[466]

At the same time, the administrative burden associated with acquiring and maintaining funding,

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[462] Michael H Hall, et al, "Cornerstones of Community: Highlights from the National Survey of Nonprofit and Voluntary Organizations," Catalogue no. 61-533-XPE (Ottawa: Statistics Canada, 2004), online: <http://sectorsource.ca> at 23.

[463] *Ibid.* at 47.

[464] Hall, *supra* note 459 at v.

[465] *Ibid.*

[466] Hall, *supra* note 460 at viii.

and mandated collaborations is increasing.[467] Many organizations report that funding is "often accompanied by onerous demands for financial accountability," causing significant labour costs to be taken away from day-to-day operations and putting NPOs under "considerable strain."[468]

The number of volunteers, donors, and monetary donations in Canada is declining.[469] The latest Satellite Account, made available in 2010 on the 2008 fiscal year, found that while income in the non-profit sector increased that year, the pace of the increase was slower than in previous years.[470] In particular, individual donations decreased by approximately 3% while investment income dropped by 20%.[471] The John Hopkins Project found that a major stumbling block in non-profit sector development was in their ability to deliver dual economic and social value, noting how "Canada is only beginning to understand how it can make the most of the civil society assets it has created," and posing two key questions: What social and economic contributions is its non-profit and voluntary sector best able to provide? And, how can it best be enabled to make these contributions?"[472] These questions reflect a growing unease that the non-profit sector is not being utilized to its full potential. Resources are not being deployed effectively to address the social and environmental challenges that many activist NPOs aim to address. In his 2009 testimony to the House of Commons Standing Committee on Industry,

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[467] Hall, *supra* note 459 at v. See also Lynn Eakin, "We Can't Afford to Do Business This Way: A Study of the Administrative Burden Resulting from Funder Accountability and Compliance Practices" Wellesley Institute (2007), online: <www.wellesleyinstitute.com>.

[468] Hall, *supra* note 460 at viii.

[469] Hall, *supra* note 459 at v.

[470] Satellite Account of Non-Profit Institutions and Volunteering, 2010. Ottawa: Statistics Canada.

[471] These numbers may be more reflective of effects from the 2008 global financial crisis and economic downturn that followed, rather than an overall trend in the sector.

[472] Hall, *supra* note 459 at v.

Science, and Technology, Tim Draimin, Executive Director of the Social Innovation Generation, noted how restrictive tax regulations and capitalization options have become a serious challenge for NPOs seeking access to capital and diversifying sources of operating income, stating "these financial barriers are unnecessary obstacles for a new breed of social entrepreneur that is emerging and limits the potential impact of their innovations. The sector needs the flexibility to explore new forms of social finance."[473]

In addition to being private producers of public goods and offering additional assurances to donors due to their nondistribution constraint, NPOs historically have also play a significant role in public policy advocacy, despite its frequent omission from neoclassical economic analysis. NPOs have had a long and storied tradition of participating in public policy advocacy to further enhance community development and the social economy as a whole. They gain special knowledge in their engagement with the communities that they seek to serve, becoming experts in certain societal issues and thereby adding a critical voice in the policymaking process. The relationship between the non-profit sector and policymakers can be mutually beneficial, but of course it rests on tenuous ground given the financial challenges that NPOs face on a day-to-day basis. That then raises the question, does increased involvement with commercial activities cause conflict with an NPO's mission?

The non-profit dilemma is, of course, not isolated to Canada, as American neighbours have also struggled with how NPOs can competitively generate revenue without compromising their values. Former American non-profit leader Dan Pallotta, author of the 2008 critically acclaimed book *Uncharitable* has argued that society's "economic apartheid" of the for-profit

[473] Testimony of Tim Draimin, Social Innovation Generation, to the Standing House of Commons Committee on Industry, Science and Technology, Meeting No. 43, 40th Parliament, 2nd Session, November 16, 2009, at 15:40.

and non-profit sectors "undermines our ability to eradicate great problems and, ironically, puts charity at a severe disadvantage to the for-profit sector at every level."[474] His concerns stem from both legal and economic restraints as well as social and cultural restraints that the public has placed on the non-profit sector. He argues that in five key areas – compensation, risk-taking, long-term vision, advertising, and capital investment – NPOs are stunted because there is a public expectation that every dollar donated goes directly to the needy. The anti-capitalist sentiment that pervades the non-profit sector (and particularly its donors) puts non-profits in "a one-legged footrace with a competitor in a Ferrari."[475] Pallotta points to the following: NPOs cannot (1) be paid competitive compensation packages for fear of looking greedy; (2) take innovative risks for fear of being wasteful; (3) invest in long-term solutions because immediate short-term needs are expected to prevail; (4) adequately purchase advertising over concerns they are being extravagant; and (5) raise capital or provide a financial return leaving the for-profit sector monopolizing the capital markets. He argues that "[i]f we allow charity to use free-market practices, we will see an increase in the money being raised, more effective solutions, and a circular reinforcement that will further increase investment in solving the great problems of our time."[476] He insists that the limitations placed on the non-profit sector preventing the eradication of a great deal of human suffering, and therefore are immoral. Pallotta's book has been endorsed by several heads of prominent charities and NPOs, and highlights a level of unrest that seems to have been permeating the American non-profit sector for some time.

Tightening regulations and the decrease in financial resources directly impact the

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[474] Pallotta, *supra* note 15 at 9.

[475] *Ibid.* at 43.

[476] *Ibid.* at 46.

sector's effectiveness in the advancing the social economy and contributing to the public advocacy process. Specifically in regard to charities, one reporter for Charity Village asks the poignant question, "are charities apathetic or afraid?," citing several instances in which the Canadian government has increased its scrutiny on the political activities of charities, leaving charities less keen to pursue prominent advocacy roles for fear of jeopardizing their tax exempt status.[477] Dwindling resources have posed significant challenges on infrastructure and day-to-day operations, while the increase of project-based funding may redirect goals and place time limits on achieving long-term solutions. Having a greater proportion of funding directed at specific projects also influences how NPOs address their advocacy needs.

It should be noted that decreasing donations to the non-profit sector, as well as greater compliance requirements, may not be seen by some as negative. For example, what is the ideal number of donations for the non-profit sector, from a social welfare perspective? Neoclassical scholars may argue that the right amount is the amount that is received, no more, no less. If that means less NPOs as a result, then likely they were not serving a purpose that justified their existence. Others may argue that heightened compliance requirements and greater levels of accountability are warranted, despite the strain on NPOs, in order to prevent corruption. Take for example Portland Hotel Society (PHS) Community Services, a Vancouver-based NPO that provided social housing to Vancouver's Downtown East Side. At the time, it was North America's only safe-injection site. A 2013 KPMG audit conducted for the provincial government revealed that PHS had at least eight spinoff companies owing PHS almost $500,000,

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[477] Heather Yundt, "The Politics of Advocacy: Are Charities Apathetic or Afraid?" Charity Village, 1 October 2012, online: <https://charityvillage.com>.

"present[ing] and elevated risk of fraud, corruption, and abuse."[478] In 2014, an audit led by BC Housing and Vancouver Coastal Health revealed that PHS is "in weak financial shape, is more than $113,000 into its bank overdraft and drew $1.2 million from lines of credit and a business loan."[479] Several expenses that did not fit the mandate of the NPO were also exposed in the audit, such as luxury trips for managers at expensive hotels and other questionable expenditures such as limousine rides, spa gifts, etc.[480] Stories like PHS, extraordinarily egregious as it may be, provide solid justification in requiring stringent levels of compliance. If NPOs exist partly to solve the agency problem that exists between donees and the third parties they seek to help, then higher levels of compliance may be necessary to ensure NPOs play their role properly.

It is unclear what the next few decades will mean for the non-profit sector, whether it will expand or shrink, whether it will be a driving force in social change, or if, instead, social entrepreneurs will flock to other corporate models in order to actualize their ideas and accelerate their social businesses. In Canada, the sector is at an impasse. The CRA has become more restrictive in its interpretation of the *ITA* and its crackdown initiated in 2012 on charities violating the "political activities" restrictions, including the launch of 60 political activities audits, led to accusations of an "intimidation campaign" by Stephen Harper's Conservative government in purposefully targeting left-leaning organizations.[481] It is unclear whether the new Liberal government under Prime Minister Justin Trudeau will scale back on these types of audits,

[478] Lori Culbert & Rob Shaw, "Portland Hotel Society Spinoff Companies Set Off 'Alarm Bells' in Audit" *Vancouver Sun* (27 March 2014), online: <www.vancouversun.com>.

[479] *Ibid.*

[480] Frances Bula, "Nonprofit Service Agencies Under Greater Scrutiny in Wake of PHS Scandal," *The Globe and Mail* (1 April 2014), online: <www.theglobeandmail.com>.

[481] Dean Beeby, "Sierra Club Latest Environmental Charity Hit by Revenue Canada Audits" CBC News (30 April 2015), online: <www.cbc.ca>.

but for many the prognosis is good. Regardless, the ongoing controversy has left an indelible mark on non-profit leaders that engage in advocacy, and may have given the next generation of non-profit leaders pause. There seem to be more and more justifiable reasons for social entrepreneurs to avoid using the non-profit form. Is this a problem? On one end of the spectrum, proponents would argue that the erosion of the non-profit sector is a significant pervasive problem that speaks to the heart of social value ordering in society. For others, particularly those holding a neoclassical perspective, a slow erosion of the non-profit sector does not necessarily mean more should be done to bolster it. It may simply mean that there is less need, or that this need is being met elsewhere. These complex arguments are not being solved any time soon. But what we see in the next section are reactions from industry to circumvent restrictions that seem to be inhibiting the ability for NPOs to achieve social change.

3.3 Growth of the Social Enterprise

The past decade has been one of rapid change as the growth of commercial NPOs and supporting organizations has begun to grow at a significant pace. First, a brief word on the terminology. As seen earlier, the term "commercial NPOs" has been widely used by scholars, particularly economic scholars that study the non-profit sector. Outside academia however, the descriptor of "commercial NPO" is rarely used and innovators within the non-profit sector – and interestingly, the for-profit sector – have elected to adopt the more nuanced term of "social enterprise" to describe their activities.

There is considerable disagreement within and among nations as to the definition of "social enterprise." The term has generally been used quite broadly by organizations, with the tendency to encompass both (1) enterprising non-profits, which can be considered as NPOs "exploring the development of business activities for the dual purposes of generating revenue and furthering their mission"[482] and (2) for-profit businesses "whose primary purpose is the common good."[483] In the United States and the United Kingdom, the emphasis has been to focus on the latter definition as what comprises a social enterprise – NPOs are not generally incorporated into the definition.[484] On the other hand, Social Enterprise Canada has elected to concentrate only on the NPO component, and define social enterprises more narrowly in that respect, calling them "businesses owned by nonprofit organizations that are directly involved in the production and/or selling of goods and services for the blended purpose of generating income and achieving social, cultural, and/or environmental aims."[485] None of the above organizations attempting to define social enterprises are governmental bodies, and indeed, several for-profit companies in Canada have chosen to identify themselves as social enterprises, despite the lack of an NPO as a controlling shareholder. It is evident that the term is in its early developmental stages, with little regulatory intervention or clarity, and its usage continues to be treated differently among groups.

Social Enterprise Canada has offered four reasons for why there has been rapid growth of social enterprises across the nation: (1) the general understanding that there are some needs the market will never meet on its own; (2) the opportunity for entrepreneurs to advance mission-related goals; (3) the diminished and changing nature of government funding; and (4) the

[482] Centre for Social Innovation, "Enterprising Nonprofits Toronto," online: <http://socialinnovation.ca/enp>.

[483] Specifically, the Social Enterprise Alliance defines social enterprises as "businesses whose primary purpose is the common good. They use the methods and disciplines of business and the power of the marketplace to advance their social, environmental and human justice agendas." Social Enterprise Alliance, "The Case for Social Enterprise Alliance," online: <www.se-alliance.org/why>.

[484] See e.g., Social Enterprise UK, "What are Social Enterprises?," online: <www.socialenterprise.org.uk>.

[485] Social Enterprise Canada, "What is a Social Enterprise?," online: <www.socialenterprisecanada.ca>.

promise of social enterprise as a vehicle for social innovation.[486] Many organizations within each sector have struggled to properly identify their dual mandates to funders, investors, and policymakers. Many NPOs are including for-profit arms or formally incorporating for-profit subsidiaries, as well as finding other creative and at times legally questionable ways to get around laws that hamper their abilities to grow and utilize the engine of the market to disseminate social goods and services.

Social entrepreneurship has gained significant momentum, and several articles have come out trumpeting the potential innovation of social enterprises. The growing popularity of several hubs, such as MaRS Discovery District, and notable journals, such as the *Stanford Social Innovation Review,* which began in 2003,[487] showcase a rising interest in bridging the for-profit/non-profit divide to address some of the world's most pressing social and environmental challenges.

As noted earlier, there have been criticisms with the growing commercialization of NPOs. Weisbrod in particular has voiced his concern, arguing that the rationale behind tax breaks for NPOs is due to the fact that they offer goods and services that are valuable for society, but would otherwise be unprofitable to provide. Citing numerous of examples, he finds that "in short, the drive for profit exposes nonprofits to the charge of losing sight of their social goals."[488] For Weisbrod, because of the various legal and reputational risks involved, he recommends

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[486] Social Enterprise Canada, *The Canadian Social Enterprise Guide, 2nd ed*., (Enterprising Non-Profits, 2010), online: <www.socialenterprisecanada.ca> at 4.

[487] The Stanford Social Innovation Review describes on its website that it is "written for and by social change leaders in the nonprofit, business, and government sectors who view collaboration as key to solving environmental, social, and economic justice issues," online: <www.ssireview.org/>.

[488] Burton Weisbrod, "The Pitfalls of Profits: Why Nonprofit Organizations Should Get Out of Commercial Ventures," (Winter 2004) 2:3 Stanford Social Innovation Review 40 at 44.

NPOs avoid commercial activities that distract them from their mission.

As more NPOs and for-profit companies express the desire to pursue both social and economic value in their mandates, policymakers and legislators have struggled to keep up with the pace of innovation.[489] Weisbrod asks an important question: "Can public policy encourage nonprofits to provide unprofitable but socially desirable outputs without also creating incentives to seek funds in ways that undermine the nonprofits' capacity to act in the public interest?"[490] The increased ambiguity between for-profit and non-profit actors has led legislators to implement new corporate entities in order to address increasing demands for change. And while "there's no magic answer,"[491] it certainly seems there are several countries that are willing to give it a try.

Who is involved in deciding what kind of society we want to live in? Large scale corporate actions wield enormous power, and it is foolhardy to believe that political actions are necessarily separated from corporate influence and powerful lobbying efforts, or that regulators and corporate actors at elite levels are distinctly separate.[492] The ability of large corporations to marshal their power means voices from smaller organizations and every day citizens are easily drowned out. While the imbalance of corporate power may easily push NPOs to seek more funding sources as the solution in gaining a stronger, more competitive voice in the advocacy

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[489] Paul Martin, Canada's former prime minister, when commenting on the increase of social enterprises, noted: "Government policy hasn't caught up…I think Canada is ready for it. I think Canada is looking for it." Wingrove, *supra* note 17.

[490] Weisbrod, *supra* note 488 at 46.

[491] *Ibid.*

[492] In the US, the Supreme Court decision in *Citizens United v Federal Election Commission* 130A S Ct 876 (2010), which eliminated the ban on corporate political spending, could magnify this point in the future. See also Adam Liptak, "Justices, 5-4, Reject Corporate Campaign Spending Limit: Dissenters Argue that Ruling Will Corrupt Democracy," *The New York Times* (22 January 2010).

process, the funding challenges put NPOs at an incredible disadvantage. NPOs may need to quickly innovate in order to create self-sustaining economic opportunities that can increase their impact in the social economy while also amplifying their voice within the public policy advocacy process, but there are risks. Some may argue that the rise of commercial NPOs are closer to corporations wrapped in sheep's clothing, and end up only further dampening marginalized voices from within the non-profit sector. These proponents may favour hybrids as a way of ensuring the core of the non-profit sector remains untouched, or may disfavour them entirely on the fear that hybrids will only divert scarce resources away from the sector. The spectrum of opinion may be vast and the inability to foresee what may happen from particular sets of circumstances leaves much to be desired.

CHAPTER 4: Global Emergence of Hybrid Corporate Legal Structures

A new generation of alternative legal entities is emerging on the global horizon. These corporate structures – which have been called hybrids, blended enterprises, and socially responsible enterprises, among other names – combine traditional for-profit and non-profit legal characteristics in their design to compel businesses to pursue both economic and social mandates, and each contain features that may be particularly attractive for those currently situated in either the for-profit or non-profit sectors. These new legal entities such as the community interest company in the United Kingdom, and the benefit corporation and low-profit limited liability company in the United States, are some alternative models for businesses that wish to have governing infrastructure to support their social value output in addition to profit. Other countries, such as Australia, Belgium, Greece, Denmark, Japan, South Korea, and Israel are also in the early stages of developing hybrids.[493] Some of these hybrids have gained significant usage and traction in their home nations, others have not. Restrictions on dividends, obligations on directors to consider community interests, and community purpose asset locks are only some of the unique governing features. Conceptual boundaries surrounding the for-profit/non-profit divide are being tested as hybrid structures begin to grow in recognition.

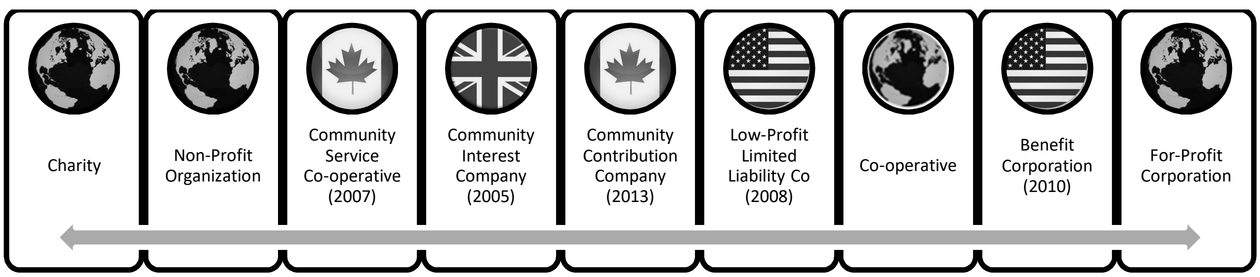
Below is a chart highlighting how current Anglo-American hybrid corporations are situated within existing corporate alternatives. On one end of the spectrum, charities[494] are the most legally restrictive in terms of profit generation as their main purpose is to produce social

[493] For more on Belgium, Greece, and Denmark, see Tineke Lambooy & Aikaterini Argyrou, “Improving the EU Legal Environment to Enable and Stimulate Social Entrepreneurship as a New Economic Structure,” (April 2014) 11:2 European Company Law 70. Japan and South Korea have indicated an interest in the UK CIC; Office of the Regulator of Community Interest Companies, “Annual Report 2012/2013,” online: <www.bis.gov.uk>.

[494] Note that all charities are NPOs, but not all NPOs are charities.

value under certain heads of charity recognized by the law, and thus charities receive the greatest tax advantages and ability to issue donation receipts. On the other end of the spectrum are for-profit corporations, which have a much debated corporate purpose in scholarship but generally can be regarded as entities pursuing the singular objective of profit-making. Social gains resulting from corporate actions are considered ancillary, subordinate, and/or supporting this singular objective. The hybrids listed below are compared relative to each other within that spectrum, from the most restrictive and socially-focused, to the least restrictive and profit-focused. If the entity only exists within a particular nation, then that nation's flag is shown.

Figure 1: Anglo-American hybrid legal structures



Corporate hybrids are legal innovations that have received little scrutiny from scholars to date. This lacuna is largely because they are very new institutional phenomena. In the corporate context, a hybrid can be defined as a corporate legal structure that contains legal features which require the dual pursuit of economic and social mandates. The emergence and development of corporate hybrids signifies the beginning of a new institutional tool for the CSR movement. New hybrid institutions are providing opportunities for entrepreneurs seeking to house social enterprises while also attempting to counterbalance private sector negative externalities, affirming that "the independence of social value and commercial revenue creation is a myth."[495] This chapter addresses five "next generation" alternative legal structures that have appeared in the United Kingdom, Canada, and the United States within the last decade, that have, or are in the process of, recalibrating efficiency within their design and integrating a social mission into corporate governance. These hybrids offer a peek at the potential future of CSR and sustainability and how these concepts can be built into an organization's governing infrastructure, while also pointing out potential challenges. They are as follows: the community interest company, the community contribution company, the low-profit limited liability company, the B Corporation (privately regulated), and the benefit corporation. None of these hybrids receive special tax treatment.

4.1 United Kingdom: Community Interest Company

The community interest company (CIC) was the very first of the new generation of hybrids. Implemented in the UK in 2005, CICs are established to trade goods or services for the community interest.[496] The particular novelty of CICs is that they are able to do what charitable and non-profit organizations cannot, which is raise equity capital in exchange for shares. CICs are designed to enable and encourage the investment of private wealth into community projects.

To qualify for CIC status, interested parties must first pass a "community interest test" administered by the CIC Regulator, a public official who has "a continuing monitoring and enforcement role" over CICs.[497] An interested party submits to the CIC Regulator a declaration

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[495] Julie Battilana, et al, "In Search of the Hybrid Ideal" (2012) Stanford Social Innovation Review 51 at 52.

[496] *UK Companies Act*; *The Community Interest Company Regulations 2005*, No. 1788 [*CIC Regulations*].

[497] *Ibid.* at s. 27, s. 35, and Schedule 3; see also Department for Business, Innovation and Skills, "Community Interest Companies," online: <www.bis.gov.uk/cicregulator>.

that it is not an excluded company engaged in political activity[498] and a “community interest statement” indicating that the company will carry on its activities for the benefit of the community as well as how those activities will indeed create a benefit.[499] The CIC Regulator may elect not to allow a party to become a CIC if a reasonable person might consider that the activities only benefit “the members of a particular body or the employees of a particular employer.”[500] The stated community purpose of the CIC becomes a primary focus for CIC directors.

The most noteworthy features in the CIC are its asset lock and dividend cap. The asset lock restricts CIC assets and profits from being either transferred for full fair market value (to ensure the CIC continues to retain the value of the assets transferred), or transferred to another CIC subject to an asset lock or a charity, or is otherwise made for a community benefit.[501] This simple feature helps to ensure that assets which are intended for community benefit remain in that realm. Entrepreneurs interested in establishing a CIC need to pay particular attention to this feature. Once a business is established as a CIC, there are permanent, long-term consequences. Dividends on CIC shares and interest on bonds are capped to ensure that profits are either retained by the CIC or used for a community benefit purpose; cap amounts are set by the Regulator.[502] The dividend cap purports to ensure an ongoing reasonable balance between the interests of shareholders and the community interest.

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[498] *UK Companies Act*, s. 35(6); *CIC Regulations*, Reg. 6.

[499] *CIC Regulations*, Reg. 2.

[500] *Ibid.* at Reg. 4.

[501] *UK Companies Act*, s. 30, 31; *CIC Regulations*, Part 6.

[502] *UK Companies Act*, s. 51.94.

In addition to the asset lock and dividend cap, CICs have annual reporting requirements where they must account for how their hybrid has benefited the community and engaged stakeholders.[503] Stakeholder interests are prominent in the CIC model. CICs are recommended to form stakeholder advisory groups for the CIC's benefit and each CIC crafts its own individualised stakeholder process. The CIC is required to describe its stakeholder efforts in an annual report, which is placed on a public register at Companies House[504] and reviewed by the CIC Regulator.[505] The latter can reject a CIC's report or require revisions before it is accepted.[506]

The CIC Regulator plays a seminal role in administering and maintaining CICs in the UK. The Regulator's role is seen as one with "a light touch regulation and an emphasis on proportionality."[507] In addition to having the power to investigate complaints, the Regulator may also act if a CIC is found to be violating its community purpose or asset lock provisions, change the makeup of the board, or even terminate a CIC when necessary. Along with ensuring proper registration and regulation of CICs, the Regulator has also been important in addressing big picture issues. In the CIC 2011/2012 annual report, the Regulator identified public concerns that CICs were taking away resources and business from the charitable sector, noting fears in these early years with "private sector intrusion into public service delivery."[508] This trend is a challenge that many hybrids catering to the non-profit sector will have to address in the early

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503 *Ibid.*, s. 8.1.1.

504 Companies House, online: <http://www.companieshouse.gov.uk/>.

505 *CIC Regulations*, Part 7.

506 *Ibid.*

507 Office of the Regulator of Community Interest Companies, "Annual Report 2011/2012," online: <http://www.bis.gov.uk> at 15.

508 *Ibid.* at 7.

years.

Research on the CIC model is limited. Hybrids are faced with attempting to balance financial interests and enforceable rules to integrate social mandates, but each frequently seem to trade-off against the other.[509] One scholar notes that the CIC form "faces the most serious obstacles to enhancing financing, by virtue of the dividend cap and asset lock…Yet, the very same…mechanisms endow the CIC with the staunchest commitments to social good of all the forms."[510] In addition to these mechanisms, "the possibility of private enforcement by shareholders and public enforcement by the CIC Regulator make the CIC a particularly unique corporate form encapsulating dual mandates.[511]

The legal characteristics of the CIC may come across as too limiting for many of those currently situated in the for-profit sector. The market for corporate control is disrupted by the asset lock and dividend cap, and entrepreneurs who envision broader market dissemination by way of acquisition by larger corporations will not clamour toward this model. The CIC, therefore, tends to be more attractive for those in the non-profit sector. Since a CIC structure allows capital to be raised through the issuance of shares, it creates economic opportunities that have traditionally been closed off to charitable and non-profit organizations. As well, a CIC structure may be more attractive to individuals or groups wanting to start community projects or programs but have little interest in relationships based on membership such as those found in a cooperative.

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509 Dana Brakman Reiser, "Governing and Financing Blended Enterprises" (2010) 85 Chicago-Kent L Rev 619 at 654.

510 *Ibid.* at 654.

511 *Ibid.* at 630-636.

The number of CICs reached over 12,000 as of June 2016.[512] There were over 2,000 CICs created in 2012 alone.[513] It is reported that over 100 new CICs are registered every month,[514] and a considerable number of CICs have survived the three-year mark. With respect to cooperatives, sources indicate there are presently over 5,933 independent cooperatives in the UK, with the UK cooperative economy at £35.6 billion and approximately 13.5 million members.[515] There are no equivalent statistics available on CICs' monetary contributions to the UK economy, the average size of CICs, or total members. But if it is simply a numbers game, do over 12,000 CICs spell success after 15 years in existence? Compared to the number of cooperatives, the answer seems to be yes.

4.2 Canada: Community Contribution Company

The surge of CICs in the UK garnered the attention of Canadian social entrepreneurs, and eventually led to several public consultations and inquiries at both the federal and provincial levels as to whether such a model would be feasible in the country. In 2009 – 2010, the House of Commons Standing Committee on Industry, Science and Technology conducted a statutory review of the *CBCA* and explored the issue of special incorporation structures for hybrids. On that issue, the Committee recommended that the government conduct a broad public consultation within two years as to whether the *CBCA* should be amended and a separate regulator possibly created to support a special kind of hybrid with both profit-making and non-profit goals, noting

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[512] Twitter account of the Office of the Regulator of Community Interest Companies (@TeamCIC), reports 10,601 registered CICs as of 11 April 2016, and 12,221 as of 21 June 2016, online: <https://twitter.com/TeamCIC>.

[513] Office of the Regulator of Community Interest Companies, *supra* note 507 at 13. 590 CICs were also dissolved, with key reasons for dissolution being "lack of funding, no trading activity, and poor corporate governance." *Ibid.*

[514] CIC Association, "What is a CIC?," online: <http://www.cicassociation.org.uk/about/what-is-a-cic>.

[515] Co-operatives UK, "About Co-operatives," online: <http://www.uk.coop/co-operatives>.

that the hybrid could be similar to an American low-profit limited liability company or a UK CIC.[516] Alternatively, the Committee questioned whether such an enterprise could already be created under the existing *CBCA*. Submissions were invited to explore the utility of socially responsible enterprises in the Canadian context and the extent to which current *CBCA* incorporation provisions and structures facilitate their creation.

Likely in reaction to these federal inquiries as well as in response to growing demands from local social enterprises in both the for-profit and non-profit sectors, the BC provincial government created an advisory committee in 2010 to explore the possibility of creating a new hybrid form within the province. Members from these consultations included representatives from several NPOs including a number of charities, one for-profit corporation – Tyze Personal Networks, Ltd., a self-identified social enterprise that was majority owned by an NPO, Plan Institute for Caring Citizenship (Tyze),[517] a small number of lawyers, and other stakeholders. Following these meetings, in January 2011, the Ministry of Social Development and Social Innovation created the BC Social Innovation Council to make recommendations "on how best to maximize social innovation... with an emphasis on social finance and social enterprise." Council members were "drawn from government, Aboriginal and community organisations, and business agencies with an interest in social entrepreneurship, including credit unions, foundations, academics, local and/or provincial government, business, investors, social entrepreneurs and innovators."[518] It should be noted that two of Tyze's board members became members of the

[516] Statutory Review of the Canada Business Corporations Act, Report of the Standing House of Commons Committee on Industry, Science and Technology, Meeting No. 43, 40th Parliament, 3rd Session, 25.

[517] The author of this article attended the meeting as a representative of Tyze. Discussions from the meeting are bound by confidentiality agreements.

[518] BC Social Innovation Council, "Action Plan Recommendations to Maximize Social Innovations in British Columbia" (March 2012), online: Government of British Columbia <http://innovationbc2011.crowdvine.com> .

Council. The Council reported that it received feedback from individuals and organizations in the community and the non-profit sector as well as youth, academic, business and government stakeholders.

In March 2012, the British Columbia government announced the creation of a new hybrid model, the community contribution company (C3). That same month, the Council presented 11 action items, including that the provincial government should complete the work to establish C3s as a new corporate structure. The Council noted how the C3 "could have widespread application in BC ranging from environmental service companies to business development platforms for Aboriginal and rural communities."[519] The C3 hybrid was made available to the public in July 2013, and along with the increased development of a social and policy framework to maximize social innovations in BC, the province quickly gained a reputation as "Canada's Social Silicon Valley."[520]

Nova Scotia followed suit, announcing the adoption of a hybrid similar to the C3 in November 2012 which received Royal Assent December 2012 with enacted legislation still forthcoming.[521] These provincial hybrids are each modeled after the UK CIC in that they are designed to allow traditional NPOs the ability to make a profit while keeping the social mission intact through stringent limitations on their distribution of capital. The Canadian federal government has also begun to consider paralleling this international trend. In 2014, following up with recommendations from the House of Commons Standing Committee, Industry Canada

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[519] *Ibid.* at 11.

[520] Patricia Marcoccia, "Innovation Gathering in Canada's 'Social Silicon Valley'" (21 November 2013) *Axiom News*, online: Urban Matters <www.urbanmatters.org>.

[521] Nova Scotia Canada, *supra* note 19.

opened for consultation a review of certain provisions within the *CBCA,* including a specific request for comments on adopting a federal version of the BC C3 model.[522] The comment period for the *CBCA* public consultation closed on 15 May 2014.[523]

The BC C3 hybrid has several noteworthy similarities to the UK CIC, particularly its asset lock, dividend cap, and annual reporting requirements. Like the CIC, the legal characteristics of the C3 make it particularly attractive for those in the non-profit sector in need of raising money through share capital rather than traditional funding sources– which may be a significant number. C3s may also be able to borrow against capital assets at potentially more favourable rates, and also appease social investors seeking to ensure that the social purpose of their investment vehicle cannot be removed. The C3 will allow those that were previously situated in the non-profit sector to freely utilize the market as an engine to disseminate goods and services while being unrestricted from purposefully generating a profit, all the while ensuring that social mandates remain intact.

The differences thus far in the BC version of the CIC are mainly administrative. The provincial government indicated at the start of the legislative process that it had no funding to promote or educate the C3 model to the public, something opposite to the substantial rollout that was produced at the start of the UK CIC. Furthermore, the provincial government has elected not to include the accountability mechanism of a regulator dedicated to the hybrid form, as found in the UK. Rather than passing a community interest test with regulatory approval, interested

[522] Industry Canada, *supra* note 21.

[523] As of 15 June 2016, Industry Canada has not commented any further on the proposed amendments to the *CBCA*.

parties are able to become a C3 through unanimous shareholder approval.[524] A C3 is required to indicate in its articles of incorporation that it is a C3 "and, as such, has purposes beneficial to society,"[525] which is somewhat vague terminology that may prove challenging if the C3 were to significantly gain in numbers. Because of the restrictive nature of the asset lock, legislators want to ensure all shareholders (including non-voting shareholders) are aware of the legal restrictions in the C3 model and approve of them, which differs from the practice in for-profit corporations, where typically only a majority – or on some occasions, a super majority – of voting shareholders is required. For conversions from other corporate entities, that means that no minority shareholder can be forced into a C3 model. Below is a table that outlines some of the key features embodied within the BC C3:

Table 1: Features of the BC Community Contribution Company

Name	Must have in its name either "Community Contribution Company" or the abbreviation "CCC."
Community Purpose	Required to have a community purpose that is beneficial to either the society at large or a segment of the society that is broader than those persons who are related to the C3. Purpose must be set out in its Articles, and its Notice of Articles must contain a specific statement making it clear that it is a C3, and outlining the asset lock and dividend cap restrictions.
Board of Directors	Minimum of three (3) directors are required. Directors are required to act with a view to the community purposes of the company as set out in its Articles.

[524] *BC Business Corporations Act*, [SBC 2002], C 57, s. 51.97.

[525] *Ibid.* at s. 51.911

Asset Lock	Restricted from transferring its assets for anything less than fair market value, unless the transfer furthers its community purposes, is to a qualified donee as defined in the ITA, or is to a community service co-operative as defined in the BC *Cooperative Associations Act*. Transfer of assets to a person that is related to the company is also prohibited. In essence, the idea is that the assets cannot go to an organization that is not otherwise subject to limitations on how its assets may be transferred.
Dividend Cap	Maximum annual dividend currently set at 40% of profit of the organization according to GAAP principles (plus any portion of the unpaid dividend amount for any previous year). This restriction does not apply to shareholders that are registered charities and other qualified donees as defined in the ITA. There is no cap on bonds (differing from the UK CIC).
Reporting Requirements	Required to annually publish a Community Contribution Report detailing certain activities including: (1) the total amount of dividends declared on all classes of shares; (2) the identity of shareholders receiving dividends; and (3) remunerations exceeding $75,000.
Tax Status	No additional tax benefits. Not exempt from income tax and cannot issue income tax receipts for gifts or donations to the C3.
Dissolution	60% of its assets on dissolution must go to another entity under a similar asset lock, such as another C3, or a qualified donee as defined in the ITA, or a community service co-operative as defined in the BC *Cooperative Associations Act*.

Appendix A lists out the registered BC C3s as of April 2016. While it is early in the process for BC, and only 35 C3s have been created as of that date, there is a question as to whether in the future the lack of a regulator to monitor C3 compliance will be problematic if the model were to become more widely adopted. The C3 is only required to publish its annual report in the same manner that companies are required to publish financial statements and auditors' reports under the applicable provincial acts for standard corporations.[526] It remains to be seen how the BC version will evolve in comparison to the UK CIC, despite having less regulatory infrastructure and governmental oversight, and no direct official to contact. In comparison, the

[526] *Ibid.* at s. 51.96.

UK CIC Regulator's office has three full-time and four part-time staff members, and reported that in 2012 there were over 7,000 emails and 3,000 phone calls to their office.[527] C3s do not have this support; administering and governing C3s are entirely through self-regulation. Some foreseeable risks in less regulatory infrastructure and governmental oversight include confusion among the public, minimal or improper adherence to regulations, eroded credibility in the model, and a lack of focus on big picture issues, among others. On the other hand, these concerns may be non-issues given the slow pace in which the C3 model is being adopted, and some of the regulatory void may be filled by other sources. For example, in anticipation of the C3, the BC Centre for Social Enterprise provided a small number of free workshops to educate interested parties on the details of the C3 model.[528] Another example is Accelerating Social Impact CCC, a newly formed C3 in BC whose purpose is to assist and advise social impact businesses on a variety of matters including legal options.[529] Other organizations may also step up.

As aforementioned, UK CICs have only existed since 2005, and research on the CIC model is limited. In the early years of the UK CIC's development, one scholar noted that the model "assumes [there is] a pool of investors with an appetite for wedding financial and social return and sufficient brand awareness and confidence to appeal to them…[It also] however, requires these investors to be especially devoted to the blended enterprise concept by substantially limiting the upside of their investments."[530] While it seems that this has not posed a problem for the UK CIC given its numbers, the note of caution is also warranted for the C3 in the

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[527] Regulator of Community Interest Companies, *supra* note 507 at 13.

[528] BC Centre for Social Enterprise, "Community Contribution Companies Are Coming," online: <www.centreforsocialenterprise.com/C3_BC.html>.

[529] Accelerating Social Impact CCC, online: <http://asiccc.ca>.

[530] Brakman Reiser, *supra* note 509 at 649.

embryonic years of a hybrid's development. The growth of impact investing in BC and Nova Scotia suggests that there are social investors who can balance these economic and social interests in order to sustain the C3 model, and presumably legislators would not have pursued hybrid legislation without some assurances of a means to support it, but one can only surmise.

Given the slow uptake in the C3 model's first year of existence, some explanation seems to be warranted. Some industry leaders have suggested that BC NPOs contemplating a conversion to the C3 form may find the requirement to produce an annual Community Contribution Report costly and onerous. Margaret Mason notes that "given the additional flexibility accorded to qualified donees by the legislation, [the Community Contribution Report] would be the most significant difference to using a business corporation for a social enterprise and while certainly providing a "brand" advantage, it may not provide any significant financial advantage."[531] The lack of a tax benefit may also cause NPOs to question the worthiness of conversion – the ability to raise equity capital must outweigh the NPO tax advantage. To date, it seems that BC social entrepreneurs and existing organizations are not finding the C3 model as innovative an alternative as the social entrepreneurs that have eagerly adopted the similar model in the UK, but it is unclear if this is a conscious choice or if the model is simply unheard of for many BC NPOs. Effective promotion, education, and regulation of the C3 model, as well early incentives, such as an initial pool of social finance to gain a critical mass of early adopters, would likely be the minimum necessary for this model to catch on. The BC government's lack of support beyond drafting such legislation may be shown in time to be fundamentally detrimental to C3 development in the province; however, speculation as to why there has been little interest

[531] Margaret Mason, "British Columbia's Innovation: Community Contribution Companies" (2013) Charity Talk: Newsletter of the National Charities and Not-for-Profit Law Section of the Canadian Bar Association, online: <http://www.cba.org>.

in adopting the C3 form is only that thus far – speculation.

In introducing the new C3 model to BC, BC Minister of Finance Michael de Jong announced that it would bring "meaningful, local employment in BC and generate economic wealth for [the] province."[532] There may also be hidden benefits from BC's secondary start. Canadian legislators and regulators would be wise to translate the eight to nine year lead from UK CICs into a latecomer advantage and identify where BC can benefit from the UK's experience, such as in determining valuation tools for setting dividend caps, or whether there have been actual tensions between the new CIC form and existing NPOs in terms of the sharing of resources, if at all. As put by Joel Solomon, chair of Vancouver-based Renewal Funds, "The devil is in the details. New models require testing and refinement, along with extra support of early adopters, or they are simply a public relations exercise … time will tell if it's a symbolic gesture or if there is real commitment to social goods."[533] Further research will be crucial for optimal results in the implementation of hybrids in Canada – if indeed other provinces follow suit – as well as ongoing support from both corporate and individual leaders in the for-profit and non-profit sectors.

For now, it seems that the C3 model in BC is more at risk of simply becoming irrelevant to the discussion – after its first year, there were only 14 registered C3s in BC, and after two years since its creation, there were 33 registered C3s. There is, unfortunately, precedence for unused – and therefore irrelevant – hybrid models. Another BC hybrid that seems virtually unknown, the community service co-operative, has only had 12 entities registered since its

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[532] Brenda Bouw, "B.C.'s New Business Model Makes It Easier to Make Money and Give Back" *The Globe and Mail* (9 August 2013), online: <www.theglobeandmail.com>.

[533] *Ibid.*

creation in 2007. Whether or not C3s will be headed in the same direction of community service co-operatives is yet to be determined. The likelihood that there will be changes to the status quo in the advocacy process due to hybrid development seems low at this stage in BC's non-profit sector history.

4.3 United States

4.3.1 Low-Profit Limited Liability Company

Accommodating for particular federal tax laws was the main motivator behind the first American hybrid, the low-profit limited liability company (L3C), which began in the state of Vermont in April 2008.[534] The L3C model is designed to house program-related investments (PRIs) under existing Internal Revenue Service (IRS) rules to enable foundations to better invest in PRIs without the fear of compromising their tax-exempt status. Robert Lang, identified as "the creator of the L3C,"[535] along with Carol Coren describes the L3C as "the for-profit with the non-profit soul" because "[b]y law, the "DNA" of the L3C brand ensures that profit is second to its social mission."[536] As of early 2013, L3C legislation had been adopted in nine states and two federally recognised Native American tribes.[537]

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534 Vt. Stat. Ann. tit. 21, § 3001(27) (2009); Vermont Secretary of State: Corporations Division, "Low-profit Limited Liability Company," online: <http://www.sec.state.vt.us>.

535 Robert Lang, "Letter from the Creator of the L3C," online: <http://www.americansforcommunitydevelopment.org>. Lang is the CEO of the Mary Elizabeth and Gordon B. Mannweiler Foundation.

536 Carol Coren & Robert Lang, "The L3C: The For-Profit with the Nonprofit Soul" (Winter 2009-2010) Bridges, online: Federal Reserve Bank of St. Louis <www.stlouisfed.org>.

537 In addition to Vermont, legislation has been passed in Illinois, Louisiana, Maine, Michigan, North Carolina, Rhode Island, Utah, Wyoming, and the federal jurisdictions of the Crow Indian Nation of Montana and the Oglala Sioux Tribe. For more on state legislation, see Americans for Community Development, "Laws," online: <http://www.americansforcommunitydevelopment.org/legislation.html>; see also J William Callison & Allan W Vestal, "The L3C Illusion: Why Low-Profit Limited Liability Companies Will Not Stimulate Socially Optimal Private Foundation Investment in Entrepreneurial Ventures" (2010) 35 Vermont Law Review 273 at ftn 3 (which lists all L3C legislation by state).

The problem that the L3C hybrid has been designed to address is as follows. First, foundations are non-profit organizations or charitable trusts that provide grants to unrelated organizations or individuals for charitable purposes. Under IRS rules, private foundations are required to pay out a "distributable amount" (which equates to at least 5 per cent) of their assets each fiscal year in order to maintain their tax-exempt status.[538] They may elect to spend their funds in two ways: through grants, where there is no financial return on their investment, or through PRIs, which may provide a potential return.[539] To qualify as a PRI, the investment "must be related to the foundation's mission and the risk-to-reward ratio must exceed that of a standard market-driven investment," meaning the risk must be higher and the return lower.[540] "Jeopardizing investments' under IRS rules can subject private foundations to considerably high excise taxes.[541] A PRI is sheltered from designation as a jeopardizing investment if its primary purpose "is to accomplish one or more of the [organization's exempt] purposes... and no significant purpose…is [for] the production of income or the appreciation of property"[542] or expenditures for political purposes.[543] Many foundations are reluctant to invest in for-profit entities due to the uncertainty of whether they would qualify as PRIs, despite the potential return.

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[538] The distributable amount is determined in Internal Revenue Code 4942 and the applicable regulations; see also Internal Revenue Manual, s.16, "General rules governing required distributions," online: <http://www.irs.gov> at 7.27.16.1.1. and 7.27.16.2. The Internal Revenue Manual notes that Section 823 of Public Law 97–34 reduced the required payout for private foundations so that they must distribute only their minimum investment return, statutorily defined as 5 per cent.

[539] *Ibid.*

[540] Jim Witkin, "The L3C: A More Creative Capitalism" (15 January 2009), online: <http://www.triplepundit.com>; Internal Revenue Code 170(c)(2)(B).

[541] Internal Revenue Manual, C. 27, s. 18, "Taxes on Investments which Jeopardize Charitable Purposes," online: IRS <http://www.irs.gov>; see also Internal Revenue Service, "Private Foundation Excise Taxes," online: <http://www.irs.gov>.

[542] Internal Revenue Code at § 4944(c).

[543] *Ibid.* at §4945.

The "burdensome and costly" IRS requirements to verify PRIs mean that "[o]f the many thousands of grant making foundations in the United States, only a few hundred make PRIs."[544] For the 2000 and 2001 fiscal years, PRIs were estimated as constituting approximately 0.45 per cent of the total grant and PRI output by private foundations.[545]

Enter the L3C, which has been designed to make it easier for foundations to make PRIs by bridging the gap between for-profit and non-profit agendas. The LLC choice of entity is particularly favourable because of its flexibility,[546] and the LLC state laws provide the base for L3C laws to build upon. It is clear from the wording of the L3C laws that the entity was created solely to meet PRI criteria.[547] Lang notes that "since the L3C is a legal business form with specific requirements…members are constrained to write the operating agreement in a manner consistent with L3C law," which then specifies its PRI-qualified purpose.[548] All the limitations accompanying an L3C essentially mirror the language set forth in the IRS rules, including that the L3C would not have been formed but for its charitable or educational purpose, which is meant to assure foundations that their tax-exempt status will remain secure if they make a PRI in an L3C model.

Foundations, nevertheless, have sought further assurances from the IRS. While IRS private letter rulings (PLRs) are not required prior to a foundation making a PRI, many prefer the

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[544] GrantSpace, a service of the Foundation Center, "What is a Program-Related Investment?," online: <http://grantspace.org>.

[545] Callison & Vestal, *supra* note 537 at ftn. 4.

[546] *Ibid.* at 625.

[547] Brakman Reiser, *supra* note 509 at 622.

[548] Robert Lang, "The L3C: Background and Legislative Issues," online: <http://www.americansforcommunitydevelopment.org> at 5.

comfort of one given the risks. In the early years of its development, many advocates of the L3C model sought legislative support and/or a blanket PLR from the IRS specifically identifying L3Cs as entities that automatically qualified for PRIs. The proposed "Program-Related Investment Promotion Act of 2008" attempted to have L3C entitled to a rebuttable presumption that below-market investments from foundations qualified as PRIs.[549] The proposal did not end up being introduced to US Congress and thus was not successful in producing new federal legislation or IRS rulings. Similarly, a subsequent attempt with the proposed "Philanthropic Facilitation Act of 2011"[550] was tabled before Congress. It attempted to provide a simple IRS registration and approval process to prevent foundations from spending considerable time and money obtaining PLRs each time a PRI was sought by an L3C. The proposed legislation also did not result in any federal action.

In May 2012, the IRS released proposed regulations that provided nine additional examples of investments that qualify as PRIs.[551] These regulations make no mention of the L3C but serve to better illustrate the application of the existing regulations, which may or may not help justify the existence of the L3C. Critics of the L3C model have argued that the L3C has "little to no value" without accompanying federal legislation or an IRS ruling.[552] Furthermore, opponents have questioned whether L3Cs "could divert charitable assets from non-profit

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[549] Mannweiler Foundation Inc., "The Program-Related Investment Promotion Act of 2008: A Proposal for Encouraging Charitable Investments," online: <http://www.cof.org>.

[550] Philanthropic Facilitation Act of 2011 (H.R.3420); Americans for Community Development, "Proposed Federal Legislation' (15 November 2011), online: <http://www.americansforcommunitydevelopment.org/proposedfed legislation>; GovTrack, "H.R. 3420 (112th) Philanthropic Facilitation Act," online: <http://www.govtrack.us>.

[551] Internal Revenue Bulletin 2012-21, "Notice of Proposed Rulemaking Examples of Program-Related Investments" Reg.-144267-11 (21 May 2012), online: <www.irs.gov>.

[552] Callison & Vestal, *supra* note 537 at 274.

organizations," as well as how L3Cs will be monitored "to ensure that profit remains secondary to the charitable purpose and investors do not receive an improper benefit," among other things.[553] Lang and the organization behind the L3C, Americans for Community Development, have often found themselves on the defensive regarding the viability of the model.[554] Lang has since conceded that "the IRS is not going to ever rule on the blanket acceptability of the L3C as an entity… The IRS has no preference positive or negative, as to business organizational structure. They are interested only in that the resulting structure uses the charitable invested dollars to further an allowable exempt purpose."[555]

It is unlikely the L3C will have global reach given its specificity and close adherence to jurisdiction-specific US federal tax rules. It remains to be seen how the L3C hybrid will fare in the US given the purposeful omission by the IRS in recognizing the role of, or even the existence of, L3Cs in regard to PRIs. It is unclear if foundations have been particularly drawn to L3Cs – certainly the hybrid provides greater assurance in regard to PRIs than for-profit entities, but the IRS's silence on the matter has been deafening. As of March 2013, there were 777 L3Cs in operation, and it is inconclusive whether to date L3Cs have helped increase the percentage of PRIs relative to total grant and PRI output from foundations.[556]

4.3.2 B Corporation (Privately Regulated)

Consideration of stakeholder interests has generally been allowed in for-profit

[553] Christopher Reinhart, "Low-Profit Limited Liability Companies or L3Cs" (7 October 2011) Connecticut General Assembly, Office of Legislative Research, online: <http://www.cga.ct.gov>.

[554] Lang, *supra* note 548 at 23.

[555] Robert Lang, "L3Cs and the IRS," online: <http://www.americansforcommunitydevelopment.org>.

[556] InterSector Partners L3C, "Here's the Latest L3C Tally" (8 March 2013) online: <http://www.intersectorl3c.com> (numbers based on active L3Cs reported by Secretaries of State); Lang reports there are about 1,000 L3Cs that have been formed since 2008. Lang, *supra* note 555 at 5.

corporations under several US state laws since as far back as the 1980s, when the corporate takeover boom saw several states implement "other constituency" (also known as "nonshareholder constituency"[557] or "corporate constituency"[558]) legislation. Such laws expressly permit (and in at least one state, require[559]) directors to consider interests of groups in addition to shareholders in decision-making, often particularly contemplating takeover situations.[560] A large majority of states are now other constituency states [561] – only sixteen states to date have not implemented such legislation.[562]

B Lab is a Philadelphia-based non-profit organization that began in 2008 and has capitalised on the other constituency statutes. B Lab has created a certification system that builds upon those statutes by requiring corporations to enshrine stakeholder interests into their governing documents. The B Corporation certification is unique in this regard; B Lab has elected to address governance issues in a way that is unrivalled by other CSR certifications on the market. Self-imposed and privately regulated, B Lab is attempting to establish a new kind of company, one that "harnesses the power of business to solve social and environmental

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[557] Stephen Bainbridge, "Interpreting Nonshareholder Constituency Statutes" (1992) 19 Pepperdine Law Review 991.

[558] Lawrence Mitchell, "A Theoretical Framework for Enforcing Corporate Constituency Statutes" (1992) 70 Texas Law Review 579.

[559] *Connecticut Business Corporations Act*, Sec. 33-600.

[560] For more on this, see Andrew Keay, "Moving Towards Stakeholderism? Constituency Statutes, Enlightened Shareholder Value and All That: Much Ado About Little?" (2010), online: <http://ssrn.com>; Bainbridge, *supra* note 557; Mitchell, *supra* note 558.

[561] Kathleen Hale, "Corporate Law and Stakeholders: Moving Beyond Stakeholder Statutes" (2003) 45 Arizona Law Review 823 at 833 and ftn. 78.

[562] B Corporation, "Corporation Legal Roadmap," online: <http://www.bcorporation.net>.

problems."[563] The founders of B Corporation have also been influential in persuading state legislators to create "benefit corporations" in several American states (examined in the next section), so there is particular value in understanding the motivations behind the creation of that hybrid through an examination of the B Corporation. As of early 2013, there were over 580 American B Corporations and B Lab is actively marketing its branding internationally, with 57 Canadian B Corporations, and 35 B Corporations residing in countries outside the US and Canada.[564]

In order to become a B Corporation, a company is first required to take a "B Impact Assessment" which surveys issues relating to accountability, employees, consumers, community, and the environment. A corporation is certified by B Lab once an acceptable score is obtained under their rating system (80 out of 200), and the company is required to submit supporting documents for a portion of the answers.[565] B Lab relies on the assessment and a separate auditing system to ensure B Corporations are pursuing and achieving their social mandates. Within an allotted time following certification, B Corporations must amend their articles of incorporation requiring directors to consider more than just shareholder interests when carrying out their duties.[566] In the past, a company must already be incorporated in an "other constituency" state, or must re-incorporate in one in order to make such amendments and be a certified B Corporation. B Lab is now allowing companies that are incorporated in states without this legislation to simply build stakeholder interests into a signed term sheet, with an understanding that if the

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563 B Corporation, online: <http://www.bcorporation.net>.

564 B Corporation, "B Corp Community," online: <http://www.bcorporation.net/community>.

565 B Corporation, "Become a B Corporation," online: <http://www.bcorporation.net/become-a-b-Corp>.

566 *Ibid.*

company's resident state eventually creates a benefit corporation, the company will adopt benefit corporation status by the end of their two-year certification term.[567]

American B Corporations are directly carved out of the findings in the well-known judicial case of *Revlon Inc. v MacAndrews v. Forbes Holdings, Inc.* (*Revlon*).[568] In the case, the Supreme Court of Delaware held that directors owe a fiduciary duty to maximise shareholder value in takeover contexts, regardless of nonshareholder stakeholder interests. The *Revlon* decision is generally regarded as the leading judicial precedent in support of shareholder primacy in corporate America, and B Lab has elected to address the matter head on. The requirement by B Lab that a director "shall" consider various stakeholder interests is an interesting one. Obligating directors to consider nonshareholder stakeholders, rather than simply permitting them to do so, is a significant legal difference. Such duties hold directors to a much higher standard, although B Lab's language includes the insertion of "as the Director deems relevant," a subjective standard that softens the obligation considerably, and echoes the common law position. American courts have validated the business judgment rule, meaning that the courts will defer to the board's judgment so long as the directors brought an appropriate degree of diligence in reaching a reasonable business decision at the particular time that it was made.[569] So, provided that the board's decision is within a range of reasonable alternatives, a court will always defer to that judgment.

While the numbers are sizable given the grassroots nature of the B Corporation, the number in existence is of course infinitesimally small when compared to the number of

[567] B Corporation, *supra* note 562.

[568] *Revlon, Inc.* v *MacAndrews and Forbes Holdings, Inc.*, 506 A2d 173, ALR 4th 157 (Del Sup Ct 1985).

[569] *Grobow v. Perot*, 539 A.2d 180 (Del. 1988) (which outlines the business judgment test).

corporations in the United States, which, according to the US Census Bureau, totals over twenty-seven million businesses.[570] The growth of the B Corporation has been slow and steady since its inception in 2008, much like the L3C. Dana Brakman Reiser cautions that "it remains to be seen whether this system will have strong teeth."[571] She comments that:

> [T]he B corporation form realistically offers only moral, rather than legal, assurances to non-shareholder constituencies and social interests. Stakeholders have no structural rights in governance, and no additional parties are granted standing to litigate. B corporation directors are empowered to act in the interests of other constituencies; whether they do so will depend on their own desires or feelings of moral obligation.[572]

Given that B Lab is a private organization, it does not have the authority to manipulate existing legal structures. Instead, it works with existing laws to guide corporations to change their framework. The B Impact Assessment goes to the core of the business purpose and mission, and addresses stakeholder and sustainability concerns. Corporations may choose to become B Corporations so they can align themselves with like-minded companies. The B Corporation branding may "draw in directors committed to a blended mission and investors willing to enforce it."[573] It could one day be a certification popularly recognizable to consumers. As a strategic movement that has tapped on the shoulders of business leaders and politicians for support, the B Corporation may become meaningful in educating companies how to integrate CSR principles into their governance practices.

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[570] US Census Bureau, "Statistics About Business Size (including Small Business) from the U.S. Census Bureau," online: <http://www.census.gov/econ/smallbus.html> (this number is as of 2009; more recent statistics are unavailable).

[571] Brakman Reiser, *supra* note 509 at 643.

[572] *Ibid.* at 642.

[573] *Ibid.* at 643.

Admittedly, B Corporations are loosely regulated, if at all. B Lab is a small organization that is not equipped to regulate numerous companies effectively, particularly given its additional involvement in legislative policymaking and sharp focus on marketing its brand. B Lab's motivation has tended to lean towards attracting mass participation, not ensuring proper regulation. B Lab's standards are considerably weaker in comparison to other CSR certifications that are available on the market.[574] It thus becomes a question of balance. There is some value to be had in generating a buzz and creating the impression of momentum, but the trade-off with mass inclusion is usually a lowering of standards. There may be a backlash from genuine "good" companies that are reluctant to sign on due to low standards; one executive commented that joining the B Corporation movement would be like "sprinkling holy water on the process," as standards they have set for themselves and expect from their competitors are markedly higher than B Lab's offerings.[575] So the question is, is B Corporation a mass movement for change, or does it simply allow companies to market themselves better – and if so, is this sufficient? Is there any meaning underneath the branding? There is certainly value in garnering collective strength from numbers, and legitimised advertising. Perhaps the value of aligning businesses with common interests through the B Corporation branding outweighs the need for high quality standards and adequate regulation. While B Lab's focus has understandably been on establishing the B Corporation name, B Lab will have to be careful that its ongoing effort to gain mass participation does not dilute its branding to the point where it carries little meaning.

[574] Some examples include the Global Initiative for Sustainable Ratings (GIRS), and standards provided by the Sustainable Accounting Standard Board and International Integrated Reporting Council.

[575] Comments made in a private interview by executives at Innate, an active gear company committed to clean design, online: <www.innate-gear.com>.

4.3.3 Benefit Corporation

Following intensive lobbying by B Lab and their supporters in several American states, the states of Maryland and Vermont became the first to pass benefit corporation legislation in 2010, facilitating new corporate structures designed to create both social benefits and shareholder value.[576] Maryland's benefit corporation laws took effect in October 2010[577] and Vermont's in July 2011.[578] In addition to Maryland and Vermont, benefit corporation legislation had been enacted in 23 states, and 15 other states are said to be in the interim stages of considering such legislation.[579] The governing features in benefit corporations vary somewhat from state to state, but the main common features across several of the states echo those that were first enacted in Maryland and Vermont, thus these two states are used as the example.

The ostensible purpose of a benefit corporation is to create a general public benefit, which is defined as "a material positive impact on society and the environment, as measured by a third-party standard, through activities that promote [some] combination of specific public benefits."[580] A corporation seeking benefit corporation status must include or make a clear and prominent statement in its articles that it is a benefit corporation.[581] There are no specific criteria to qualify as a benefit corporation so long as proper company approvals have been met, and that also applies if a company wishes to withdraw from being a benefit corporation. Existing state

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576 Corporate Social Responsibility Newswire, "Maryland First State in Union to Pass Benefit Corporation Legislation" (14 April 2010), online: <http://www.csrwire.com>; Outdoor Industry Association, "Vermont Becomes Second State to Pass B Corporation Legislation" (2 June 2010), online: <http://www.outdoorindustry.org>.

577 *Corporations and Associations*, Md. Code Ann. tit. 5 § 5-6C-01 (2010) [*Maryland Act*].

578 *Vermont Benefit Corporations Act*, Vt. Stat. tit. 11A § 21 (2011) [*Vermont Act*].

579 Benefit Corp Information Center, "State by State Legislative Status," online: <http://www.benefitcorp.net>.

580 *Maryland Act*, § 5-6C-01(c); *Vermont Act*, § 21.03(4).

581 *Maryland Act*, § 5-6C-03, § 5-6C-05; *Vermont Act*, § 21.05.

corporate laws are to fill any holes left in the benefit corporation laws.

A significant aspect of the benefit corporation laws is the codification of stakeholder interests in directorial decision-making. In Maryland, a director is required to consider the effects of any action or decision not to act on stockholders,[582] employees, subsidiaries, suppliers, customers, community and societal considerations, and the local and global environment.[583] Vermont has an additional sixth factor, encompassing "the long-term and short-term interests of the benefit corporation, including the possibility that those interests may be best served by the continued independence of the benefit corporation."[584] In contrast to the standard articulated in *Revlon*, this addition provides substantially the same protection as the similar provision offered by the B Corporation model by relieving directors of the duties to maximise shareholder value in a takeover situation.

In Maryland, the director has no duty (fiduciary or otherwise) to a person who is a general public beneficiary of the benefit corporation. Vermont, however, has actually gone a step further in expanding the definition of fiduciary duties for their directors.[585] Vermont directors have fiduciary duties only to those persons entitled to bring about a proceeding against the

582 In Maryland and certain other states, the term "stockholder" is used instead of "shareholder."

583 *Maryland Act*, § 5-6C-07(a)(1). Vermont has some *de minimis* differences in wording. See *Vermont Act*, § 21.09(a).

584 *Ibid.*, § 21.09(a)(1)(F). The explicit inclusion offers symbolic vindication for Vermont, home of the socially-minded ice cream business, Ben & Jerry's Homemade, Inc., whose board in 2000 had multiple offers to purchase the company but had no choice but to sell to the highest offer or risk a shareholder lawsuit. Ben & Jerry's Homemade, Inc., News Release, "Ben & Jerry's and Unilever to Join Forces" (12 April 2000) online: <http://www.benjerry.com>. But see Anthony Page & Robert A Katz, "Freezing Out Ben & Jerry: Corporate Law and the Sale of a Social Enterprise Icon" (2010) 35 Vermont L Rev 211, which argues that Ben & Jerry's had strict anti-takeover defenses that their board declined to test, and that negative reactions to the sale of social enterprises may be misguided as such sales may create more opportunities for social enterprises to do good work. Ben & Jerry's have since become the first wholly-owned subsidiary to be a B Corporation. CSRWire, "Ben & Jerry's Joins the Growing B Corporation Movement" (22 October 2012), online: <http://www.csrwire.com>.

585 *Vermont Act*, § 21.09(e).

benefit corporation. A "benefit enforcement proceeding" means a claim or action against a director or officer for failing to pursue the public benefit purpose set forth in its articles, or for violating any duty in the statute. These persons have been identified as shareholders, directors, persons or group of persons that own 10 per cent or more of the equity interests in an entity where the benefit corporation is a subsidiary, or any other persons specified in the articles of the benefit corporation.[586] While the expansion may seem slight, it is important. Shareholders, and shareholders of any parent company, can bring proceedings against the benefit corporation for violating the broader, codified stakeholder interests.[587] However, directors have the same immunity from liability as directors of regular for-profit corporations. So unless they did not act diligently, or their acts constitute fraud or negligence, the courts are unlikely to intrude upon a director's business judgment.

A benefit corporation is responsible for creating an annual benefit report, with Vermont requiring board approval prior to the report being sent out to shareholders.[588] The report is required to include: (1) a description of how the benefit corporation pursued a public benefit during the year and the extent to which the public benefit was created; (2) any circumstances that hindered the creation of the public benefit; and (3) an assessment of the societal and environmental performance of the benefit corporation, prepared in accordance with a third-party

[586] *Ibid.*, § 21.13(b).

[587] Vermont's expansion of duties thus has required setting out proper parameters of the directors' duties. See *Vermont Act*, § 21.09(a)(3). Directors are not subject to a different or higher standard of care when decisions may affect the control of the benefit corporation. *Ibid.* at § 21.09(a)(4). As well, a director is not liable for the failure of a benefit corporation to create general or specific public benefit. Directors have the same immunity from liability as directors of those state's corporations generally.

[588] *Maryland Act*, § 5-6C-08(a).

standard.[589] Vermont includes more explicit instructions on how the report must be constructed, such as outlining specific goals or outcomes, disclosing the amount of compensation paid to each director and the name of each shareholder owning 5 per cent or more of the shares.[590] These additions add a heightened level of transparency and accountability that echoes some of the disclosure requirements of public companies.[591] Vermont also has created the requirement for one director of the board to be designated as a benefit director, who is required to be independent, and prepare an annual statement detailing whether, in the opinion of that director, the company acted in accordance with its benefit purpose, and if not, why.[592] This statement and the annual benefit report are to be delivered and approved by the shareholders and also posted on the company website.

There have been recent offshoots within the benefit corporation movement, specifically the "social purpose corporations" (SPC) in California,[593] Washington, and Florida.[594] These other forms of benefit corporations have caused some confusion in the movement. SPCs are said to allow and enable businesses to consider social and environmental issues in corporate decision-making, providing "a framework to allow companies to maximize financial returns and to promote positive impact on the company's employees, community and/or the environment."[595]

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[589] Vermont has also required a statement of the specific goals or outcomes, and actions that can be taken to attain them while improving its social and environmental performance. See *Vermont Act*, § 21.14(a)(1)(D).

[590] *Ibid.*, § 21.14(a)(4)-(7).

[591] *Vermont Act*, § 21.14(b) and § 21.14(d); *Maryland Act*, § 5-6C-08(b), (c).

[592] See e.g. *Vermont Act*, § 21.10.

[593] *California State Assembly Bill 361; California State Bill 201*. The SPC in California was originally named the "flexible purpose corporation" and renamed an SPC in 2015.

[594] *Washington State House Bill 2239*; *Florida Business Corporations Act*, Title XXXVI, s. 607.502.

[595] "Social Purpose Corporations," online: <http://spcwa.com/>

Yet some of these states SPC models offer an even lighter alternative to the mainstay corporation than the benefit corporation, as their legal provisions only ensure the permissibility of considering social and environmental issues rather than requiring it. This presumably is already in the case in states with "other constituency" statutes, so their creation should be somewhat puzzling for corporate legal scholars and ultimately may be in response to a need for a social enterprise brand of corporation rather than any specific legal need.

Nevertheless, a potential alternative to shareholder primacy has been created to combat negative corporate behaviour that may be damaging to broader community, environmental, or other stakeholder interests. The question is whether social entrepreneurs, particularly those currently situated in the for-profit sector, will be attracted to the benefit corporation model, or its offshoots. Along with the relative newness of the entity, several states do not track the names and number of benefit corporations, so it is difficult to determine how many are currently in operation.[596] Nevertheless, the benefit corporation seems to be a very positive development for American corporate governance reform, as it is designed to address American corporate governance needs for social progress. The development of benefit corporation laws promotes a more stakeholder-based model with supporting infrastructure to encourage an active level of social responsibility, and it will be interesting to see how it fares in its critical nascent years of development. An important research enquiry will be to measure and quantify the contribution that benefit corporations ultimately make towards sustainable development and other stakeholder concerns.

[596] Benefit Corp Information Center, "Find a Benefit Corp," online: <http://www.benefitcorp.net/find-a-benefit-corp>.

4.4 The Future of the Hybrid Sector

There is now a movement underfoot that has attempted to sidestep the shareholder primacy model, allowing businesses to pursue both economic and social mandates in their corporate decision-making through alternative legal structures. This emerging generation of hybrid corporate legal structures is beginning to come into focus on the global stage. The next few decades will be very telling as to the success of hybrid legal structures, and whether they gain any traction in entrepreneurial practice. The global hybrid phenomenon is serving as a live experiment putting to test ongoing research informing business leaders that long-term vision, sustainable purposes, and multi-stakeholder collaboration are essential for the long-term success of the firm.[597] Hybrids are providing opportunities for entrepreneurs seeking to house social enterprises while also attempting to counterbalance private sector negative externalities and affirm that "the independence of social value and commercial revenue creation is a myth."[598] Investors in hybrids are aware of the social mandates embodied within these entities and the particular legal limitations regarding financial upsides, if any, meaning that hybrid investors, by nature, are social investors.

There are potential issues arising within any jurisdiction introducing a new hybrid into the roster of alternatives. Hybrids may funnel away resources traditionally used by charities and NPOs, such as corporate donations, etc.[599] There is the risk that mainstream corporations may feel they have little obligation to consider social issues or environmental concerns, which are

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[597] Barton & Wiseman, *supra* note 293; Robert G Eccles, Ioannis Ioannou, & George Serafeim, "The Impact of a Corporate Culture of Sustainability on Corporate Behavior and Performance," (14 November 2011) Harvard Business School Working Paper No 12-035 (finding that high sustainability firms outperformed by 4.8% per year in 18 year period).

[598] Battilana, *supra* note 495.

[599] Regulator of Community Interest Companies, *supra* note 507 at 7.

now supposedly left for hybrids and NPOs to address. Some corporations may already hold the view that social and environmental concerns should be resolved solely by the public sector, among other reasons. Regulators may also be motivated to hold similar views. Hybrids may end up only satisfying a niche market that, once saturated, is ineffectual in promoting any significant social change. Others may argue that corporations have no place in addressing social needs in the first place – profit motivations may skew intentions, supporting a neoliberal agenda rather than a search for the common good. Some may argue that certain hybrids are redundant or offer little to already existing corporate alternatives, and their entrance only muddies the waters for entrepreneurs. The discussions that are just beginning to take shape among industry leaders and scholars with respect to the hybrid phenomenon are multifaceted, nuanced, oftentimes based more on conjecture rather than probative research in these early years. There are thus several big picture issues to consider in research, such as how these models are situated within local and global social economies, how they balance alongside other alternatives, how they are to be treated as subsidiaries in corporate groups, and if they indeed take away from resources that are more greatly needed elsewhere or if instead they create an influx of private cash into the social sector. There is also an important question as to whether tax and other laws should be adjusted to accommodate these models, and if so, exactly how.

Considering the potential risks associated with the onslaught of hybrids is critical, but one should also consider the risks in maintaining the status quo, and the potential upside that may be realized from this global trend. While there is always the potential for a particular hybrid to become a disruptive innovation[600] in a nation's corporate sector, working its way up the

[600] The term "disruptive innovation" is used liberally here, as it is often used to refer to technological advances. For more on disruptive innovation, see Chapter 7.

market and eventually displacing the mainstream model, the likelihood of this occurring is slim. As discussed in Section 2.2, entrenched ideological beliefs and path dependence will make it very difficult to uproot the established power structure, and pragmatically, it is questionable how hybrids would infiltrate global multinational enterprises and similar well-established forms of industry. It is likely that most hybrids will settle within a niche sector of the market, operating more as a small supplement relative to the mainstream corporate model rather than as one that may overtake it. Nevertheless, hybrids are beginning to play an important role in challenging the mainstream model and forcing legislators to contemplate the legal limitations within that model. They are "a reminder to the international community that it is possible to pursue both economic viability and social responsibility."[601] Hybrids may be integral in growing the social economy and significantly enhancing sustainable practices, if the jurisdiction calls for it and legislators are strategic in their deployment. There is untapped potential to be had in the correct implementation of hybrids within a nation's corporate landscape.

[601] United Nations, Department of Economics and Social Affairs, "Co-operative Enterprises Build a Better World" (26 October 2011), online: <http://social.un.org>.

PART TWO: The Canadian Hybrid Experiment and Early Lessons

CHAPTER 5: A Canadian Model of Corporate Governance

The global development of corporate hybrids has not been without setbacks. There have been winners and losers in the hybrid game. The UK CIC has been – with some exceptions of course – heralded as a successful model, and BC and Nova Scotia legislators seem to be banking on its relative success to justify a Canadian version. On the other hand, the American low-profit limited liability company is in many ways an example of a failed model. Its ineffectiveness has led to a plateau in numbers and ultimately, dormant law.

Canada is an interesting country in which to study the growing development of social enterprise law. Ranked 5th in the 2015 World Happiness Report,[602] and consistently ranked as one of the best places to live in the world in the United Nations Annual Human Development Report,[603] Canada is currently a live Petri dish of hybrid experimentation. The C3 and CIC appearing in two provinces, murmurings within other provinces on other hybrids, and Industry Canada requesting in its *CBCA* public consultation for more information on "socially responsible enterprises" are a few of the signals pointing towards more widespread adoption of hybrids if all goes well. Canada is at a critical juncture where international hybrids are being tested on home turf. This Chapter 5 builds the necessary foundation in which to ascertain the value of hybrid laws – through the examination of existing laws. There is no way to fully understand an 'alternative' without first comprehending the thing to which the 'alternative' is being compared

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[602] John Helliwell, Richard Layard, & Jeffrey Sachs, eds, "World Happiness Report 2015," online: <http://worldhappiness.report/>.

[603] United Nations Development Programme, "UN Human Development Report" (various years), online: <www.undp.org>.

against.

For Canada in particular, understanding the existing laws on the corporation are somewhat challenging. Despite the significant role that Canadian corporations play in national issues, corporate legal scholarship does not seem to be an expanding field of study in Canada. Edward Waitzer, commenting on Canada's proximity to the United States and its relatively small governance community, noted this apparent stagnation in scholarship.[604] Analysis of Canadian corporate governance is often quietly lumped together with American legal scholarship, under the assumption that the fundamentals of Canadian governance simply mirror those in the United States. While there is some merit to this stance – Canada does have features that in many ways reflect and respond to those in the United States – just as there are cultural similarities between the two nations, there are also stark differences.[605] For example, when remarking on Canada's relatively strong financial position following the GFC in a speech to the Institute of Corporate Directors, Purdy Crawford stated:

> How were we able to do this? [...] Ultimately all this has been possible because of our culture. We are so very different from our great neighbour to the south where the rule seems to be if something is not prohibited, you can do it. For better or for worse, we are more accepting of regulation.[606]

Crawford went on to add that while the United States "is the greatest wealth-generating society in the world…this great characteristic has also resulted in great excesses."[607]

[604] Edward Waitzer, "Corporate Governance Reform – Discussion Paper" (26 October 2012) [draft with author].

[605] Davis, *supra* note 211 at 981.

[606] Purdy Crawford, "Canada – The Great Recession and the Evolution of Corporate Governance" Speaking Notes for the Institute of Corporate Directors (9 June 2011) [draft with author].

[607] *Ibid.*

This Chapter 5 will explore the Canadian model of corporate governance, particularly where it differentiates from the shareholder primacy model discussed in Chapter 1, if at all. Canada's corporate legal development serves as a country-specific test as to whether the implementation of social enterprise law can help to advance the social economy. Canada is a particularly useful Petri dish because BC has already adopted the UK CIC and Nova Scotia is in the works, and there are other provinces such as Ontario that are contemplating the adoption of an American hybrid model, the state benefit corporation. These hybrids cater to different sectors – the features of a Canadian CIC version is expected to appease those currently situated in the non-profit sector more so than in the for-profit sector due to its economic constraints. On the opposite end of the spectrum, the legal characteristics of the American benefit corporation are most similar with those already found in a regular for-profit corporation, thus are likely to be more attractive for entrepreneurs and venture capitalists eager to identify as a social enterprise without relinquishing any profit-making capabilities.

As outlined in Section 4.2, the very slow start of the BC community contribution company puts a significant question mark on the utility of that model in the province – time will tell as to whether or not significant traction will be gained, but the diagnosis in these early years is not good. Furthermore, increased pressure surrounding the possible implementation of the American benefit corporation makes the need to understand Canada's existing governance model all the more critical. If the benefit corporation is designed mainly to address American corporate governance needs for social progress, then before Canada elects to adopt similar laws, there must first be an accurate depiction and understanding of Canada's own legal position. This will ensure that Canada does not simply adopt an American solution to an American problem that is not reflective of Canada's current legal stance, if indeed there is a distinction to be had. Any nation considering the adoption of hybrid corporations into their own laws must conduct a thorough analysis of their existing corporate alternatives and how they function in corporate practice, so as to better project how the intrusion of new alternative corporate models will fare.

Corporate governance models are frequently addressed in Anglo-American corporate legal scholarship, with shareholder primacy touted as the dominant model that governs modern corporations.[608] As seen in Chapter 1, common themes in academic debate include whether shareholder primacy is efficient and whether it should be the dominant model, among other things.[609] However, for many of Canada's legal practitioners, theoretical models of governance are foreign to the day-to-day functioning of providing legal services that support good governance practices within corporations. Academic discussions on shareholder primacy and counter-hegemonic alternatives as discussed in Chapter 2 are rarely put to the test against the backdrop of Canadian corporate practice.

The act of recognizing a Canadian model of corporate governance has its own set of challenges. As one practitioner interviewed for this study noted:

> Many Canadian executives and directors have been schooled on US-style governance and that is just a function of the US market being so much bigger—SEC rules, media, scandals, etc…When you are trying to study corporate governance as a director or a CEO might, it is easy to assume that Canadian corporate governance is one and the same as US corporate governance.[610]

Shareholder wealth maximization is frequently cited as a fundamental feature in American

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[608] See e.g., Hansmann & Kraakman, *supra* note 2; Elson, *supra* note 385. Shareholder primacy is also frequently assumed to be the dominate model in articles that critique it, see e.g., Stout, *supra* note 244.

[609] See e.g., Lee, *supra* note 103; Fisch, *supra* note 103.

[610] Practitioner #22. Practitioners interviewed for this Chapter 5 have been assigned random numbers for attribution to certain lengthier quotes, in order to aid readers in identifying whether particular comments are from the same or a different practitioner. When a practitioner's specific words are used to describe the sentiment of a number of practitioners, a specific reference is not used in some instances.

corporate governance (not excluding of course, criticisms against this norm that still continue to acknowledge its strong presence).[611] Canadian corporate legal scholars have also assumed the prevalence of shareholder primacy in modern day corporations, while often ignoring issues of differentiation between Canada and the United States.[612] While growth of corporate governance as a field of study in the past few decades has been formidable, Canadian legal scholars often rely on American research due to the lack of Canadian-specific scholarship, and much of the theoretical analysis has blurred country lines.

How can one offer alternatives to a nation's mainstream model, if the mainstream legal model is itself misunderstood? As Canadian legislators begin to move toward the implementation of hybrids, the question must be asked: What *is* Canada's actual legal model to govern its corporations? The answer to that question is the first step in determining how Canada should proceed in the adoption of corporate hybrids, if at all.

This Chapter 5 outlines the parameters of a Canadian model of governance. Appendix B outlines the methodology of this chapter. Interviews were conducted with 32 leading senior legal practitioners across Canada, who spoke candidly on matters involving shareholder primacy, director duties, stakeholder interests, common law and the courts, regulatory bodies, corporate norms, and the future trajectory of Canadian corporate governance, among other things. The observations from these senior practitioners provide a pulse check on the Canadian governance landscape, providing frank and thoughtful insights on some of the fundamental principles that

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[611] See e.g. Fisch *supra* note 103 at 637 (asserting that shareholder primacy "defines the objective of the corporation as maximization of shareholder wealth"); Bainbridge, *supra* note 103(describing two principles of shareholder primacy: the shareholder wealth maximization norm and the principle of ultimate shareholder control); Berle & Means, *supra* note 3.

[612] See e.g. Janis Sarra, ed, *Corporate Governance in Global Capital Markets* (Vancouver: UBC Press, 2002).

drive the decision-making of Canadian corporations. Taken within the context of today's legal and regulatory environment, these insights piece together the framework of a Canadian model as a baseline to properly establish hybrids in the country, while also helping to inform future research.

Section 5.1 begins by outlining a widely-held academic definition of the shareholder primacy model of corporate governance, made up of five core principles, and puts it to test against Canadian corporate legal practice. Section 5.1.1 examines the question of who should have ultimate control of the corporation, and draws upon practitioners' observations regarding the current debates on shareholder rights plans and other defensive tactics in Canada. Next, Section 5.1.2 delves into a discussion on the management of the corporation, and the question of whether "best interests of the corporation" and "best interests of the shareholders" is a significant or negligible difference in Canadian corporate law. In Section 5.1.3, practitioners consider the role of stakeholder interests in corporate decision-making, and offer their thoughts on the landmark *BCE* decision and how its findings have affected Canadian corporations, if at all. Section 5.1.4 then addresses the protection of minority shareholder interests, and Section 5.1.5 considers whether the market value of a company's shares should be regarded as the principal measure of shareholders' interests. Finally, Section 5.2 provides a broader overview of Canada's legal and regulatory landscape governing Canadian corporations. How have the courts helped to form Canadian corporate governance? What has been the securities commissions' role? The chapter concludes with some overall remarks on the outline of a Canadian model and how that informs on whether certain hybrids should or should not be implemented in the future.

5.1 Examining the Legal Principles of Canadian Corporate Governance

As discussed in Section 1.2, Henry Hansmann and Reinier Kraakman's 2001 article

"The End of History for Corporate Law" argued that the basic law of corporate governance across nations had already achieved a high degree of uniformity to the shareholder primacy model and that "continuing convergence toward [this] single, standard model is likely."[613] According to Hansmann and Kraakman, some key normative principles in this consensus include:

> (1) ultimate control over the corporation should rest with the shareholder class;
>
> (2) the managers of the corporation should be charged with the obligation to manage the corporation in the interests of its shareholders;
>
> (3) other corporate constituencies, such as creditors, employees, suppliers, and customers [which, together with shareholders, are included as "stakeholders"], should have their interests protected by contractual and regulatory means rather than through participation in corporate governance;
>
> (4) noncontrolling shareholders should receive strong protection from exploitation at the hands of controlling shareholders; and
>
> (5) the market value of the publicly traded corporation's shares is the principal measure of its shareholders' interests.[614]

Practitioners were provided with Hansmann and Kraakman's definition of shareholder primacy, and asked if they found the definition to be an accurate depiction of Canadian corporate governance. They were invited to weigh in on each of the five principles, and discussions followed from there.

5.1.1 Control of the Corporation

Principle: *"Ultimate control over the corporation should rest with the shareholder class."*

[613] Hansmann & Kraakman, *supra* note 2 at 439.

[614] *Ibid* at 440-41. There seems to be little contention in legal scholarship regarding Hansmann and Kraakman's definition of shareholder primacy. See e.g., Bainbridge, *supra* note 4 at 573 (which describes two principles of shareholder primacy: the shareholder wealth maximization norm and the principle of ultimate shareholder control); Fisch, *supra* note 3 at 637 (which asserts that shareholder primacy "defines the objective of the corporation as maximization of shareholder wealth"); Lee, *supra* note 103 at 535 (which defines shareholder primacy as "the view that managers' fiduciary duties require them to maximize the shareholders' wealth and preclude them from giving independent consideration to the interests of other constituencies").

Several practitioners agreed that, in Canada, control belonged with the shareholder class – but with caveats. The principle of ultimate shareholder control was described as "mostly right," "correct subject to general laws of the land," and "somewhat true but with very significant exceptions." Many focused on the shareholders' abilities to elect and remove directors as signifying ultimate control, but pointed out that this control was limited and far removed from the day-to-day control exercised by the board and management. Three practitioners likened the control of shareholders to that of voters in a democratic country, where "as citizens of the country, our voting franchise is how we elect our representatives." Directors are the elected officials who now "have obligations to everybody and, ultimately, they have to answer to electorate or the shareholders."[615] Shareholders therefore are not in a position to decide the specific measures that a corporation will take in executing or adopting business plans. In that sense, there is ultimate control but "on a day-to-day basis, control really rests with the board for resolution."[616]

A small minority of the practitioners supported greater shareholder control since shareholders are the ones that have taken on the financial risk. However, one practitioner put it in the context of the corporation's existence, pointing out that when the company's financial situation has deteriorated "the party that's economically at risk is the creditor rather than the shareholder…[In that circumstance,] there's more obligation to the creditor."[617] A significant majority of the practitioners tended to prefer greater director control in general.

Interestingly, there were differing interpretations as to whether Canada was trending

[615] Practitioner #17.

[616] Practitioner #24.

[617] Practitioner #20.

towards greater board or shareholder control. A few practitioners felt that Canada was moving towards greater director control in practice, noting how "the biggest change over the last ten to fifteen years has been the increased role and responsibilities of directors, ensuring governance at the board level is robust."[618] Other practitioners identified how administrative rules were generally changing in favour of the shareholder, as shareholders have been getting a sympathetic ear from the regulators and the stock exchanges, which have "expanded the universe of shareholders' rights on various matters well beyond what the law ever contemplated."[619] In a mergers and acquisitions (M&A) context, many practitioners pointed to the securities regulators' shareholder-centric position on defensive tactics as representing significantly greater shareholder control in Canada, particularly when compared with the American position on these measures.

5.1.1.1 Poison Pill Debate

Canada is considered a very bidder-friendly jurisdiction as National Policy 62-202 *Take-Over Bids – Defensive Tactics* (NP 62-202) leaves Canadian boards with a limited number of defences when faced with an unsolicited take-over bid.[620] This position is now under review in Canada. The Canadian Securities Administrators (CSA), the organization responsible for the securities regulation of all provinces, has released proposed National Instrument 62-105 *Security Holders Rights Plans*, which allow target boards to implement shareholder rights plans (known as "poison pills")[621] for a longer period than currently permitted when facing a hostile bid,

[618] Practitioner #5.

[619] Practitioner #13.

[620] *Take-Over Bids – Defensive Tactics*, OSC NP 62-202 (4 July 1997).

[621] A shareholder rights plan is a defensive tactic employed by companies to discourage hostile take-overs. This is done by making the shares of a company less attractive to the potential acquirer, either by allowing existing shareholders to buy more shares at a discount, or allowing shareholders to buy the acquirer's shares at a discounted price after the merger.

subject to shareholder approval.[622] An alternative proposal has been put forth by the Autorité des Marchés Financiers (AMF), the organization mandated by the Quebec government to regulate Quebec's financial markets.[623] The AMF proposal seeks a new regime to govern all defensive measures, allowing boards a greater overall arsenal to defend target companies in the face of unwanted take-over bids. The extended comment period for these proposals closed in July 2013.[624] As one practitioner observed:

> The proposals can be seen as a subtext of who actually should have ultimate decision making authority in the context of change of control transactions: whether it should be the shareholders, which is the current approach of the securities regulatory scheme and the approach the commissions have traditionally taken on poison pills, or whether the boards should be more empowered, which is the path the courts seem to have taken but the regulators have not.[625]

An overwhelming majority preferred the AMF proposal and felt a regime change was necessary, with one practitioner calling it "more intellectually honest"[626] than the CSA proposal.[627] Another practitioner believed the proposals were motivated by the desire of the Ontario Securities Commission (OSC) to "get out of the pill hearing game" and that "all the OSC

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[622] Canadian Securities Administrators, "Notice and Request for Comment: Proposed National Instrument 62-105 Security Holders Rights Plans, Proposed Companion Policy 62-105CP, and Proposed Consequential Amendments" (14 March 2013) *Ontario Securities Commission*, online: Ontario Securities Commission <www.osc.gov.on.ca>.

[623] Autorité des Marchés Financiers, "Consultation Paper: An Alternative Approach to Securities Regulators' Intervention in Defensive Tactics" *Autorité des Marchés Financiers* (14 March 2013), online: Autorité des Marchés Financiers <www.lautorite.qc.ca>.

[624] For some helpful summaries providing greater detail on the current proposals, see e.g., Robert Black, et al, "The Competing Visions of the CSA and AMF on Shareholder Rights Plans and Take-over Bid Defensive Tactics" Davis LLP Securities & Corporate Finance Bulletin (22 April 2013) Davis LLP, online: Davis LLP <www.davis.ca/en/>; John Emanoilidis, et al, "Canadian Companies Will be Harder to Acquire Under New Poison Pill Proposals" *Torys LLP M&A Bulletin* (14 March 2013), online: Torys LLP <www.torys.com/Publications>.

[625] Practitioner #11.

[626] Practitioner #4.

[627] The exception was one practitioner, who thought it would be better to work within the CSA's proposals and get them right since that was where Canada was probably going to end up, noting how the acceptance of the AMF proposal was "just never going to happen." This practitioner did, however, prefer the AMF proposal.

is doing is largely codifying what's developed out of their own jurisprudence."[628] There was consensus among practitioners in the M&A field that Canadian boards did not have enough in their defensive toolkit to properly respond to take-over bids, citing how "as a board, you have no bargaining power in Canada." One practitioner pointed out how "shares trade over so quickly once the transaction is announced that those who are holding the shares have a stake in only one thing, which is with a transaction going ahead."[629] Once a bid is made for a Canadian company, it can almost be assumed that the company will be sold, as the board has no way of resisting the bid, and "ultimately no ability to negotiate the best price or find an alternate because the bidder just has to wait the board out and then go straight to the shareholders."[630] Many also preferred the AMF proposal because it would align more with the American standard of practice in M&A transactions. The AMF position would put Canada on a more even playing field on the global capital markets, "essentially bringing us to a Delaware state of law, which means you can indefinitely keep a hostile bidder away."[631]

While some acknowledged the motivation behind regulators' push for greater shareholders' rights was due to a concern that directors could become entrenched and refuse a take-over bid to perpetuate the board's own power, these practitioners felt that fear was unwarranted. The concern was something that "had an element of truth 30 years ago," but nowadays "directors are acutely aware of their fiduciary duties in a change of control, and that

[628] Practitioner #19.

[629] *Ibid.* The practitioner went on to state: "A lot of people would say that the people who bought shares are the ones whose interest you should be protecting – but that starts a step too late. If the board had the proper ability to negotiate with bidders, people wouldn't sell as quickly and people would stick it out and reap the rewards of doing that."

[630] *Ibid.*

[631] Practitioner #24.

they are exposing themselves to hellacious lawsuits if they try to entrench themselves with any form of conflict of interest."[632] Some practitioners seemed to share a common sentiment that the OSC was "substituting its visceral reaction for the business judgment of the directors," leaving boards "emasculated."[633] Several said that "better run companies would have more director primacy" as the directors have the knowledge and capability to make better long-term decisions. The majority of these practitioners said that negotiating by the board was the most effective way to obtain the best deal for shareholders. One practitioner, who strongly argued in favour of the corporation being run solely for the economic benefit of the shareholders, felt that the regulators have "tried to write a plan to eliminate the power of the board," which philosophically "is exactly where the power ought to be" as a fiduciary of the shareholders.[634]

Some practitioners were cautiously optimistic that the acceptance of either proposal could temper the commissions' shareholder-centric position slightly in the future, signifying a possible trend towards greater board control. One noted how "right now the securities administrators all think, to a greater or lesser degree, that we have gone too far and it's time to make take-over protection stronger."[635] Another commented that the securities regulators are making decisions "based on what they believe is the right thing for investors, but not with much thinking as to what is the right answer for a corporation."[636] A handful of practitioners contended that, given how the current debate on poison pills has a particular focus – which is solely looking

[632] Practitioner #8.

[633] Practitioner #27.

[634] Practitioner #8.

[635] Practitioner #9.

[636] Practitioner #28.

at protecting investors in the capital markets from the commissions' view – the debate should not be construed to represent the overall governance model in Canada.

The discussions by practitioners suggest the answer to who holds ultimate control depends very much on what aspect of the law a practitioner elects to focus on. Fiduciary duties aside, securities commissions have clearly favoured shareholders having the ultimate say in take-over situations, as investor protection is a statutory mandate set out in each commission's enabling statute. In this context, and specifically regarding the current debate on the proper allocation of power in the treatment of poison pills, many of the practitioners expressed frustration over the fact that greater director control, in their minds, is more beneficial to shareholders by increasing their share value in the face of a take-over bid.

On 14 September 2014, the CSA announced that, after considering both the CSA and AMF proposals and reviewing subsequent comments, it would be pursuing a "harmonized regulatory approach" regarding take-over bids in Canada. Specifically, the CSA has indicated that its proposed amendments would require that all non-exempt take-over bids:

(1) be subject to a mandatory majority (more than 50 per cent) minimum tender of all outstanding target securities (excluding tenders by the bidder itself or its joint actors);

(2) be extended by the bidder for an additional 10 days once the mandatory minimum tender condition has been met and the bidder has announced its intention to immediately take up and pay for the securities deposited under the bid; and,

(3) remain open for a minimum of 120 days, subject to the ability of the target board to waive to a period of no less than 35 days in certain circumstances and on certain conditions.[637]

The announcement does not provide any guidance as to how the regulators plan to regulate

[637] Canadian Securities Administrators, "Canadian Securities Regulators Move Forward with Harmonized Regulatory Approach for Take-Over Bids in Canada" (11 September 2014), online: <www.securities-administrators.ca>.

poison pills once the new regime is adopted. The CSA indicated its intention to publish proposed amendments for comment in the first quarter of 2015, but has not done so as of June 2016.

Stepping back from the poison pill debate, the board and management clearly exert greater day-to-day control in practice. And of course, shareholders continue to have the power to elect and remove directors, as well as the power to approve fundamental changes, access the oppression remedy, and use or threaten other remedies such as class actions. Decisions that will follow the proposed amendments as to how securities commissions across Canada approach poison pills specifically, and defensive tactics as a whole under the anticipated harmonized approach, will dictate whether there will be a power swing toward greater board control in an M&A context in the future, something heavily favoured by a significant majority of the practitioners interviewed. Practitioners clearly see the value in the board acting as the "brain" of the corporation, and allowing directors greater capacity to act in their fiduciary duties on behalf of their constituents in takeover situations.

5.1.2 Manage in the Best Interests of Whom?

Principle: *"The managers of the corporation should be charged with the obligation to manage the corporation in the interests of its shareholders."*

A few practitioners conceded that people mostly think that the obligation of the board and management is to manage the corporation in the interests of its shareholders. Despite this, all practitioners agreed that the theoretical principle was inconsistent with Canadian corporate law, which under s. 122 of the *CBCA* requires that directors and officers manage the corporation in the "best interests of the corporation" as opposed to the shareholders.[638] The topic of the debate,

[638] *CBCA, supra* note 20 at s. 122 ("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" and

then, became whether or not the difference between "best interests of the corporation" and "best interests of the shareholders" was simply a technical one or if there was a noteworthy Canadian difference to be had.

A handful of practitioners strongly felt there was no difference, stating that "it's the same thing" with one noting how "it's fine for directors to believe that it is in the best interest of the corporation, which to me means the best interest of its shareholders, notwithstanding that the Supreme Court goes [a little out of bounds] in this allegation."[639] Others felt there was a difference between the two, with a few holding comparably strong views on the fact that there was a difference, including this practitioner, who stated:

> It's entirely different, that is not our common law…It should be a matter of complete indifference to the directors what the interests of the shareholders are, except if it makes a difference to the corporation. There's nothing wrong with taking shareholders' interests into account, but that's incidental…I don't think the law could possibly be clearer if you look at the corporate statutes and look at what the courts have said.[640]

A few practitioners noted the difference when compared to the United States, Delaware in particular, where their laws indicate that directors' duties are to the corporation and the shareholders, which a few practitioners felt was treated as one and the same by the American courts. One distinguished how American jurisprudence "is more clearly articulate that the interest of the shareholder should be foremost in the thoughts of the board in terms of maximizing shareholder value than perhaps has been articulated historically in the Canadian

"exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances").

[639] Practitioner #8.

[640] Practitioner #12.

jurisprudence."[641] There is, therefore, "a slightly different focus in Canada."[642] In terms of its application, one practitioner noted that boards do not have an obligation to any potential stakeholder but described it as a "kind of continuum…the board feels they have a greater obligation to consider the shareholders, employees, and the local community they operate in, but the obligation probably decreases as the strength of the relationship with other constituents increases."[643] Another put it in the context of proportionality:

> There is a difference….You do have to consider all the influences of the company when you're making decisions, because it is in the best interest of the corporation, but when you look at what that means – the corporation – predominately you're talking about the investors, the people who put in their money to own a stake in the company….As a director, you're out there for all the world to see as to how the shareholders have judged and measured you. You don't have that same scrutiny with these other stakeholders…so practically, directors are driven to that same relative view.[644]

Nevertheless, a large majority of the practitioners felt that even if there was a theoretical difference between "best interests of the corporation" and "best interests of the shareholders," the difference was largely indistinguishable in practice because a business case could be made that best interests of the corporation equated to the best interests of the shareholders.[645] Many expressed how one can easily make an argument that if the corporation is acting in the best interests of all of its stakeholders, over time the wealth of shareholders will be maximized. Most agreed (with a few exceptions) that the shareholders should be the foremost priority for directors,

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[641] Practitioner #13.

[642] Practitioner #24.

[643] Practitioner #21.

[644] Practitioner #27.

[645] Comments from various practitioners included the following: "you can make an argument; at least academically you can as a director, that if we run this corporation in the best interests of all of its stakeholders over time we will maximize wealth for shareholders"; "in order to be a good corporation and do what your shareholders want and make value for your shareholders, it may make an awful lot of sense to do good things for the community or good things for the environment or good things for your employees, because it's good for the owners."

with other stakeholders' interests being considered depending on the issue at hand.

A number of practitioners implied that the negligible difference could become relevant in narrow circumstances. For example, the difference could become acute in times of financial distress or when a significant stakeholder is involved. Two gave the example of a pipeline across First Nations territory, where in that scenario the corporation should have regard to the broader interest of stakeholders.

One of the practitioners that found a stark difference between the best interests of the corporation versus the shareholders admitted that "certainly the entire shareholder community in Canada would say it's all about the shareholders, absolutely."[646] Nevertheless, this practitioner reiterated the point that doing what's in the best interests of the corporation is really something for the directors to determine, and is not beholden to any particular stakeholder group, including shareholders. When this practitioner was informed that several participants felt that "best interests of the corporation" and "best interests of the shareholders" were of negligible difference, the practitioner responded:

> If you are trying to advise a board in a manner that keeps them out of harm's way, that's different. Providing that kind of advice, practically speaking for a lawyer advising a client, is much different than talking about the legal theory. Because you can have all kinds of laws, but when you've got one group who is the most likely to sue you, you tend to worry about that group…People's sense of right and wrong will also change over time but I don't think the legal theory is going to change. So it is kind of a flexible concept that can accommodate a lot of different views of a lot of different kinds of directors.[647]

A few practitioners echoed this sentiment, reflecting on how Canada is more flexible in that it can, in any particular set of circumstances, put the best interests of the corporation to a wider

[646] Practitioner #12.

[647] *Ibid.*

group of stakeholders.

In a significant majority of times during a corporation's existence, directors may find there to be little practical differences between decisions made in the "best interests of the corporation" and the "best interests of the shareholders." Many practitioners felt that there should be a healthy balance and greater proportionality given to the interests of shareholders, who have taken on the financial risk. Given the strong business case to consider stakeholder interests, these interests almost always align with increasing share value in the long-term. A few practitioners did cite some limited circumstances where the difference may become more acute. Simply, can "best interests of the corporation" take into account interests other than the shareholders better than "best interests of the shareholders"? The theoretical answer is obviously a yes, and the answers from these practitioners also suggest the affirmative is possible in practice. Many questioned whether actions made in favour of stakeholders' interests are even distinguishable from actions benefiting shareholders and the corporation in the long-term.

While the distinction between the interests of the shareholders and the corporation may be negligible in most all circumstances, there is value in understanding Canadian corporate law operates at a different starting point then that of American counterparts. The freedom of a board to have an unfettered focus on the short and long term interests of the corporation, keeping in mind shareholders' interests will always be intimately intertwined with such interests, provides a theoretical mindset more attune to environmental issues such a climate change, sustainability, and other community benefit issues that are likely downgraded when the understanding is that there is to be a singular objective of shareholder wealth maximization alone.

5.1.3 Consideration of Stakeholder Interests

Principle: *"Other corporate constituencies, such as creditors, employees, suppliers, and customers, should have their interests protected by contractual and regulatory means rather than through participation in corporate governance."*

While there were some differences among practitioners in the treatment of this principle and the meaning behind "participation in corporate governance,"[648] the overwhelming majority interpreted the principle to mean that the protection of non-shareholder stakeholder interests were outside the scope of corporate governance practices, particularly with respect to the board's corporate decision making.

A handful of practitioners agreed with the principle, citing significant protections available to non-shareholder stakeholders through contractual and regulatory means. One felt the principle was correct because shareholders are the ones without contractual rights, thus directors had a primary duty to protect their interests above those that already have built-in protections through contract and/or regulation. Another felt strongly that contractual and regulatory protections were sufficient for these interests, reflecting on how "we've forgotten what contracts do…Corporations have to operate within a contractual set of obligations they've undertaken and a regular set of obligations."[649] When asked whether regulation was sufficient protection for environmental interests, the practitioner responded that "the people that should be sued are the government for being totally negligent about adequately regulating the destruction of our environment…the bulk of the deficiency is the intellectual paucity of environmental

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[648] Some practitioners had a different interpretation of the meaning of "participation of corporate governance" in this principle. One practitioner, for example, pointed out that in continental Europe, unions were provided with representatives on boards. Any practitioner who construed the principle in this manner was in agreement with it. When the principle was interpreted to mean there was a strict choice "between people protecting their own rights, rather than having a voice in the corporate decision," then generally speaking, practitioners tended to agree that it is "an accurate statement, but it isn't a complete statement."

[649] Practitioner #8.

regulation."[650]

Several questioned how Canadian common law fit within this principle, with a few recognizing that courts "have become more aggressive in identifying and protecting the non-contractual rights of other corporate stakeholders"[651] and a handful pointing out how "it's a little bit different in Canada as a result of *BCE*—the Court has decided that other stakeholders, irrespective of their contractual relationships with their company, have an interest that needs to be protected."[652] Practitioners were asked to opine on the 2008 decision in *BCE Inc. v 1976 Debentureholders* (*BCE*)[653] and its impact, if any, on Canadian corporate governance practices.

5.1.3.1 Peoples and BCE Decisions

Prior to 2004, a series of cases in Canada, particularly from Ontario, spoke to the existence of a fiduciary duty for directors to take reasonable steps to maximize shareholder value.[654] These cases generally fell in line with the seminal Delaware Supreme Court case of *Revlon Inc. v. MacAndrews & Forbes Holdings*,[655] where the court held that directors were found to owe a fiduciary duty to maximizing shareholder value in take-over contexts, regardless

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[650] *Ibid.*

[651] Practitioner #30.

[652] Practitioner #21.

[653] *BCE, supra* note 405.

[654] See e.g. *Casurina Limited Partnership v Rio Algom Ltd*, [2004] 40 BLR (3d) 112 at para 27, 181 OAC 19 (Ont CA); *Pacifica Papers Inc v Johnstone*, [2001] 15 BLR (3d) 249 at para 30 (BCSC) affirmed in *Pacifica Papers Inc v Johnstone*, [2001] 93 BCLR (3d) 20, 19 BLR (3d) 63 (BCCA); *Gazit* (*1997) Inc v Centrefund Realty Corp.*, [2000] 8 BLR (3d) 81 at para 69, [2000] OJ No 3070 (Ont SCJ); *CW Shareholdings Inc v WIC Western International Communications Ltd*, [1998] 160 DLR (4th) 131, 39 OR (3d) 755 (Gen Div); *Benson v Third Canadian General Investment Trust Ltd*, [1993] 13 BLR (2d) 265, 14 OR (3d) 493 at 500 (Gen Div); *347883 Alberta Ltd v Producers Pipelines Inc,* [1991] 3 BLR (2d) 237, 80 DLR (4th) 359 at 399-402 (Sask CA).

[655] *Revlon*, *supra* note 568.

of non-shareholder interests. Along with the prior Delaware case of *Unocal v. Mesa Petroleum*[656] and the 1919 case of *Dodge v. Ford*,[657] *Revlon* is often cited (whether accurately or not[658]) as a case that exemplifies the existence of shareholder primacy in corporate America.

The decision of *Peoples Department Store Inc. (Trustee of) v. Wise* (*Peoples*)[659] stimulated several responses from legal professionals and scholars on its significance to the future of Canadian governance.[660] In brief, following the bankruptcy of the Peoples Department Stores Inc., the trustee brought an action against the company's directors for breaching their fiduciary duties by, prior to the bankruptcy, implementing a credit scheme that favoured Peoples' parent company, Wise Stores Inc., over its creditors. Regarding the "best interests of the corporation," the SCC stated:

> [I]t is clear that the phrase the "best interests of the corporation" should be read not simply as the "best interests of the shareholders." … [I]n determining whether they are acting with a view to the best interests of the corporation it may be legitimate, given all the circumstances of a given case, for the board of directors to consider, inter alia, the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment.[661]

The court cited with approval the 1972 case of *Teck Corp. v. Millar,* in which it was

[656] *Unocal v Mesa Petroleum Co*, 493 A (2d) 946 (Del Sup Ct 1985) [*Unocal*].

[657] *Dodge v Ford Motor Company*, 170 NW 668 (Mich Sup Ct 1919).

[658] See e.g. Lynn A Stout, "Why We Should Stop Teaching *Dodge v. Ford*" (2008) 3:1 Virginia Law & Business Review 163.

[659] *Peoples Department Stores Inc (Trustee of) v Wise*, 2004 SCC 68, 3 SCR 461.

[660] Readers are encouraged to review the several summaries and analyses that are available. See e.g. Catherine Francis, "*Peoples Department Store Inc. v. Wise*: The Expanded Scope of Directors' and Officers' Fiduciary Duties and Duty of Care" (2005) 41 Can Bus LJ 175; Edward Iacobucci, "Indeterminacy and the Canadian Supreme Court's Approach to Corporate Fiduciary Duties" (2009) 48 Can Bus LJ 232; Darcy L MacPherson, "Supreme Court Restates Directors' Fiduciary Duty – A Comment on *Peoples Department Stores v. Wise*" (2005) 43 Alta L Rev 383.

[661] *Peoples, supra* note 16 at para 42.

held that if directors "observe a decent respect for other interests lying beyond those of the company's shareholders in the strict sense, that will not… leave directors open to the charge that they have failed in their fiduciary duty to the company."[662] *Peoples* marks the first instance where the court specifically validated the business judgment rule, meaning the courts will defer to the directors' business judgment so long as those directors used an appropriate degree of prudence and diligence in reaching a reasonable business decision at the particular time the decision was made.[663]

The theoretical and practical implications of the SCC's findings were mixed. Scholars including Catherine Francis noted that the court's findings were "significant and far-reaching," and as a result that "directors and officers must be scrupulous in their decision-making process and, if they ignore the interests of significant stakeholders, they do so at their peril."[664] Ian Lee found the SCC decision "striking" in its clear rejection of shareholder primacy.[665] On the other hand, others in the business sector felt that the decision changed little in terms of the usual form of redress for creditors, known as the oppression remedy. While acknowledging that the decision broadened directors' duties, the business judgment rule easily counterbalanced this effect.[666]

In response to *Peoples*, Stephanie Ben-Ishai suggested that the Canadian corporate governance debate is operating on the false underlying assumption that the shareholder primacy

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[662] *Teck Corp v. Millar*, [1972] 33 DLR (3d) 288, 2 W.W.R. 385 (BCSC) at para 97.

[663] *Peoples, supra* note 16 at paras 64-65.

[664] Francis, *supra* note 57 at 183.

[665] Ian B Lee, "*Peoples Department Stores v. Wise* and the 'Best Interests of the Corporation'" (2005) 41 Can Bus LJ 212 at 213.

[666] "Peoples v. Wise: Much Ado About Nothing?" (Spring 2005), online: McMillan LLP <http://www.mcmillan.ca/Peoples-v-Wise-Much-Ado-About-Nothing>.

model accurately describes Canadian corporate law's treatment of public corporations.[667] She noted that "[w]idespread current thinking among the Canadian legal community supports the view that *Peoples* is an unjustified departure from Canadian corporate law's principal-agent, shareholder primacy understanding of the board of directors' role in public corporations."[668] She makes the case that the Canadian legal understanding of public corporations in actuality reflects a director primacy norm rather than a shareholder primacy norm, and applied the team production theory to Canadian corporate law.[669]

Ben-Ishai suggested that, because the director primacy norm accurately describes Canadian corporate law, further consideration needs to be given to corporate law's relative relevance in dictating how Canadian corporations currently operate. In particular, "[d]o directors of Canadian corporations really think of themselves as mediating hierarchs and corporations as teams? More importantly, can directors of Canadian corporations play a mediating hierarch role given the current composition of corporate boards?"[670] Responses to these questions would help inform whether the director primacy norm is the ideal norm for Canadian corporate law.[671]

In *Peoples*, the SCC made no mention of American case law and did not expressly distinguish the *Revlon* and *Unocal* cases. But such references should not be expected, or seen as a missing element to the SCC's decision in *Peoples* – Canadian courts in general, and the SCC in

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[667] Stephanie Ben-Ishai, "A Team Production Theory of Canadian Corporate Law" (2006) 44:2 Alta L Rev 299 at 305-14.

[668] *Ibid* at 301.

[669] Blair & Stout, *supra* note 351.

[670] *Ibid* at 321.

[671] *Ibid.*

particular, certainly do not have to account for American case law in their decision making. The court was, however, vague in its formulation of its fiduciary duties, leaving "directors and courts little guidance as to the appropriate yardstick against which to measure the discharge by the directors of their duties in any particular fact situation."[672] Lee expressed his disappointment over the SCC's failure to address the normative aspects of shareholder primacy head-on, finding it unfortunate given "there are good reasons for questioning shareholder primacy."[673]

In the subsequent 2007 decision of *Ventas Inc. v. Sunrise Senior Living Real Estate Investment Trust,*[674] the Ontario Court of Appeal, while indicating that there is "no doubt" that the directors of a target corporation in a take-over context have fiduciary obligations "to take steps to maximize shareholder… value in the process," made no mention of *Peoples*.[675] Legal practitioners J. Alex Moore and William Ainley surmise that "the implicit conclusion in *Ventas* was that, whatever it meant to owe a duty exclusively to the corporation, it did not displace the fiduciary obligation of a board to maximize shareholder value when the corporation was being sold."[676]

The findings in *Peoples* regarding stakeholder interests created a springboard for future decisions to build upon. In the highly anticipated 2008 decision in *BCE Inc. v. 1976*

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[672] J Alex Moore & William Ainley, *BCE v.1976 Debentureholders: An Unexamined Question Considered*, online: Davies <http://www.dwpv.com> at 5.

[673] Lee, *supra* note 665 at 222.

[674] *Ventas, Inc v Sunrise Senior Living Real Estate Investment Trust*, 2007 ONCA 205 at para 53, 85 OR (3d) 254, Blair JA.

[675] *Ibid.*

[676] Moore & Ainley, *supra* note 88.

Debentureholders,[677] the SCC affirmed *Peoples* and appeared to further temper the shareholder primacy norm.[678] In brief, debentureholders of Bell Canada, a subsidiary of BCE Inc., used an oppression remedy to seek relief concerning the privatization of BCE by a consortium of private equity buyers under a plan of arrangement that had been determined by BCE's directors to be in the best interests of BCE and its shareholders. Upon the completion of the arrangement, the debentureholders stood to lose approximately 20 per cent of the short-term trading value of their holdings.

Moore and Ainley noted that "in light of the questions raised following the *Peoples* decision, and the confusion the decision created at the Quebec Court of Appeal in *BCE*, the question of how *Peoples* could be reconciled with the perceived duty to maximize shareholder value was ripe for examination."[679] Edward Waitzer and Johnny Jaswal also commented that *BCE* gave the SCC "a rare opportunity to articulate and clarify its view with respect to proper corporate purpose and the responsibilities of directors."[680] In its decision, the SCC reiterated its holding in *Peoples* that directors were permitted to consider the interests of, among others, "shareholders, employees, creditors, consumers, governments and the environment."[681] As well,

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677 *BCE*, *supra* note 9.

678 Readers are again invited to review the summaries and analyses available for greater details on the case. See e.g. Mohammad Fadel, "*BCE* and the Long Shadow of American Corporate Law" (2009) 48 Can Bus LJ 190; Jeffrey Bone, "The Supreme Court Revisiting Corporate Accountability: BCE Inc. in Search of a Legal Construct Known as the 'Good Corporate Citizen,'" online: Alberta Law Review Online Supplement <http://www.albertalawreview.com>; J Anthony VanDuzer, "*BCE v. 1976 Debentureholders:* The Supreme Court's Hits and Misses in its Most Important Corporate Law Decision Since *Peoples*" (2009) 43 UBC L Rev 205; Sarah P Bradley, "*BCE Inc. v. 1976 Debentureholders*: The New Fiduciary Duties of Fair Treatment, Statutory Compliance, and Good Corporate Citizenship?" (2010) 41 Ottawa L Rev 325.

679 Moore & Ainley*, supra* note 80 at 5.

680 Edward Waitzer & Johnny Jaswal, "*Peoples*, *BCE,* and the Good Corporate "Citizen"" (2009) 47 Osgoode Hall LJ 439 at 442.

681 *BCE*, *supra* note 9 at para 39.

the court held that directors were "not confined to short-term profit or share value," but that when the corporation is of a going concern, directors were to look to the long-term interests of the company.[682] The court also reinforced its support for the business judgment rule.

Most interestingly, the court held that directors were required to act in the best interests of the company "viewed as a *good corporate citizen*"[683] and "commensurate with the corporation's duties as a responsible corporate citizen."[684] The court did not go further in their concept of corporate citizenry. Jeffrey Bone has pointed out that the court failed to create a test or legal framework on how to determine good corporate citizenry, and it is unclear whether this aspect of the decision was intentional, due perhaps to a reluctance to give the concept legal teeth.[685] The viability of good corporate citizenry as a legal concept remains to be seen.

Scholars weighing in following the *BCE* decision tended to express frustration over the lack of clarity in the law. Waitzer and Jaswal felt that *BCE* "add[ed] to the confusion surrounding directors' duties and the indeterminate nature and scope of their agency obligations."[686] They noted that:

> Even the questions of whether directors may consider, should consider, or are obliged to consider stakeholder interests, and, if so, at what point, were not addressed clearly by the Court. Early in its reasons, it noted that, in *Peoples*, 'this Court found that although directors *must* consider the best interests of the corporation, it may also be appropriate, although *not mandatory*, to consider the impact of corporate decisions on shareholders or

[682] *Ibid* at para 38. Regarding the oppression remedy, the court found there was no violation by the directors in their fiduciary duties.

[683] *Ibid* at para 66.

[684] *Ibid* at para 82.

[685] Bone, *supra* note 678.

[686] Waitzer & Jaswal, *supra* note 96 at 455.

> particular groups of stakeholders.' Later, the Court stated that 'the duty of directors to act in the best interests of the corporation comprehends a duty to treat individual stakeholders… equitably and fairly.' Is this duty mandatory?[687]

In rendering its decision, the court seemed to reject the fiduciary duty to maximizing shareholder value in change of control transactions as applied by American courts in *Revlon.* The SCC provided directors with considerable flexibility in considering the interests of other stakeholders in determining the best interests of the company. Nevertheless, the wording from the courts, both at trial and on appeal, was careful to sidestep any conflict between the *Revlon* case and the Canadian cases *Peoples* and *BCE.* The trial judge in *BCE* found that "the ruling in *Peoples* is not necessarily incompatible with the application of the *Revlon* Duty [in *BCE*]," but did not engage further on the matter and did not indicate that *Revlon* was even applicable in Canadian law.[688] The SCC's exploration of the topic was also limited to a brief discussion of *Revlon* that Moore and Ainley felt did not fully engage the issue, noting:

> Rather than explore whether there are any special duties placed on directors in the context of a potential change of control, the Court, in a cursory fashion, considered the "*Revlon* line" from Delaware merely to address whether *Revlon* stands for the proposition that the interests of shareholders prevail over those creditors. However, even on this narrow question the Court neither rejected nor endorsed Delaware law.[689]

The SCC, instead, relied on the former Delaware Supreme Court Chief Justice Veasey to leave open the possibility that *Peoples* and *Revlon* were not necessarily in conflict:

> [It] is important to keep in mind the precise content of this 'best interests' concept — that is, to whom this duty is owed and when. Naturally, one often thinks that directors owe this duty to both the corporation and the stockholders. That formulation is harmless in most instances because of the confluence of interests, in that what is good for the corporate entity is

[687] *Ibid* at 461.

[688] *BCE Inc., Re,* [2008] RJQ 1029, 43 BLR (4th) 39 at para 203.

[689] *Ibid.*

> usually derivatively good for the stockholders. There are times, of course, when the focus is directly on the interests of the stockholders. But, in general, the directors owe fiduciary duties to the corporation, not to the stockholders.[690]

In particular, the SCC found that the "the *Revlon* line of cases has not displaced the fundamental rule that the duty of the directors cannot be confined to particular priority rules, but is rather *a function of business judgment of what is in the best interests of the corporation, in the particular situation it faces*."[691] Then little more regarding *Revlon* was said by the court.

Mohammed Fadel noted that, in the wake of the decision, "the Canadian corporate law of directors' duties has become beset by uncertainty, incoherence and confused rhetoric with respect to one of the most basic issues of corporate law: how to reconcile the competing interests of shareholder and non-shareholder corporate stakeholders."[692] Jeffrey MacIntosh expressed the view that, "only legislative intervention (in particular, declaring that directors duties' are owed to shareholders alone) can adequately address the difficulties that [*Peoples* and *BCE*] have created."[693] Others pointed to the possible inclusion of non-shareholder stakeholder interests as a potential diminution in directorial accountability.[694] Allowing directors to be accountable to many generally results in directors becoming accountable to no one.[695]

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[690] *BCE*, *supra* note 9 at para 87, citing Norman E Veasey & Christine T Di Guglielmo, "What Happened in Delaware Corporate Law and Governance from 1992-2004? A Retrospective on Some Key Developments" (2005) 153 U Pa L Rev 1399 at 1431.

[691] *BCE*, *supra* note 9 at para 87 [emphasis added].

[692] Fadel, *supra* note 94 at 190.

[693] Jeffrey G MacIntosh, "*BCE* and the Peoples' Corporate Law: Learning to Live on Quicksand" (2009) 48 Can Bus LJ 255.

[694] See e.g. VanDuzer, *supra* note 86.

[695] This may in fact already be an issue needing to be tackled in governance reform, as director accountability has expanded in many ways: directors are accountable to courts, regulators under public interest powers, and

On the other hand, from a practical standpoint, Jeremy Fraiberg found that while directors did have a limited scope to forego maximizing shareholder value in change of control transactions under *BCE*, it was unlikely the scenario would ever occur.[696] The formidable business judgement rule applies, rendering the provision somewhat latent in practice. The need for balance between stakeholder interests and business judgment has meant that the inclusion of stakeholder interests in law has been unremarkable for those looking to reform the model through purely legal means. That may be why, on a theoretical level, almost all corporate governance reformists have agreed that the inclusion of stakeholders in the governance model is necessary, and the issue seems to have reached a plateau in scholarly discussions.

In the study at hand, no practitioner expressed dismay over the ultimate result of *BCE* when asked. Many specified that whatever they felt about the rest of the decision, the end result in favour of BCE Inc. was the correct one. A handful of practitioners found the SCC's findings in *BCE* very positive overall, making comments that they quite liked the decision and its conclusion, calling it "a breath of fresh air,"[697] and declaring that the court in *BCE* "really started to get it right."[698] These practitioners were pleased that the decision "gave a little more

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accountability through statutory means. This increase in director accountability and liability requires there to be acute awareness of what decisions are properly made at the board-level and what directors should be held accountable for. See e.g. Paul Cantor, "Oversight and Insight: Building Blocks for Enhanced Board Effectiveness" (2012) 163 Director Journal 3. Allowing stakeholder interests to properly be considering in board decision making enables a team production model to take hold (Margaret Blair & Lynn A Stout, "Director Accountability and the Mediating Role of the Corporate Board" (2001) 79 Wash ULQ 403).

[696] Jeremy D Fraiberg, "Fiduciary Outs and Maximizing Shareholder Value Following *BCE*" (2009) 48 Can Bus LJ 212.

[697] Practitioner #16.

[698] Practitioner #4.

ammunition to the notion that the board can take a broader view when it makes its decisions."[699]

Others expressed hesitancy over how important the case was to Canadian corporate law. One practitioner, for example, was "not a believer that one case is particularly important in the general scheme of things" or that a particular case "fell off one side or the other at the head of a pin on a very narrow point."[700] Instead, the practitioner felt it was important to consider the "run of cases" and with respect to *Peoples* and *BCE*, they felt that "neither of them did anything particularly surprising" and that it "was not a watershed."[701] A few practitioners considered the decision "a reflection of the times" that was also "a product of a lot of things that preceded it, and not just within the legal arena but within society, in the larger sense."[702] Another practitioner, who previously expressed that "best interests of the corporation" had a significantly different intent and meaning than "best interests of the shareholders," believed the court had simply "repeated the law the way it's always been," and echoed the sentiment that the decision was one that happened gradually along a broader trend in Canadian corporate governance history. The practitioner felt that, aside from the good corporate citizen concept, the decision "wasn't groundbreaking."[703]

Interestingly, the majority of practitioners found several problems with how the findings of the court were articulated, calling it "a thin piece of work," "incoherent," "terrible," "peculiar," "written by people who didn't understand corporate law," "basically written by their

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[699] Practitioner #16.

[700] Practitioner #2.

[701] *Ibid.*

[702] Practitioner #25.

[703] Practitioner #12.

clerks," and the articulation of the fiduciary duties of the board "contrary to common sense" and "a bit impractical, frankly." Several felt that the decision would not assist the lower courts on what the right approach was to oppression, fairness, etc., depending on the context.

Nevertheless, many conceded that the decision could not be ignored, since "it's the Supreme Court of Canada and it's a very recent and big case."[704] One practitioner said that *BCE* is "kind of a dog's breakfast; there's something in there for everybody" but there was no question that *BCE* has caused legal advisors "to tell any board that they can – and indeed should – take into account non-shareholder value issues."[705] The practitioner pointed out that "these are all things that we used to take into account before *BCE*, but *BCE* is now giving you more of an overt license to do it."[706]

Many practitioners felt the decision was a clear step away from a shareholder primacy model of governance, with one stating that it "clarified that the *Revlon* rule[707] does not apply in Canada, and boards are not required to act in the role of auctioneer in an M&A context, with their sole goal being to maximize shareholder value."[708] Nevertheless, a few practitioners bemoaned the fact that the SCC left questions open when they could have been settled. One wished that the SCC "had been far more hawkish and clear" and "would really like the court to specifically clarify Canada's take on corporate governance versus the US because we are such a

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[704] Practitioner #19.

[705] *Ibid.*

[706] *Ibid.*

[707] *Revlon,* supra note 568.

[708] Practitioner #21.

small market compared to our neighbours—we're inundated with US information."[709]

5.1.3.2 Good Corporate Citizen

Practitioners were asked whether they thought boards were aware of the Supreme Court's comments regarding how the best interests of the corporation are to be "viewed as a good corporate citizen" and "commensurate with a responsible corporate citizen" as per *BCE*.

Answers were split down the middle, with almost half either somewhat disagreeing or disagreeing, and the other half either agreeing or strongly agreeing. There tended to be two camps among practitioners, with one considering the good corporate citizen concept "an interesting throwaway line…a bit gratuitous,"[710] and the other finding that it "really does set Canada on its own path."[711] Some practitioners pointed out that the good corporate citizen concept was something "better understood amongst the lawyers" and "business people tend to not pay that much attention to it or not be as aware of it."[712] A handful of practitioners also noted that many companies want to be viewed as good corporate citizens, and "this is not because of anything the Supreme Court says."[713] One sensed that the good corporate citizen concept was "not getting any airtime" in small to mid-cap companies struggling for capital relative to larger companies that were "not going to live or die quarter by quarter" because "it's hard to think of these concepts when you're in survival mode."[714]

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[709] Practitioner #22.

[710] Practitioner #12.

[711] Practitioner #28.

[712] *Ibid.*

[713] Practitioner #26.

[714] Practitioner #27.

There was much discussion on how the "good corporate citizen" concept was difficult to apply, as can be seen from these various responses:

> Nobody really knows what it means. If I went to a client and said, 'Be sure when you do that that you're acting as a good corporate citizen because that's what *BCE* says,' the next line is going to be, 'And what does that mean?' and I'm going to shrug and say, 'I don't really know.' They'll say, 'Why did you tell me that? What do you want us to do with that?' Practically speaking people don't run around talking about it that way.[715]
>
> Obviously a good corporate citizen is better than saying, 'You better up your profits this quarter.' But I really do think it's a bit of apple pie, motherhood type of statement. It's pretty hard to say. I mean, are you going to have liability if you're not viewed by the outside as a good corporate citizen?[716]
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> The Supreme Court makes this bizarre statement to stakeholders about good corporate citizenship and then specifically refers to some purported stakeholders. If you're going to go there, you either should have given guidance or not gone there. They sort of left it. They got it out there, but it's still sort of a blank page.[717]

One practitioner felt that there was an "upwards trend" towards good corporate citizenry, and wasn't sure if that was a reflection of legal development so much as "a maturing of some of the thinking that goes on in the boardroom,"[718] while a handful noted that an increase in independent directors and director education is "really having an impact" on director awareness of these legal concepts.[719]

A small group of practitioners felt the need to qualify their answers, citing how their personal preferences on the matter were divergent from their legal take on the state of the common law. These practitioners, most of which found the *BCE* decision a disappointment in its

[715] Practitioner #12.

[716] Practitioner #4.

[717] Practitioner #9.

[718] Practitioner #10.

[719] One practitioner had a notably different take, finding director education and certification programs a "huge disservice to the capital markets" because they cause inexperienced people to believe they have the tools to sit on a board "just because he or she has taken a course – that's a nonstarter."

applicability to legal practice, expressly stated that they appreciated the direction of the court in supporting more of a "social conscience" in corporations. Despite this, a few questioned whether the law had the capacity to do so; others questioned whether it was even appropriate.

5.2.3.3 Influential to Practice?

Practitioners were asked whether *BCE* had influenced the decision making of Canadian boards. The collective response was that boards have been influenced by the decision, with almost all agreeing or strongly agreeing, and only one practitioner somewhat disagreeing. Nevertheless, there was significant consensus that the influence was more regarding the *process* of decision making, and there was serious question as to whether it had made a difference in terms of changing results. On how the *BCE* decision largely influenced the process, here are some select responses from various practitioners:

> That's why take-overs in Canada are so complex; the documentation is so complex, and they outline in great detail every meeting that's been held, every discussion that's been held, what the fairness opinion said, what other valuations have said, etc.…The result becomes a very process-driven process; processes can be used to defend judgments, but they don't necessarily facilitate making good judgments.[720]

> Let me repeat something I have said to counsel boards at various situations: the reason you hire lawyers and investment bankers and all of that is so that you can demonstrate how thorough a process you went through. You sat through the process, and you basically say: we dotted our i's and we crossed our t's and this was the result we have.[721]

> Did we consider the various issues? Did we record that we considered them? Did we get the advice that we needed to consider them? *BCE* has built into corporate governance more procedural requirements. My instinct is … where you had situations where people were attempting to be conscientious I suspect they would have got to the same place, but now they won't get there without jumping through hoops.[722]

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[720] Practitioner #9.

[721] Practitioner #6.

[722] Practitioner #18.

> If you're faced with a take-over bid and you've some competing stakeholders, clearly *BCE* will be mentioned. If you're going into a plan of arrangement and you need to do the fairness criteria, it may be mentioned but more as something that's entirely decipherable rather than unclear…*Magna*[723] was one of the first cases where it was really argued in detail. It was not pretty.[724]

There were many that pointed to the risks of having an overloaded process, and how it can quickly become boilerplate, stating how "the more you make something process-driven, the less meaning it has for people."[725]

In answering whether Canadian directors in actuality consider non-shareholder stakeholders in their corporate decision making, whether it be due to Canadian corporate law or otherwise, 71% agreed that directors take stakeholder interests into account, 10% remained neutral, and 19% disagreed. Several suspected that any consideration of stakeholder interests was due more from business motivations than anything required by corporate law.

One practitioner acknowledged that "it's early days yet, it's hard to tell" what the effects of *BCE* are, but as a practical manner "a lot of practitioners would probably tell you that a

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[723] *Re Magna International* (2010), 101 OR (3d) 736 (ON Sup Ct), aff 'd (2010), 101 OR (3d) 721 (Div Ct); Ontario Securities Commission, "In the Matter of The Securities Act, RSO 1990, c S-5, as Amended and In the Matter of Magna International Inc and In the Matter of the Stronach Trust and 446 Holdings Inc" Decision and Order (24 June 2010), online: OSC <http://www.osc.gov.on.ca>. Briefly, the *Magna* decision attempted to expand and/or clarify on some findings in BCE. The court confirmed that it would only consider whether there is a valid business purpose from the perspective of the corporation; there is no need to determine a valid business purpose from the shareholders' perspective. However, where the court is considering different interests within the same class of stakeholders, more weight can be placed on the shareholder vote in determining the fairness and reasonableness of the arrangement than in circumstances where the court is balancing competing interests between different classes of stakeholders. The details of *Magna* are particularly complex, thus readers are encouraged to review the several summaries and analyses available for further details on the case. See e.g., Edward Iacobucci, "Making Sense of *Magna*" (2011) 49 Osgoode Hall LJ 237; Anita Anand, "Was Magna in the Public Interest?" (2011) 49 Osgoode Hall LJ 311; Emmanuel Pressman, et al, "Key Lessons from the *Magna* Decision" Osler Corporate Review (September 2010), online: Osler <www.osler.com>; Kent E Thomson, et al, "The Magna Proceedings: Devising a Litigation Strategy and Elaboration on the *BCE* Test" online: (2011) Lexpert/American Lawyer, Davies <www.dwpv.com>.

[724] Practitioner #9.

[725] *Ibid*.

high enough offer price in a take-over will still prevail."[726] A handful of practitioners noted that the decision "may have given a target board some more ammunition with which to fight off a bid that they don't like." Others were much more skeptical as to the impact of the decision. When advising clients, one practitioner put it bluntly: "I say, 'the owners get the money and at the end of the day the Supreme Court said that's right.' Cut through all of the flowery language, the nice poetry, that's what happened."[727]

As with the similar finding from practitioners' comments in Section 5.1.2 with regard to the "best interests of the corporation," practitioners tended to feel that the exercise of considering stakeholder interests could result in a different result in narrow circumstances. A few practitioners provided theoretical examples, and a small number referenced the TMX/Maple transaction[728] as "a great test case where the board could have come to a non-maximizing shareholder value decision."[729] One practitioner pointed out that oftentimes it was not just a process issue for boards, but some stakeholders are a force to be reckoned with in any case. Creditors, for example, can be very influential and it is difficult for boards to ignore them. The

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[726] Practitioner #4.

[727] Practitioner #8.

[728] The TMX/Maple transaction involved the take-over of the TMX Group Ltd., Canada's main stock exchange company, by a consortium of banks and pension funds under the Maple Group Acquisition Corp. One practitioner described how in the transaction,

> The board clearly felt strongly that it had fiduciary obligations to stakeholders that went well beyond the shareholders, because they act as a market for the financial system and it was very important. Interestingly, OSC was wearing two hats in that transaction. The one hat [was concerned about] shareholder interests being protected…but they were also the regulator of the Toronto Stock Exchange and very much wanted the ultimate owner of the Toronto Stock Exchange to honor all those other obligations it has to other stakeholders.

The practitioner noted how the transaction was "a lot of pure corporate theory playing out in practice, where the securities regulators and corporate theory have collided…trying to come up with a transaction that would be good for the Canadian market and good for the shareholders of the TMX."

[729] Practitioner #29.

practitioner put it this way: “The board is not sitting around saying, ‘Gee, I wonder who this would harm? Maybe it would be the creditors.’ Usually the creditors are right in their face, it’s not like they have to put the creditors on their agenda.”[730] Another reflected on how the desire to consider stakeholder interests tended to be linked to lifespan of the corporation, as directors were more inclined to listen to stakeholder interests when the company is in insolvency or near insolvency.

5.1.3.3 Extent of Consideration: May, Should, or Obligated?

The *BCE* decision left open for many—directors, practitioners, and academics alike—the question as to the extent of obligation to consider stakeholder interests.[731] Thus, in an attempt to see if there was some consensus among this group of leading Canadian practitioners, all were asked the question, “Do you believe directors may, should, or are obligated to consider stakeholder interests?”

Several practitioners did not commit to one option, but chose two (such as “between may and should” or “they should and they are obligated to”). On the continuum of may being the least restrictive for directors, and obligated being the most, where the most restrictive answer was used as the recorded answer of the practitioner, 44% of practitioners said directors were

[730] Practitioner #18.

[731] See e.g., Iacobucci, *supra* note 26 at 234; Waitzer & Jaswal, *supra* note 680 at 442. Regarding the decision, Waitzer and Jaswal noted how:

> Even the questions of whether directors may consider, should consider, or are obliged to consider stakeholder interests, and, if so, at what point, were not addressed clearly by the Court. Early in its reasons, it noted that, in *Peoples*, ‘this Court found that although directors *must* consider the best interests of the corporation, it may also be appropriate, although *not mandatory*, to consider the impact of corporate decisions on shareholders or particular groups of stakeholders’ [emphasis in original]. Later, the Court stated that ‘the duty of directors to act in the best interests of the corporation comprehends a duty to treat individual stakeholders… equitably and fairly.’ Is this duty mandatory?

obligated to consider stakeholder interests, 40% felt that directors should consider them, and 16% felt directors may consider them. Comments that help to colour in practitioners' answers, as well as other noteworthy ones, are cited below.

One practitioner, who believed there was a legal obligation, summarized the sentiment echoed by most of the practitioners who answered in that manner, stating that "the trick is they can make a decision that may be counter to those interests, but they're obligated to consider them in the event."[732] For practitioners that did not think there was an obligation, a few offered reasons why, explaining that "it doesn't seem possible for the same group of people to owe conflicting duties to two different groups"[733] and that it is almost impossible to impose this kind of an obligation to have regard for the interests of all stakeholders, because "how do you differentiate, how do you favour, how do you choose?"[734] Many concluded that once they have taken stakeholder interests into account, then the decision made, absent conflicts of interest and gross negligence, "should not be second guessed" as per the business judgment rule. Thus, the obligation really became one of process.

Even in circumstances where one believed the law requires less than obligatory consideration, several practitioners recommended caution on the matter, saying "it's an easy test to meet and it's a foolish test to fail."[735] One practitioner in particular pointed out that "if you don't pay attention to a stakeholder interest, then you are left defending yourself saying, 'I didn't have an obligation to do it.'" The practitioner went on to state:

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[732] Practitioner #23.

[733] Practitioner #26.

[734] Practitioner #10.

[735] Practitioner #29.

> Why not just pay attention to it and then decide to dismiss it? This is where we get caught up in process so much as lawyers. It's just a safer thing to do. Turn your mind to it. Decide if it's important then move on. Our job is to protect our clients and so, it'd just be crazy for us to say, 'you don't have to consider that.' It's much safer to say, 'Consider it, balance it, then decide what you think is the right thing to do.'[736]

Most found that there was little change to corporate decision making subsequent to *BCE*, and a handful felt that this was because Canadian corporate law had already progressed to incorporating stakeholder interests through the oppression remedy and "best interests of the corporation," among other things. It may be that in the past "it just wasn't as open a discussion" as one practitioner put it,[737] but the consideration of stakeholder interests seems to have become a live issue in Canadian corporate governance practices. Some practitioners were disappointed with how *BCE* has forced a very process-driven exercise in Canada. Practitioners did not offer any solutions as to how to counteract the negative aspects of this process without stripping away the broader goals and/or interests that presumably are aiming to be served.

In the aftermath of *BCE*, it is somewhat unclear from a legal stance how the consideration of non-shareholder stakeholders fit in the decision making equation for Canadian directors. Practitioners cited a range of reasons why directors should consider stakeholder interests: due to *BCE*, concerns regarding the oppression remedy, the business case for doing so, or simply to play it safe given the ambiguity of Canada's legal position on the matter. Given that the combined total of 84% of the practitioners interviewed felt that directors were either obligated to or should consider stakeholder interests as a practical legal matter, directors may be well served by considering non-shareholder stakeholder interests in their corporate decision making, and documenting such process whenever possible.

[736] *Ibid.*

[737] Practitioner #24.

With regard to the good corporate citizen concept, one practitioner noted how the concept was "a bit of surprise coming out of our courts…they are not usually quite so bold."[738] Practitioners were split on how the concept has resonated with Canadian boards, if at all. Many found it highly irrelevant to board decision making, whereas others felt boards were keenly aware, but emphasized there were usually broader business reasons for companies electing to act with a social conscience. There is a high chance that without the push of external market forces, such as changing business trends and strategies,[739] process alone will do little in motivating corporations to act as good corporate citizens—the concept seems to have been somewhat lost in translation from the courts. Corporations are free to capitalize on the statement made by the Supreme Court, but since there is no legal meaning behind the concept, they equally can ignore it. The likelihood that it will become more relevant as a corporate governance tool in the future is unclear at this point in Canadian corporate governance history.[740]

While *Peoples* and *BCE* are somewhat unclear as to whether or not the consideration of stakeholder interests is a mandatory requirement, practitioners have been advising boards to document their consideration of stakeholder interests since the effort is minimal enough when weighed against the risks. Thus it seems that not only has the consideration of these interests in Canada been calcified in board practice, but so has the act of documenting such consideration.

5.1.4 Protection for Minority Shareholders

Principle: *"Noncontrolling shareholders should receive strong protection from exploitation at the hands of controlling shareholders."*

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[738] Practitioner #28.

[739] See e.g., Lubin & Esty, *supra* note 6.

[740] Industry Canada, *supra* note 21.

Many practitioners reflected on how Canada is home to several controlled companies, thus strong minority protection is particularly important. In Canada, it is easy for both founding and institutional shareholders to be able to exert extreme pressure on boards. Due to those significant players and illiquid stock, one practitioner noted how "movement in the stock can be quite dramatic."[741] That being said, there was overwhelming agreement that the principle of minority shareholder protection was "baked into our corporate law."[742] Given the several options available to minority shareholders and other stakeholders, there tended to be consensus that in Canada, "we are well taken care of."[743] The oppression remedy[744] in corporate law and Multilateral Instrument 61-101 *Protection of Minority Security Holders in Special Transactions* (MI 61-101)[745] from the securities regulators were often cited by practitioners as the most notable protections, although others raised the ability to bring derivative actions,[746] and another

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741 Practitioner #27.

742 Practitioner #21.

743 There were two notable exceptions in the group. One practitioner felt that there "is not enough of a corporate perspective to protect the minority—it needs to go further" and "would just prefer to see it dealt with in corporate legislation, rather than securities." Another, who did support the principle of minority protection, felt somewhat less sympathetic towards the plight of minority shareholders, reflecting on how "if I buy shares as a minority in a controlled corporation, I do so knowing that it is a controlled corporation and that there's going to be a controlling shareholder at the end of the day."

744 The oppression remedy is set forth in s. 241 of the *CBCA* and similar provincial statutes to describe the broader right of action on behalf of certain stakeholders (such as creditors) to apply to a court to rectify matters complained of where: (i) any act or omission of the corporation effects a result; (ii) the business or affairs of the corporation have been carried on or conducted in a manner; or (iii) the powers of the directors of the corporation have been exercised in a manner that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of any security holder, creditor, director or officer. This right goes beyond shareholders of a corporation.

745 Multilateral Instrument 61-101 *Protection of Minority Security Holders in Special Transactions*, OSC MI 61-101, 31 OSCB 1321, (1 Feb 2008).

746 A derivative action set forth under s. 239 of the *CBCA* and similar provincial statutes creates a broader right of action on behalf of certain stakeholders (such as creditors), in addition to shareholders, to bring on behalf of a corporation to enforce the directors' duty to the corporation when the directors are themselves unwilling to do so. A complainant, who may be a registered or beneficial holder of a security (including shares and debt obligations), a director or officer or former director or officer of the corporation, or "any other person who, in the discretion of the court, is a proper person to make an application," may bring an action, upon obtaining the leave of the court, to

pointed to specific rules under the Toronto Stock Exchange requiring minority approvals.

In particular, a number of practitioners expressed how the minority protection principle was "more true in Canada than in the US," in that "we are fairly unique" by having the concept of an oppression remedy, which protects not only minority shareholders but other stakeholders as well. One commented on how the oppression remedy in the past was existing "but only theoretically available," whereas now it becomes an important tool in corporate law.[747] Another expressed that the remedy "really does work" in that "it scares the majority shareholders more than anything. You can get into court in pretty short order. Courts do listen even though the cases may have gone a lot of times the other way."[748] On the other hand, one practitioner pointed to some limitations in the oppression remedy. It is only available against shareholders that own more than 50% of the company and a claimant also has to be an affiliate of the company to be a proper defendant. Since there are a lot of Canadian companies controlled by 40-45% of shareholders, the practitioner felt that the remedy had more limited use than one would assume.

Regarding MI 61-101, most felt it had gone a long way toward ensuring procedural and substantive fairness in related party transactions. There was an exception made by one practitioner, who felt that the rule did not prevent enough transactions that some would consider abusive because "it simply becomes a kind of formula to get through" and therefore in many

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enforce a right of the corporation, including rights correlative to the duties of the officers and directors of the corporation.

[747] Practitioner #16.

[748] Practitioner #14. See also, Stephanie Ben-Ishai & Poonam Puri, "The Canadian Oppression Remedy Judicially Considered: 1995-2001 (2004) 30 Queen's LJ 79. In reviewing oppression cases in Canada, Ben-Ishai and Puri contend that Canadian courts have applied the remedy in a way that reflects the primacy of shareholder interests and nexus of contracts model in corporate law. However, the increasing success of creditors as non-shareholder applicants pointed to a possible change in attitude by the courts. Ben-Ishai and Puri suggest the cautious approach by the courts is likely to continue in the near future.

instances "it just degenerates into a process."[749]

Other options were also considered by the practitioners. A few noted that while derivative actions were possible in Canada, they were not common and "terribly expensive to launch," and very few practitioners referenced this option. Others highlighted how the Toronto Stock Exchange has provided greater protection for minority shareholders by providing majority and minority requirements for approval of certain types of transactions, which listed companies are required to follow.[750]

Overall, most felt there was a good balance between the oppression remedy and MI 61-101 in protecting minority interests. Reflecting on Canada's position in the principle, a few practitioners expressed how the strength of Canada's statutory remedies, some of which specifically take into account the interests of other stakeholders, meant that Canada "cannot have a model that is 100 per cent shareholder primacy."[751]

Clearly, there are built-in principles in Canadian common law designed to protect minority shareholders from exploitation at the hands of controlling shareholders. While there were some nuances as to how effective the principles were in practice, the general sentiment amongst practitioners was that this principle was well supported in Canadian statutory and

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[749] The practitioner cited *Magna* as an example (see *Magna*, *supra* note 723 for further references), stating:

> There was vehement disagreement about whether that is a fair transaction or not and yet it passed muster through that whole process….What the OSC will say is, "at least we put it out in the open." People see what's going on. Yes, it may only be process, but it can't be done behind closed doors and if someone's unhappy with it, then they can go to court and try to put a stop to it and so on. The argument that would come up is not that one shareholder has some protection, but is it strong protection? That's where you might find some difference of opinion.

[750] For further discussion on the role the Toronto Stock Exchange has played in Canadian corporate governance, see Section 5.2.3.1.

[751] Practitioner #18.

common law rules, and that Canada also offers statutory protections to other stakeholders beyond what is outlined in the principle.

5.1.5 Principal Measure of Shareholder Interests

Principle: *"The market value of the publicly traded corporation's shares is the principal measure of its shareholders' interests."*

Under Hansmann and Kraakman's definition of shareholder primacy, the corporation is managed in the best interests of its shareholders, and the principal measure in a public company is the market value of the company's shares. For Canadian public companies, since the proxy voting system does not make the identity of a company's shareholders accessible to its board, and since directors are to manage a corporation in its best interests—which many practitioners identify as predominately meaning the interests of its shareholders—how can Canadian directors know what shareholders' interests are? Presumably market value is the measure. Practitioners' responses, however, were mixed, with many finding the principle problematic or incomplete, and others qualifying it in several instances.

Several practitioners expressed that, while it was hard to escape measuring a company's worth by market capital or by share price, sometimes market value doesn't have any resemblance to intrinsic value, particularly for highly illiquid stocks. Market value, explained some practitioners, "has nothing to do with the shareholder" and "more to do with shareholders' expectations."[752] Many said that the applicability of the principle depended in large part on the type of company and the investment criteria, with a few practitioners citing how since there are many illiquid companies in Canada, market value "is not really useful figure." It is just one of many measures and "doesn't really tell that much." Some practitioners recognized circumstances

[752] Practitioner #28.

where in the short-term market value will dip, such as in cyclical businesses or in fluctuations expected in anticipation of an M&A transaction. As put by one, "sometimes the best interest of the corporation will point you in the other direction and…quite often a board will take a step that does drive down or diminish share price in the short-term in the long-term best interest of the company." Many practitioners observed that, from the point of view of legal theory, those directors "are perfectly entitled to do that and indeed, they are doing the right thing."[753] Despite this, some noted that many external pressures force boards and management to do things in the short-term to prevent driving down the trading value at the expense of long-term benefit.

There were many practitioners who came down hard on the principle as a whole. One said that "if recent market experience has demonstrated anything, it is how fallible market values are as a measure of corporate or shareholder value."[754] Another found the principle "completely ridiculous" and "sufficiently obtuse," contending that the market value on any given date never represents the true value. Still one other practitioner who strongly disagreed with the principle made the argument that if market value were the sole test, "you would say that the current Canadian practice on poison pills, which is finally now under review, is the right practice...and essentially eliminate the efficacy of the poison pill."[755] Overall, practitioners tended to agree with one practitioner's comment that "it makes all kinds of sense to do a whole bunch of things that don't generate short-term value for shareholders if it advances long-term interests."[756]

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[753] Practitioners noted how it is usually the case in an acquisition transaction that the acquirer shares drop and the target company's shares go up, especially if shares are going to be issued by the acquirer to complete the deal.

[754] Practitioner #30.

[755] Practitioner #9.

[756] Practitioner #8.

The assertion that market value is an unreliable measure in relation to the intrinsic value of a company is certainly not novel. One of the common arguments against the shareholder primacy model is its overreliance on market value as representative of shareholders' interests. It has been well-documented in academia and elsewhere that market value is a fundamentally flawed measure of value in many instances, representing at times "irrational exuberance and anxiety" in the marketplace, with the events leading up to the GFC as the most recent and obvious example.[757]

5.2 Canadian Legal and Regulatory Landscape

While the securities commissions' stance on defensive tactics is largely touched upon in Section 5.1.1.1 regarding the poison pill debate, and the courts' proficiency in recent common law decisions is discussed in Section 5.1.3.1, this Section 5.2 discusses these issues from a broader perspective, addressing the nation's corporate legal and regulatory landscape and practitioners' views on how the courts, regulators, and other bodies have shaped the development of corporate governance standards in Canada.

5.2.1 Inadequacy of Legislators and Courts as Governance Leaders

There seemed to be a common understanding among many of the practitioners that the legislators and the courts were less influential in the development of corporate governance in Canada for a variety of reasons. While legislative action may be an appropriate route in governance reform, only a few practitioners mentioned the role of the legislatures in the development of corporate governance in Canada. That itself may signal how small a role legislators have played in the governance sphere, and indeed of those that brought up the role of

[757] Huang, *supra* note 155.

legislators during discussions it was almost always to point out their insignificance in Canadian governance. One practitioner pointed out that "legislators aren't well equipped" to deal with corporate issues and that corporate legislation "changes very infrequently in Canada."[758] Any efforts to illicit legislative change become "an extremely slow progression." Another practitioner reasoned that corporate legislation is "not something that politicians get particularly excited about" as "it's not something their constituency gets excited about."[759] Furthermore, since corporate legislation operates on a jurisdiction basis, it has not proven to be a robust method of helping governance practices evolve in Canada.

As for the courts, many practitioners did not to shy away from their strong feelings on the inadequacies of the courts in providing clarity in governance:

> I'll let my cynicism shine through here. As a broad overgeneralization, the courts are staffed by ex-litigators, many of which do not come from a corporate background…and that applies to the Supreme Court of Canada quite nicely. As a result, they've come to these decisions with immense brain power but not a lot of practical, corporate experience.[760]

> I don't think that the Canadian judges have a lot of self-confidence when they go to corporate law, and that's why decisions like *BCE* and *Peoples* are so weak…they have been criticized as not being done with a huge amount of conviction or expertise…When you go to court in Canada, you're going to get a very conservative kind of reaction…we don't have a lot of knock 'em dead corporate cases.[761]

> Off the top of my head, I couldn't name a corporate solicitor that's gone to the bench. You can have some challenges where you've got somebody dealing with a business case that really has no background on how these things really work, but anything really weighty in the business sense, no matter which way it goes, is likely to be appealed. Often these things shake out at the higher courts because, in general, these courts are

[758] Practitioner #28.

[759] Practitioner #31.

[760] Practitioner #22.

[761] Practitioner #1.

> quite sophisticated.[762]
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> Too few of our judges have any commercial experience….It's a bit of a crap game of who's going to hear the case. The real fear of going to court in a corporate matter is you'll get somebody who you've got to sort of start educating.[763]

A few practitioners noted how the courts may be limited in developing governance standards in Canada because "all the courts can do is discourage bad behaviour by sanctioning it. They simply have no instrumentalities to promote good behaviour."[764] A number of practitioners noted that generally, the courts give a lot of deference to the board due to the business judgment rule, with one practitioner observing that "it's a pretty low bar to jump over in order for the courts to say, 'I have to defer.'"[765] If the boards have followed proper process, avoided conflicts, and obtained enough information to make an informed decision, Canadian courts have proven that they are very reluctant to interfere.

Several lamented on the differences in Canada's courts compared to the US, noting that "there is a lot more self-confidence about the way things are done there,"[766] and commenting on how Canada does not have a set of developed common law principles in corporate law as they do in Delaware. Practitioners noted how the Delaware courts in particular have "a very active and knowledgeable court system," so that state has the opportunity to be the national corporate law-maker, whereas that is simply not the case in Canada. Practitioners generally found that Canadian courts have become "intellectually shallow on business issues" because of the

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[762] Practitioner #25.

[763] Practitioner #14.

[764] Practitioner #26.

[765] Practitioner #27.

[766] Practitioner #1.

securities commissions' deep involvement with public companies, although many practitioners found that the Ontario commercial list of judges was particularly adept. Several appreciated the strength of the Ontario commercial court, calling it "proficient" and "sophisticated" while others noted how provinces like Alberta make an effort to direct particular corporate cases to certain judges. One practitioner even envisioned a day when Canada would have a bench as advanced as the Delaware courts, commenting that "we can get there" and pointing to how judges on the Ontario commercial bench "are able to come up with some very nuanced and good decision making in real time."[767] Indeed, some practitioners noted that, while the courts haven't been as influential in the past on corporate governance, "litigation is increasing" and one practitioner pointed out that "courts are being used in the governance world more tactically, so people will fire in court procedures as a tactical matter, as shareholders against boards, boards against shareholders."[768]

5.2.2 Guidance from Securities Commissions

Whether by choice or through a process of elimination, securities commissions are now playing a major role in shaping Canadian corporate governance practices. One practitioner described it this way: "Canada is split into two—what the courts say, and what the securities commissions say. And what the practitioners determine to be one way or the other tends to be reflective of which power source they believe has the most sway, and is the most relevant."[769] By virtue of the fact that the securities commissions are by design created for the purpose of

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[767] Practitioner #4.

[768] Practitioner #27.

[769] Practitioner #31.

protecting investors, with a "public interest" jurisdiction to protect the capital markets,[770] many practitioners sensed that their influence has pushed Canada towards a more shareholder-centric model of governance.

Most practitioners identified with one practitioner's statement that "it's the securities commissions through the CSA, their national umbrella, which have driven the standards of corporate governance."[771] Many found it a curious Canadian phenomenon that the securities regulators were significantly affecting the corporate legal sphere. Practitioners recounted how when the securities regulators initially began encroaching on a space that was traditionally for the legislatures and the courts, it was "extraordinarily controversial." When the commissions first proposed adding special approval thresholds on related party and other transactions over a decade ago, one practitioner stated that

> [i]t was a hot issue at the time as to whether they were overstepping their jurisdiction. They were a specialized securities regulatory body, not a specialized corporate governance body or a corporate law body, so what business did they have in changing what the legislature had enacted in the *Business Corporations Act*? This has nothing to do with the raising of capital, the issuance of securities, or the fitness to sell securities of individuals that need license under the traditional views of what the *Securities Act* was there for.[772]

The regulators' involvement was understandable to some, in that the commissions have an interest in the governance of organizations accessing the capital market because "if they are better governed, presumably they will need less securities regulation."[773] Practitioners reflected on how eventually people got past the notion of the securities commissions overstepping their

[770] *Securities Act,* RSO 1990, c S-5, s 127(1) para 3. See also the equivalent section in other provincial acts.

[771] Practitioner #20.

[772] Practitioner #13.

[773] Practitioner #28.

jurisdiction and have now generally accepted the commissions' role in the Canadian corporate governance sphere.

A couple of practitioners, upon reflection, considered the role of the commissions from a theoretical standpoint. One practitioner recalled how the OSC recently came out with a paper on board diversity and measures through disclosure to encourage having more women on boards, and reflected,

> My first reaction is, although it's a subject that interests me, is this the right place for the securities commission? Traditionally they kept out of the issues like that, and it really caused me to think about whether they belong there and whether that's the right thing for the securities commission to do. I suspect their conclusion is if they don't, nobody else will, and somehow they work that into their 'public interest' mandate that it will be in the best interest of Ontario investors if they can add this diversity dimension to boards…but it's a surprising step.[774]

The other said that, in terms of appropriate jurisdiction under the CSA and AMF proposals, "there's an open question…their jurisdiction ends somewhere and some defensive tactics in theory wouldn't involve any sort of securities issuance."[775] Nevertheless, both said that practitioners have tended to follow what the securities commissions have said, whether or not it's securities-related or corporate law-related, without questioning their jurisdictional reach.

When asked explicitly whether the securities commissions were overstepping their role, several practitioners felt this was absolutely the case, but nevertheless, "there's a void, someone's got to fill it."[776] The growing role of the securities commissions in developing governance standards has been evident. Among the several ways that the commissions have

[774] Practitioner #18.

[775] Practitioner #23.

[776] Practitioner #14.

influenced governance standards, one practitioner recounted specifically how the commissions have required disclosure about director independence, have imposed independence standards for audit committees, and have made other disclosure requirements related to executive compensation, "which ultimately influences the board's behaviour if it has to be disclosed."[777] Other ways that they have influenced boards are pronouncements about selective disclosure. As one practitioner noted, "having the commission up there hovering on top of the corporation does influence the way directors see their job, the way boards are put together, and the way they conduct themselves."[778]

Overall, the practitioners' viewpoints in terms of the appropriateness of the commissions' role in governance tended to vary. The majority felt the regulators were "better than the alternative." For example, a few noted that the Alberta Securities Commission has been quite effective in reform, commenting on how their past involvement in the National Policy 58-201 *Corporate Governance Guidelines*[779] has helped increase the overall quality of corporate governance in Canada. Absent the securities commissions establishing rules and guidelines, and the courts enforcing them, Canada would not have the robust system that exists today. Another pointed out that the commissions have probably gone as far as they can in the governance sphere, and "having got to that point, nobody's going to come out today and say, oh get rid of all that, it doesn't do anything."[780] Some pointed to how the commissions have "been a positive in creating more fairness in transactions" under MI 61-101. Whether or not the practitioners agreed or

[777] Practitioner #18.

[778] Practitioner #32.

[779] *Corporate Governance Guidelines,* OSCNP 58-201, 28 OSCB 3640 (15 April 2005).

[780] Practitioner #26.

disagreed with what the securities commissions did generally, many conceded that the regulators are "knowledgeable and better equipped" than governmental or judicial bodies in the field, and the courts are helpful in providing outside constraints when the securities commissions "become a little bit too zealous."

Other practitioners tended to express general unhappiness over the regulators' dominance in the governance area. Several felt the commissions are not well-versed in evidentiary rules and "make it up as they go along." They also often fail to establish principles that can guide lower courts, with some agreeing that the commissions "are more effective on the rule-making side than the jurisprudential side."[781] A few remarked that the commissions have often disregarded findings from the courts. One practitioner noted that Canada's stance on defensive tactics "seems to give a short shift to what *BCE* is about...ultimately, the securities regulators are just saying, 'We don't care about *BCE*—that's just the Supreme Court of Canada, who cares.'"[782] And for a few practitioners, it was highly regrettable that the securities commissions have dominated, with one stating that there is "no place or need for securities regulators to interfere with the carefully engineered corporate structure."[783] This practitioner found that the commissions' interference inhibits boards' ability to fulfill their mandated duties, resulting in "the fate of the company being put in the hands of arbitrary shareholders." The practitioner found the commissions' myopic focus on shareholder democracy "farcical" and said that "Canadian business, our communities and society at large, are the losers as a result."[784] This

[781] Practitioner #5.

[782] Practitioner #4.

[783] Practitioner #16.

[784] *Ibid.*

practitioner much preferred that the securities regulators follow the lead of the courts in *BCE*, and the AMF proposal with regard to defensive tactics.

Many practitioners felt that greater power by the securities commissions in the governance sphere would mean greater shareholder primacy in Canada. One reflected on how, "notwithstanding all of the academic and judicial writing on the duties of the directors, as long as the securities commission holds their current view, we are, in an M&A context, still very much of the shareholder primacy model and that was tested very much by the *Magna* case."[785] Another reflected a general sentiment by some of the practitioners that "what's in the best interest of the shareholder doesn't align with better governance. That's where it falls down."[786]

The underlying issue tended to rest on the fact that since the securities regulators are able to act on a coordinated basis across the nation they are better equipped than those dealing with the administration of the corporate laws. One practitioner pointed out that the CSA "becomes a very convenient place to deal with changes," citing how the shareholder advisory group, the Canadian Coalition for Good Governance, in terms of changes that they or their constituency would like to make, "deliberately seeks out changes through securities regulation" because they don't view it as practical to pursue changes in corporate legislation, even if, from a philosophical perspective, it is more appropriate for that venue.[787]

5.2.3 Other Players

A number of other non-regulatory bodies were addressed by practitioners in terms of

[785] Practitioner #29.

[786] Practitioner #28.

[787] Practitioner #32.

their influence to Canadian governance. The few that received particular airtime from some practitioners included the Toronto Stock Exchange (TSX), the Canadian Coalition for Good Governance (CCGG), and Institutional Shareholder Services Inc. (ISS).

5.2.3.1 Toronto Stock Exchange

As a practical matter, most if not all public entities are listed on the TSX, hence they are regulated by the TSX.[788] To be granted a listing, companies are required to sign a listing agreement where they agree to comply with TSX rules, including any subsequent rules issued by the TSX over time. The TSX played a historical role in sponsoring the 1994 Dey Report[789] and, similar to some of the discussions in the previous section, there were open questions as to the appropriateness of the stock exchange in requiring rules beyond what was provided in the statutes.

One practitioner noted how the shareholder community has "very effectively and perceptively focused on the stock exchange as an instrumentality through which the boundaries could shift in favour of shareholder votes on more and more things."[790] A number noted how shareholder groups have had some success in persuading TSX management to increase shareholders' rights to approve actions that were traditionally in the hands of the board. Several shared the sentiment of this practitioner that "it is a very interesting phenomenon that the employees of a for-profit listed company are making decisions that affect the relationship between the rights of shareholders and the power of a board to manage the business and affairs

[788] One practitioner noted how the universe of issuers with publicly traded securities that are not listed on the TSX or TSX Venture Exchange is very small.

[789] Toronto Stock Exchange Committee on Corporate Governance in Canada, *Where Were the Directors? Guidelines for Improved Corporate Governance in Canada* (Toronto: Toronto Stock Exchange, 1994).

[790] Practitioner #13.

of the company,"[791] and a number expressed some latent concern over this. The practitioner went on to comment that "it seems like a curious group of individuals from a policy perspective to be making corporate law, effectively" and another stated that "at a certain point you begin to wonder whether it's appropriate for them to make governance rules."[792] Another practitioner's view was pragmatic, in that "if [the TSX rules] work for the way these companies operate, I guess I'm okay with that" but they did emphasize that

> sometimes you worry there's a bit of a conflict of interest because the exchanges want to attract the issuers to the exchange. The exchange goes all over the world in places where there are growing economies to encouraging people to get listed in Canada. So there is a certain tension that they would want to make it attractive to be listed here.[793]

While the exchange is not making universal rules for particular jurisdictions, they are making rules for every listed company and "it's a bit naïve to suggest that if a company does not like their rules, [it] can just delist and go somewhere else."[794] Thus, some practitioners identified the TSX as "a battleground where governance issues are discussed and are dealt with because it's a place that is willing to entertain the discussion."[795]

However, a number of practitioners noted that the TSX has "taken a backseat" on influencing governance practices of late, with one pointing out that once the securities commissions began getting involved in governance matters, "more or less the people didn't pay

[791] *Ibid.*

[792] Practitioner #24.

[793] Practitioner #18.

[794] Practitioner #13.

[795] Practitioner #13.

attention any more to what the stock exchange was saying."[796] Another practitioner felt, however, that the TSX was "stepping back into the governance game" and "giving more powers to the shareholders."[797] Still, one other practitioner shared how "you never feel with the TSX that they serve a comprehensive philosophy about how governance should be."[798]

5.2.3.2 Shareholder Advisory Groups

A handful of practitioners expressed their views on the influence of shareholder advisory groups in Canada, specifically the CCGG and ISS. Again, due to the lack of guidance from the courts and legislatures on governance, these practitioners found the rise of shareholder advisory groups a very positive one generally, as the organization has stepped in to advance good governance principles nationwide and have been influential in setting and regularizing several governance standards. Nevertheless, a number of these practitioners expressed their level of discomfort with the amount of power and influence held by these representatives of institutional shareholders.

Specifically, these practitioners shared concerns over how the CCGG has more sway outside their constituent membership and "have made themselves players in the market." Canadian demographics allow for these groups to wield enormous amounts of power since significant amounts of concentrated investment capital in Canada are managed by funds and fund managers. Many of those funds' operational policies state that, on any matters that go to a shareholder vote, they will vote with the CCGG or ISS's recommendations without looking behind why they are recommending it, "giving these groups more influence than anybody

[796] Practitioner #26.

[797] Practitioner #27.

[798] Practitioner #19.

bargained for." One practitioner commented specifically on how the ISS, being the watchdog for institutional shareholders and public companies, "have a bee in their bonnet about how much power they have over the words they say about companies."[799] This practitioner pointed out how "the comment of 'I like this practice' or 'I don't like that practice'" from the ISS "could turn majority voting from an 80 per cent approval to a 50 per cent approval" and they can influence all kinds of decisions. The practitioners noted how public companies are occasionally frustrated with the level of influence wielded by these groups, with one explaining that "there's no recourse if information put out by these groups is wrong, and it dramatically affects a decision that a company is taking."[800] Another reflected on how "investors may not understand that they're not getting much in terms of independent analysis on some of these big corporate decisions when they invest in a fund."[801] Most of these practitioners expressed a need for either disclosure rules, guidelines, or some other form of regulation to control these groups due to their enormous ability to influence the market.

There is an interesting phenomenon in Canadian governance. While it seems clear that the courts have tended towards greater board control and broader consideration for stakeholder interests, by and large the judiciary have fallen by the wayside in terms of developing corporate governance practices, with the exception of the occasional important case that brings particular issues to the forefront. For public companies, the securities commissions have increasingly stepped up their role in corporate governance to fill this void, along with other non-regulatory bodies like the TSX and shareholder advisory groups. These groups are very influential in the

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[799] Practitioner #27.

[800] *Ibid.*

[801] Practitioner #19.

regulation of public companies, and by design seek to protect shareholders' investments which most often translate to increasing shareholders' rights. It remains to be seen from the CSA's proposed harmonized approach to take-over bids and any final determinations regarding the CSA's proposed National Instrument 62-105 and the AMF proposal as to whether the regulators will be tempering their positions toward shareholder primacy in the future.

5.3 Looking Ahead

One practitioner said that good governance simply boiled down to one concept: common sense. Another had a unique take on the importance of governance in Canada, or lack of importance, finding "there is scant evidence whether good governance makes any difference" and likening it to a chicken soup theory, meaning "people say it does help because they want it to.... I have never seen a bad decision become a good decision because of corporate governance."[802] This position was imparted to on another practitioner, querying whether that practitioner agreed with the position. Reflecting for a moment, the practitioner responded:

> You know what would be even better…it's the stone soup theory. To me that has some real appeal, because then, it's artificial. It's a stone, but everybody is contributing something. It does make something; it makes something worthwhile for everybody's benefit. How we got there? Nobody individually knows.[803]

Corporate governance is in a constant state of evolution, deriving from various laws, customs, and processes, with legal, regulatory, and institutional pressures as well as issues tied specifically to particular product and service markets. It is undeniable that there are significant normative underpinnings. The exercise of outlining a Canadian model of corporate governance is a tricky one: comparative analysis can be drawn from not only theoretical definitions but real

[802] Practitioner #6.

[803] Practitioner #28.

world national comparisons as well, based on a variety of selected factors. One practitioner in the study reflected on how corporate governance "is one of those things that people struggle to define,"[804] and another noted that corporate governance "is a never-ending process…standards today are different than they were 10 years ago, 20 years ago, and so on…."[805] Outlining a national model may be a daunting task, and part and parcel of staking a position is that it is particularly vulnerable to alternative viewpoints, exceptions, and criticisms. Nevertheless, a healthy and robust discussion on the big picture view of Canadian corporate governance is needed. While American academic articles are frequently churned out addressing corporate governance issues, the discussion only occurs in fits and starts within Canadian legal scholarship.

In speaking with 32 highly trained and highly skilled legal professionals on Canadian governance matters, similar debates and discussions tended to take shape, and these debates and centres of tension mark the borders of how Canadian corporate governance is being challenged and developed—be it through the courts, legislators, securities regulators, or other bodies and external forces. One practitioner described the corporation as "more of an organism, with various components through it. That organism is a growing, evolving one, and it changes with the times, and beneath the society in which it operates."[806] This is also true of a holistic national governance framework that guides these corporations.

Practitioners' views on an overall Canadian model tended to depend in large part on what each practitioner found most compelling: the constancy of the corporate statutes and trajectory of the common law, or the power and influence held by the regulators. Leaving aside

[804] Practitioner #3.

[805] Practitioner #7.

[806] Practitioner #28.

change of control transactions for the moment, the building blocks of Canadian corporate law have some notable differences when compared with the academic definition of Anglo-American shareholder primacy, and common law developments have emphasized those differences. The legislation requires management to act in "best interests of the corporation" and makes available the oppression remedy, and taken with the 2004 *Peoples* decision and the 2008 *BCE* decision, practitioners tended to agree that Canada corporate law has "overtones of a broader stakeholder model." One practitioner put it succinctly:

> In fact, the shareholders do not have primacy in the corporate context in Canada, although directors generally think that they do. It's a very difficult distinction that the Canadian courts made based upon our corporate statutes and it's a very difficult distinction to explain to boards of directors.[807]

Perhaps this difficult distinction may be why many practitioners tend to keep those nuances in a Canadian model limited to boilerplate provisions. Several practitioners found the differences in Canadian law compelling and important, but the majority found the practical impact of these differences largely boiled down to a change of the process in corporate decision making only. Indeed, as one commented, "the areas of distinction between Canada and US that's recognized by high-end M&A corporate lawyers in Canada probably isn't recognized anywhere else."[808] Another practitioner found this to be due to the fact that "the Canadian public, in my mind, is so influenced by the US experience, the US media, and US information that it doesn't even know whether the law in Canada is the same or different."[809] And for many practitioners, deemphasizing the difference does little to no harm—keeping the focus on ensuring the process is complied with, but ending up with the same answer after going through the process is a less

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[807] Practitioner #24.

[808] *Ibid.*

[809] Practitioner #22.

controversial route, from a legal viewpoint.

Of course, the current state of Canadian corporate law is only one part of a larger story. For public companies, the Canadian securities commissions have become increasingly influential in the governance sphere. Isolated to a public M&A context, the lack of defensive protections available to boards and the shareholder-centric position held by the regulators generally point to greater shareholder control in Canada. Interestingly, a significant majority of practitioners did not prefer this trend. While a few included broader communitarian reasons, the large majority focused on how boards were not being utilized effectively in unlocking greater value for their shareholders in M&A transactions. So in fact priorities between the regulators and practitioners supporting greater board control are very much aligned—getting the highest share value for their shareholders is the priority. Regulators have tended towards increasing shareholder rights in order to accomplish that goal, whereas the overwhelming majority of practitioners in this study felt that action is misplaced. They contend that directors are in the best position to unlock share value, as it is their fiduciary duty in the best interests of the corporation, but directors are being denied the proper tools to do so. The practitioners' concerns tended to be focused on *how* the regulators have elected to protect shareholders' value—it should not be through shareholder approvals they say, but through greater powers bestowed on the board to exercise their duties to the corporation—which in almost all cases should translate to greater shareholder value. The CSA's proposed harmonized approach to regulating take-over bids may signal a step away from how Canadian governance is currently forming in the M&A context. Indeed, as one practitioner put it, "the shareholder primacy model has different ingredients to it" meaning "there are some elements that are stronger than in others" and most importantly, "the sands on this can shift."[810]

The conflicting theoretical positions from the courts and the securities commissions have enriched the dialogue on the current environment of Canadian corporate governance. One practitioner said that "we're still digesting the *BCE* decision—we've got a ways to go" and another wondered if Canada is experiencing "an overture in decisions."[811] While most felt that Canadian governance norms and culture are becoming quite well-developed, the frequent pull in different directions from the regulators and influential power sources in Canada have left Canadian governance in a "period of uncertainty. We're still trying to figure out what the model should be."[812] Corporate statutes have not changed, but power dynamics can shift. The rise of board education and influence has created more robust mechanisms to govern corporations, while the mobilization of collective action by shareholder advisory groups like the CCGG and the ISS has meant that that the institutional investors in Canada are a significant force to be reckoned with.

The common law has made the process of considering stakeholders in the best interests of the corporation more overt, well beyond what is assumed in Anglo-American corporate legal scholarship. Layered onto this corporate legal base, the securities commissions have provided other measures to bolster the field of corporate governance in Canada, while seeking to protect the integrity of the capital markets and the interests of investors within those markets. These efforts, along with those from other organizations, have raised and normalized governance standards, created more robust checks and balances, and helped to develop a stronger voice in

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[810] Practitioner #26.

[811] Practitioner #16.

[812] Practitioner #28.

the corporate governance movement within the last several decades. Tensions may be part and parcel of vigorous development, and the current debate on the treatment of poison pills should be seen as another healthy milestone in the evolution of Canadian corporate governance.

Looking ahead, future drafters of hybrid legislation in Canada will benefit from recognizing the tenets and the pressure points that form a Canadian model of corporate governance. While this qualitative study has shown that there can be a range of opinion as to how a Canadian model is defined, there are takeaways. The high-level assumption that Canadian corporate law is one and the same as American corporate law is incorrect. The hotly debated topic of shareholder primacy within American scholarship – regarding its merits, failings, suggested reforms, etc. – needs to be reengineered when catering to a Canadian audience and particularly when developing hybrids that are meant to serve as an alternative to shareholder primacy. The way in which Canadian corporate laws have been formed by the legislature, and have been interpreted by the courts, indicates that Canada has a more flexible model of governance which incorporates the consideration of non-shareholder stakeholder interests in corporate decision making – a feature that some American hybrids tout as unique from the mainstream. Landmark decisions by the SCC have emphasized these statutory differences, particularly in *BCE*, causing many practitioners to inform boards that they can – and indeed should – take into account non-shareholder value issues. Stakeholder interests may have always had a role in governance under Canadian statutory laws, but the courts have now generated a need for boards to document their process of considering those interests.

The dominance of the securities commissions in corporate governance has led to several consequences, some of which have been immensely positive for Canadian corporate development – such as the enhancement of shareholders' rights in particular areas – and other consequences that have been negative. In particular, the commissions' tendency toward equating greater shareholder control to better investor protection is problematic. The fundamental principles that have formed the building blocks of Canadian corporate law since the *CBCA*'s implementation in 1976, such as the board's fiduciary duties to the best interests of the corporation, and others that have been enhanced through the common law, such as the consideration of broader stakeholder interests, provide the best protection for share value. Although in its early stages, the CSA's move to lessen Canada's bidder-friendly position through its proposed "harmonized" regulatory approach is a step in the right direction to correct power imbalances between hostile bidders and target boards. As for reformers looking beyond share value in the pursuit of more sustainable public companies, the path of least resistance in the current corporate environment is also through increased board control, not greater shareholders' voting rights.

The legislature and the courts can and should be providing the critical foundations for our corporate laws, but in recent history they have not proven to be robust methods of helping governance practices evolve in Canada. The *CBCA* was last comprehensively revised in 2001, and during that period there have been significant shifts in Canadian governance standards. The long awaited consultation process by Industry Canada regarding revisions to the *CBCA* now provides legislators with the opportunity to ensure that Canadian governance moves along the desired path of development. Industry Canada's willingness to consider the implementation of new socially responsible enterprises within Canada's corporate landscape marks an interesting turn of events, but such an examination must also give heavy weight to the differing features found in a Canadian model of governance as compared to other nations, particularly those with hybrids Canada may imitate. Industry Canada may need to be deferential to the jurisdictions that have been overtaken by securities commissions or other bodies, such as the TSX in certain instances, but on the other hand, there are areas where Industry Canada must take the lead in forming the laws that govern Canada's corporations. Whether this includes the additional implementation of hybrids designed to elicit increased socio-economic contributions from Canada's social entrepreneurs remains to be seen. Canada's corporate laws need to be modernized to reflect Canada's leading position in good governance practices, as set by those in the legislature and the judiciary who have the mandate to consider the development of Canadian corporations as a whole, and not just in relation to its investors.

Using the insights gathered in this Chapter 5, the following Chapter 6 peels back the Canadian hotbed of corporate hybrid innovations and critically examines the potential benefit corporation, offering a pragmatic look at the legal ramifications of implementing this hybrid in Canada. Chapter 6 applies the information from Chapter 5 and weaves together a conversation that needs to be had between social thought leaders, legislators, and corporate practitioners before any further hybrid legislation becomes widespread in Canada. It becomes clear through the analysis that Canada should be wary of adopting American-stylized hybrids that do not account for Canada's existing progressive corporate legal stance, particularly given the indications Canada may be primed to attain a mainstream model which integrates CSR practices into its governance framework. As Canadian social leaders actively pursue hybrids in the coming years, it is critical that those leading the hybrid movement are informed on the status of Canadian corporate governance, so incoming hybrids can be tailored specifically to Canadian social and legal needs.

CHAPTER 6: Canada's Role in the Hybrid Game

The findings in Chapter 5 provide an interesting query to the analysis in Chapter 2 as to whether the shareholder primacy model is applicable to Canadian corporate law. The assumption in Section 2.2 is that there are serious limits to reforming the shareholder primacy model because of embedded ideological beliefs and path dependence. And yet, the empirical data gathered in Chapter 5 reminds us that the fundamental features of Canadian corporate law do not necessarily adhere to shareholder primacy, and in many ways is strongly indicative of a more stakeholder-based model. Nevertheless, recent history suggests that the Canadian securities commissions have pushed Canada's governance model towards shareholder primacy.

The fact is, Canada's southern neighbours affect Canadian culture and norms significantly, and yet, may also provide a useful antithesis in which Canadian culture can further differentiate and be ingrained. Partial convergence resulting from our global capital markets, as explored in Section 1.6, has also played a factor. Going forward, Canadian attributes in governance may continue to align with American ones, or they may cleave. Education is fundamental to differentiating Canadian laws, if indeed those reformers find particular laws that make up a Canadian corporation superior to that of the US. The state of the law on poison pills is in a state of flux, yet foundational tenets continue – including that directors are to act in the "best interests of the corporation," interpretations from the common law in *Peoples* and *BCE,* and the oppression remedy, to name a few as described in Chapter 5. These features must be kept in mind when considering the creation of new hybrid laws to form an 'alternative' to the existing model.

There are three "next generation" hybrids currently at play in Canada: the potential benefit corporation; the C3 and CIC enacted in BC and Nova Scotia, respectively; and the little known community service co-operative enacted in BC in 2007. British Columbia is quickly gaining a reputation as "Canada's Social Silicon Valley" as it ventures into socially innovative corporate legislation.[813] Other provinces are beginning to consider emulating the actions of this Western province, with little research done to justify such backing. How can Canada benefit most from the enactment of hybrids, if at all? The first half of this Chapter 6 considers the American benefit corporation in light of the information gleaned from Chapter 5, and the latter half considers what can be done to spur innovation and advance the social economy in Canada. The subsequent Chapter 7 will summarize the evidence and provide an overall framework for legislators and social innovators to assess whether a jurisdiction is well suited for the placement of new hybrids, and if so, how to strategically implement such hybrids going forward.

6.1 Challenges in the For-Profit Sector: Considering the Benefit Corporation

There has been considerable fanfare in possibly implementing a hybrid similar to the American benefit corporation in Canada in order to address traditional for-profit sector needs for social progress.[814] The movement originated from American social activists, who partnered with willing Canadian organizations to lobby provincial governments for new legislation. Ontario and British Columbia are particular hotspot provinces where benefit corporation legislation is

[813] Marcoccia, *supra* note 520. The term, however, has been used to describe other locations in Canada, thus it certainly cannot be assumed to be an exclusive term.

[814] See e.g. Stacey Corriveau et al, "Benefit Corporations in Canada: A Tool to Support Blended Enterprise in Canada" (2011) MaRS Centre for Impact Investing [draft with author] [MaRS White Paper]; BC Social Innovation Council, *supra* note 518 at 11; Adam Spence, "In Search of the Benefit Corporation" (25 November 2010), online: MaRS Centre for Impact Investing <http://www.marsdd.com>; Sustainable Prosperity, "Beneficial Corporations" (October 2012), online: Sustainable Prosperity <http://www.sustainableprosperity.ca>.

actively being explored.[815] MaRS Discovery District, a Canadian hub in social innovation, has drafted a White Paper pushing legislators to create an equivalent to the benefit corporation, calling it "an opportunity for Canada."[816] At one point or another there has been backing by several notable advocates for the Canadian version of the benefit corporation, including Vancity Savings and Credit Union (Vancity), The Natural Step, Social Innovation Generation at Waterloo, and the J.W. McConnell Foundation.[817] In 2012, the BC Council for Social Innovation issued an action plan with recommendations to maximize social innovation in BC, of which one recommendation included furtherance of the C3 and also that the government explore the possibility of creating public benefit corporations.[818] The underlying question is whether the creation of the benefit corporation would contribute to the advancement of Canada's social economy to a greater extent than if such an entity did not exist.

When compared to several of the findings in Chapter 5, the implementation of a Canadian benefit corporation raises some immediate concerns regarding redundancy when compared to Canadian corporate laws. There are several reasons for this: (1) Canada's corporate laws are more progressive and continuing to develop; (2) the main feature of the benefit corporation mirrors these progressive laws, and its implementation would only confuse what Canada's existing corporate laws are; (3) when this feature is stripped away, there is little that the benefit corporation offers; and (4) the benefit corporation has not had exponential success in the United States to date.

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[815] See Rachel Mendleson, "Canadian 'B Corps' Put Their Money Where Their Branding is" (2 March 2012) Huffington Post Canada, online: <www.huffingtonpost.ca>; Spence, *supra* note 814; Corriveau, *supra* note 814.

[816] MaRS White Paper, *supra* note 814.

[817] That is not to say that there is support now.

[818] BC Social Innovation Council, *supra* note 518.

The most significant legal innovation in the American benefit corporation is the requirement that directors consider stakeholder interests in their decision making. As was described in Chapter 5, this feature echoes what is already available under Canadian laws, specifically under the requirement that directors manage the corporation in the "best interests of the corporation," and findings from the *BCE* decision regarding the consideration of stakeholder interests. Indeed, practitioners indicated that the effect of the *BCE* decision has made the particular requirement to consider stakeholder interests much more potent, as directors feel the pressure to document and record evidence of the process they took to consider stakeholders' interests in their decisions. There is, as well, limited impact from this feature in any case. As seen in Section 2.1.1.1 examining "enlightened shareholder value" in the UK, making explicit that directors are to consider stakeholder interests in their corporate decision making seems to have made little difference in the outcome of decisions generally – a similar view was made by Canadian practitioners following the *BCE* decision, as noted in Section 5.1.3.1. In any case, on this requirement alone, the Canadian model of governance is already more stringent than the legal offering by the benefit corporation.

Numerous practitioners in Chapter 5 cited how in practice, the "best interests of the corporation" and consideration of stakeholders leads, more often than not, to the same conclusion that would be reached if directors' fiduciary duties were solely for the shareholders' best interests. This would certainly be the case under the auspices of a benefit corporation as well, given the business case for considering stakeholders in order improve long-term corporate performance. For those who would argue that the benefit corporation is better equipped to pursue a social value mandate when this pursuit runs against economic interests of the company – perhaps, but not for reasons that have anything to do with the construction of the corporate laws.

Flexibility in corporate decision making in Canada was not lost on the senior practitioners in the study. The board is not confined to short-profit or share value, nor required to consider only shareholders' interests. The board is not simply act as an auctioneer in the face of a take-over bid, but is required to determine what is in the best interests of the corporation. As for what equates to the best interests of the corporation, one practitioner in this study, when focused on the theoretical underpinnings of Canadian corporate law, pointed out that, "that's up to the directors to determine." And of course, the court in both *Peoples* and *BCE* specifically validated the business judgment rule. This is also in addition to the SCC's comment that directors are to look to the best interests of the corporation viewed as a good corporate citizen. If there is any legal import to be taken behind those words, then in that sense, all Canadian corporations should be acting as benefit corporations.

There may be a need here to also point out the differences from a private vs. public company standpoint. A closely-held corporation in Canada that falls outside the purview of the securities regulators has little to fear in pursuing a dual mandate. In its simplest form, as one practitioner put it, "that person can be the shareholder, director, president, and chief bottle washer…their interests are aligned with the company's interest so the better the company does, the better they do."[819] Closely-held companies can pursue whatever mandate they want without conflict if there is agreement, and indeed, several practitioners in this study practising in the private company sphere were clear that these companies had great flexibility the pursue profit-maximizing goals, corporate social responsibility, philanthropic and social goals, etc. If a company elects to expand its shareholder base and cultivates it, knowing its investors, there is

[819] Practitioner #25.

little concern in pursuing a dual mission of economic and social value in its corporate pursuits.[820] Provided that the board's decision is within a range of reasonable alternatives, the court will always defer to that judgment. Directors pursuing dual mandates are well protected under Canadian corporate laws.

Granted, for public companies, it is much harder to move away from focusing on shareholders' interests, which most oftentimes translates to meaning an increase in share value. This is due to a variety of reasons including general competitive business pressures – directors are under much higher scrutiny and institutional shareholders hold considerable influence, among other things. These pressures tend to force companies' to be drawn to the short term bottom line which at times is to a company's own detriment,[821] and there have been movements to combat this type of short term behaviour led by organizations that hold considerable weight in Canada.[822] Since the question being examined is in regard to the added value of implementing benefit corporation legislation in Canada, there do not seem to be any added legal features in the benefit corporation that would combat any of the pressures that exist for the regular Canadian public corporation. The model benefit corporation legislation requires a benefit director to be on

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[820] For added comfort, directors may be constrained using several legal tools to ensure the continuance of a social objective. As one practitioner noted:

> In a private corporation, you can put all kinds of constraints on the directors. You can use a unanimous shareholders' agreement or constrain them in the articles and bylaws and say, 'Look, we're the six shareholders and we don't want you to leverage this company over this ratio, and we're going to stick that in the bylaws….We're going to put a passage in the shareholder's agreement that you can't do that,' and they can't. The shareholders are able to step in the place of directors in a private company all they want.

The practitioner went on to note this is not the case in a public company as the shareholders will keep changing.

[821] See e.g. Graham et al, *supra* note 294.

[822] A few practitioners mentioned the joint initiative between Mark Wiseman, the President and CEO of the Canadian Pension Plan Investment Board, and Dominic Barton, the Global Managing Director of McKinsey & Company, see Barton & Wiseman, *supra* note 293.

the publicly traded benefit corporation's board – which one would assume is only meant to identify the specific tasks beholden to the benefit director and not the inherent reflection of a unique intent behind the benefit director's decision making, as all directors are beholden to their fiduciary duties.[823] Other than this feature, there are no other protections offered to support the social benefit side of the benefit corporation in a public company context. The legislation is not equipped to counter the pressures that public companies face on the global capital markets. Canada's legal and regulatory landscape is in a theoretical conflict, with the securities commissions, TSX, and shareholder advisory groups having the most significant voice at the moment in governance practices. These organizations by nature are meant to protect shareholders, and shareholders' approvals on governance matters have grown considerably in the last few decades. Public benefit corporations would still be subject to NP 62-202 regarding take-over bids and defensive tactics, including any sort of amendments. Benefit corporations would have the exact same issues as all other public companies in that regard.[824]

Some state benefit corporation legislation (such as Vermont's) do specifically indicate that directors, in considering the long-term and short term interests of the benefit corporation, a board may determine that those interests "may be best served by the continued independence of the benefit corporation." The added statement may offer some solace if directors are particularly struggling in their decision and fear certain ramifications in the face of a take-over bid. From a corporate theorists' perspective, the added statement is not necessary as directors already have that right under Canadian laws. Practitioners elaborated on how in select circumstances, even in

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[823] This is reflected in the model benefit corporation legislation, but not necessarily in every state benefit corporation's laws. See Benefit Corporation Information Centre, "Model Legislation" online: <http://benefitcorp.net/for-attorneys/model-legislation>.

[824] It should also be noted that, to date, there are no benefit corporations that are public companies.

a public company context, an alternative decision other than the highest bid offer, though rare, is feasible in Canada. As legal advisors, they simply would not recommend testing the parameters unless the conditions were right, but that is beside the point. There may be business reasons for inserting this language beyond what necessary in the law, and that is understandable. It is just unclear if corporate legislation is the appropriate place for it as opposed to contractual means, as the board discretion already exists in Canada, and regardless, take-overs in a public company context would still be subject to NP 62-202.

When the stakeholder requirements are stripped away from the benefit corporation structure, the remaining legal elements seem somewhat bare. The requirement that a benefit corporation create "a general public benefit measured by a third party standard" seems impressive at first glance, but a cursory glance at the benefit corporations listed on the Benefit Corporation Information Center's directory indicates that there are would be very few businesses that would be excluded from this standard. How does the sale of pastries, for example, provide a general public benefit? How does a regular cleaning business (with no mention of anything publicly beneficial on its website, not even eco-cleaning supplies) create a public benefit?[825] One practitioner mentioned Coca-Cola's somewhat counterintuitive campaign to fight obesity.[826] Could Coca-Cola be a benefit corporation? The "third party standard" measure seems to be a low one. Any corporation that has embraced the CSR movement and adopted some form of CSR practices in their business can become a benefit corporation. Benefit corporations also have no legal features to combat the limitations in CSR. As discussed in Section 2.1.1, empirical studies

[825] This is not meant to single this company out, as it was one of several benefit corporations that had little evidence of any general or specific public benefit on its website.

[826] Coca-Cola Company, "Coming Together: Help Us Fight Obesity," online: <www.coca-colacompany.com>.

have shown that CSR trends have been consistent with strategic CSR and profit-seeking management decision making.[827] There are no built-in legal mechanisms to prevent negative corporate behaviour in a benefit corporation beyond what is already available for regular Canadian corporations.

The trouble is that the benefit corporation's definition of a "general public benefit" fits perfectly into the dogma in Adam Smith's *Wealth of Nations.* Charles Elson, an advocate of shareholder primacy in the United States, stated: "It's politically correct to suggest that a company benefit the public rather than its investors. But investors are the public."[828] If indeed the proponents behind the benefit corporation believe the hybrid is offering something clearly different from the mainstream corporation, and presumably they do, their legal features need to be more explicit and set them apart from the classic economic definition of how business translates to public benefit. Proponents claim that benefit corporation laws differ from other milder offshoots of their movement, such as states that have chosen to offer SPC legislation with laws that 'permit' the consideration of social and environmental issues, leaving some claiming the distinction between benefit corporations and SPCs as "highly technical and not very meaningful."[829] This lack of distinction seems to carry across when compared to Canadian corporate laws. Of course, benefit corporations also have the option to include the requirement to produce a "specific public benefit" in their governing documents – but so can a regular Canadian corporation.

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[827] See e.g. Siegel & Vitaliano, *supra* note 291; Fisman, *supra* note 291.

[828] Angus Loten, *supra* note 385.

[829] Social purpose corporations, *supra* note 595; Brad Edmondson, "Benefit v. Social Purpose: Small Distinction, Big Difference" (29 February 2016) Benefit Corp Reporter, online: <https://benefitcorpreporter.com>.

The last two elements of the benefit corporation to be discussed are its benefit enforcement proceedings, and its annual reporting requirements. Directors in a benefit corporation have fiduciary duties only to those persons entitled to bring about a benefit enforcement proceeding against the benefit corporation.[830] The benefit enforcement proceeding is less stringent than the oppression remedy which is available to stakeholders against majority shareholders, and derivative actions claims which can be made against directors for violating their duties to the corporation. This is in addition to protections under MI 61-101 in a public company context. The legislation does indicate that proceedings can be brought against directors for failing to pursue a public benefit, but as earlier stated, there are inherent problems with the definition of public benefit, thus it would seem unlikely anyone would be able to bring a valid claim under that provision that would not already be captured under other tortious claims.

The annual benefit reporting requirement is certainly something that is not required by Canadian private companies. Public companies have their own disclosure requirements that presumably would capture much of the content within the benefit corporation's reporting requirements, but private companies do not have 'benefit' reporting requirements. Therefore, this legal feature does offer something that private Canadian companies seeking to pursue both economic and social value do not have. It should be noted, however, that the added social gain in these reporting requirements is immensely difficult to gauge. If these reports have any semblance to the CIC community interest reports in the UK,[831] which are regulated, these reports tend to read more as promotional materials rather than attaining any level of obligatory disclosure with legal implications akin to public company filings to the securities commissions.

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[830] These features have been described in detail in Chapter 5.

[831] See *UK Companies Act, supra* note 503.

Overall, there is a concern that the benefit corporation may resort to only a branding exercise if implemented in Canada. There are no meaningful teeth behind the benefit corporation legislation, and its offerings to Canadian corporate law are minimal. In fact, some of its standards are weaker. Even worse, the adoption of the benefit corporation may only confuse or misrepresent the current state of Canadian corporate laws. If the hybrid is regarded as a clear alternative to the mainstream corporate model, there is a risk that entrepreneurs may erroneously think that they are not able to pursue both social and economic value in their businesses without running some sort of legal risk. That would hinder the very social goals that presumably leaders behind the benefit corporation are trying to achieve.

It should be noted that many American social entrepreneurs seem to, perhaps unknowingly, prioritize the virtues of the benefit corporation based on its branding and marketing potential to consumers. The benefit corporation, if applied 'as is' in Canada, could arguably be viewed as a form of "rebadging" or "badge engineering" of a corporate legal 'product.' Badge engineering in known in business (typically in the automobile industry) as relaunching a different brand to an existing or similar product.[832] The Canadian for-profit corporation allows for all the same activities the benefit corporation offers, but the branding as a 'benefit corporation' may be where the value lies in attracting social entrepreneurs – despite its limited legal teeth. This argument certainly is not one being trumpeted by proponents of a Canadian version of the benefit corporation, but the analogy fits as the legal distinctions between the Canadian corporation and the American benefit corporation are unremarkable. The potential value, then, likely lies in the marketing and branding for 'do-gooding' corporations, not in making any legal sense as a distinct alternative to the mainstream corporation.

[832] Cliff Chambers, "What is Badge Engineering?" (4 November 2011), online: <http://www.motoring.com.au>.

The benefit corporation arguably has not had exponential success in the United States to date, so there are good reasons for Canada to wait and see how it fares. Indeed, discussions are bubbling up in the United States as well, as more practitioners are beginning to pay attention and question the relevance of the benefit corporation in states with "other constituency" statutes, among other nuances in its corporate laws.[833] At a minimum, Canadian legislators should wait and see how the benefit corporation develops in the US, including the possible development of exciting offshoots, and consider the subsequent discourse that plays out. Implementing American benefit corporation laws in Canada would effectively be adopting an American solution to an American problem. Doing so will lose sight of Canada's own corporate culture and norms, underdeveloped as they may or may not be.

Delaware case law has made it clear that directors have a duty to maximize shareholder value upon change of control transactions, and the creation of the state benefit corporation is a direct response to that case law. Their hybrids are designed to address American corporate governance needs for social progress. But a Canadian way is important and should be regarded as distinct from that of the United States. The MaRS White Paper recognizes that a failure to educate the Canadian public on existing common law may have created the need for a benefit corporation in Canada. This is not enough of a reason to create a new kind of corporate entity with similar governing features to Canada's developing progressive stance, and potentially hinder that development. There is currently the potential for all Canadian corporations have a wider responsibility to consider environmental interests, and to have sustainability baked into their DNA. The common law may be at the brink of this and adopting American-style

[833] Noam Noked, "Benefit Corporations vs. Regular Corporations: A Harmful Dichotomy" The Harvard Law School Forum on Corporate Governance and Financial Regulation (13 May 2012), online: <http://blogs.law.harvard.edu/>.

innovations will not push this forward.

To be clear, the private ‘B Corporation’ brand in an American context may indeed serve a purpose in identifying ‘good’ companies, and for Canadian companies there may be merit in marketing themselves as social purpose businesses while the laws for social enterprises are in flux and provincial governments consider the expansion of hybrids. The B Corporation process can raise internal environmental and governance standards in a manner that legal structures alone cannot through its Impact Assessment. Nevertheless, one cannot help but wish a Canadian certification process would originate that could allow for a unique Canadian voice to take shape in this movement. While Canadian companies interested in becoming B Corporations may elect to amend their governing documents to ensure non-shareholder stakeholder interests are enshrined in their mandate – a B Corporation requirement – unless the language is extraordinarily descriptive or restrictive, the inclusion of stakeholder interests would only replicate what is already protected under Canadian common law. Redundancy in the law is unnecessary, adds to confusion, and should be avoided. It is unclear what kind of fact scenario would require additional language in company documents to make the difference. Canadian directors employing CSR principles in their governance are well protected on several fronts in the common law, and it is not unreasonable to predict greater specificity in the future to some extent.

6.1.1 CSR in Canada

Corporate reformers seeking to create more sustainable governance from the private sector must take stock of existing laws and pinpoint ultimate goals. While CSR has become a dominant force in recent decades within academic scholarship, the role of corporate law in eliciting CSR practices has been a limited one, particularly in a Canadian context. The question is where the creation of entirely new hybrid corporate legal structures embodying CSR concepts fit into the equation. The current corporate landscape is particularly relevant in either diverting or strengthening Canada's position on shareholder primacy, and a progression towards "transformational" corporate governance may have been transpiring for some time now. The term "transformational" is borrowed from the business sector to help identify a tangible goal for corporate governance reform in Canada. The non-profit organization Canadian Business for Social Responsibility (CBSR) partnered with Coro Strandberg to describe 19 qualities of transformational companies, in particular describing what these companies do, how they do it, and with whom they interact.[834] Highlights from this list include having a sustainable purpose, long-term vision, and multi-stakeholder collaboration. Methods for achieving this form of transformational governance are multifaceted and may be dependent on the particular industry in which a corporation is involved. But the corporate legal elements that form the skeleton for transformational corporate governance, and particular market forces pulling away from old methods of governance, seem to be trending in Canada. A new era of reform has entered the CSR movement. Douglas Branson has noted that the CSR movement is "converging with, rather than diverging from, broader trends in corporate governance."[835] The collaborative interplay between normative and legal constructs and the coordinative mechanism of regulation that continuously interacts with external pressures significantly contribute to the establishment of corporate laws that incorporate CSR fundamentals.

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[834] Canadian Business for Social Responsibility, "19 Qualities of Transformational Companies," online: <http://www.cbsr.ca/qualities-of-transformational-companies>. The 19 qualities are: (1) sustainable purpose; (2) sustainable customer offerings; (3) solutions-oriented; (4) restorative. How they do it: (5) long term vision; (6) sustainability governance and culture; (7) leadership; (8) employee engagement; (9) inclusive business; (10) closed-looped; (11) resource productivity; (12) value-chain influence; (13) stakeholder accountability and transparency. Who they interact with: (14) customer engagement; (15) industry standards; (16) multi-stakeholder collaboration; (17) finance community; (18) public engagement; and (19) public policy advocacy.

[835] Branson, 'Redux,' *supra* note 266 at 1225.

Canadian legal scholars may disengage from the circular argument as to whether stakeholder interests and shareholder primacy can co-exist and whether stakeholders need to be recognized under the law. The *Peoples* and *BCE* decisions have made it clear that stakeholder interests are permissible considerations for any board to consider, not only with respect to how appeasing stakeholder interests may increase shareholder wealth, but also because considering those interests furthers the best interests of the corporation, when viewed as a good corporate citizen. Legal practitioners have solidified the concept by recommending that their clients document any consideration of stakeholder interests to protect against potential legal challenges. There has thus been an evolution in practice whereby 'permissive' consideration has calcified into a normative requirement. The codification of stakeholder interests into the Canadian legal governance framework has set the path for reforming Canadian corporate governance practices with respect to for-profit companies. Broad-based change to the shareholder primacy norm is necessary, and Canada is moving in that direction.

From a soft law perspective, the Canadian government has actively endorsed practicing CSR, including publishing CSR policies on social and environmental sustainability. Of course, as seen in Chapter 2, CSR has not been without its controversies. While CSR is viewed by some as an important key to solving many of the world's social and environmental problems, others have viewed as simply "cheap makeup for ugly companies,"[836] or even a threat to the public domain.[837] These internal struggles exist in the background of any discussions on hybrid alternatives catering to the for-profit sector. Nevertheless, the CSR guidelines implemented by

[836] Quote from Beate Sjåfjell in a panel discussion at the Sustainable Companies Project Final Conference, 5-6 December 2013, University of Oslo, Norway.

[837] See Joel Bakan *supra* note 382.

the Canadian government provide an interesting look at how CSR may play an influential role in outlining Canada's governance model. The federal government has encouraged the practice of CSR at home and abroad by endorsing the International Organization for Standardization's 2010 report *ISO:26000 Guidance on Social Responsibility*[838] and by implementing its own enhanced CSR Strategy: *Doing Business the Canadian Way: A Strategy to Advance Corporate Social Responsibility in Canadas Extractive Sector Abroad* [839](Strategy), which builds upon the experiences gained since the 2009 launch of Canada's 1st CSR Strategy, *Building the Canadian Advantage: A CSR Strategy for the International Extractive Sector.*[840] The Strategy adopts international performance guidelines set by the International Finance Corporation's *Performance Standards on Social & Environmental Sustainability* (2006),[841] the US State Department's *Voluntary Principles on Security and Human Rights* (2000),[842] the Global Reporting Initiative's *Sustainability Reporting Framework* (2011)[843] and the *UN Guiding Principles on Business and Human Rights* (2014).[844] The Canadian government's establishment of a Centre for Excellence

[838] International Organization for Standardization, *ISO 26000:2010 Guidance on Social Responsibility*, (2006) online: International Organization for Standardization <http://www.iso.org>.

[839] Global Affairs Canada, "Canada's Enhanced Corporate Social Responsibility Strategy to Strengthen Canada's Extractive Sector Abroad," online: <http://www.international.gc.ca/>

[840] Department of Foreign Affairs and International Trade Canada, *Building the Canadian Advantage: A CSR Strategy for the International Extractive Sector* (March 2009), online: Foreign Affairs and International Trade Canada < http://www.international.gc.ca >.

[841] International Financial Corporation, *Performance Standards on Environmental and Social Sustainability*, (effective 12 January 2012), online: IFC < http://www.ifc.org>

[842] US Department of State, *Voluntary Principles on Security and Human Rights*, (2000), online: US Department of State <http://www.state.gov/documents/organization/202526.pdf>.

[843] Global Reporting Initiative, *Sustainability Reporting Framework*, (2011), online: <https://www.globalreporting.org>.

[844] *UN Guiding Principles on Business and Human Rights* (new to the Strategy in 2014), online: <http://www.ohchr.org/>. Global Affairs Canada notes that the Guiding Principles "identify distinct but complementary responsibilities of companies and governments regarding human rights, resting on three pillars: 1)

in CSR provides a repository of information on related policies and practices along with a forum to advance pertinent CSR issues.[845] Together with Canadian common law, these guidelines create the outline for a Canadian transformational governance model.

In 2002, Janis Sarra noted that norms for effective corporate governance were underdeveloped in Canada.[846] As our global consciousness becomes increasingly aware of the environmental crisis at hand, the expectation that corporations will incorporate their own externalities into their business models does not seem unreasonable. *BCE* has left the law uncertain in a range of scenarios,[847] and this may work to favour broader community and environmental interests. Other reform efforts are worth noting. Significant improvements to curtail negative corporate externalities have been made within the CSR and SRI movements, although the strengths and motivations differ amongst its proponents. Green indices and other innovations from the social sector have attempted to recalibrate markets to account for hidden costs associated with the shareholder primacy model.[848] These efforts do not change the structure of the corporation *per se*, but go a long ways toward lessening the negative consequences attributed from the shareholder wealth maximization norm inherent in the corporate model and

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the state duty to protect against human rights abuses by third parties, including business; 2) the corporate responsibility to respect human rights through due diligence; and 3) ensuring greater access to effective remedies for victims. Global Affairs Canada, *supra* note 839.

[845] Centre for Excellence in Corporate Social Responsibility at the Canadian Institute of Mining, Metallurgy and Petroleum, online: CIM <http://web.cim.org/csr/>.

[846] Janis Sarra, "Corporate Governance in Global Capital Markets, Canadian and International Developments" (2002) 76 Tul L Rev 1691 at 1706.

[847] Waitzer & Jaswal, *supra* note 96 at 462.

[848] See Section 2.1.1 for more detail on CSR and SRI, including its limitations. See also e.g. Ethical Funds, "Ethical Funds," online: <http://www.ethicalfunds.com> and the work of the Social Investment Organization, its members, and affiliates (Social Investment Organization, "Social Investment Organization," online: SIO <http://www.socialinvestment.ca/>).

contributing to the external pressures that lend themselves to the coordinative mechanism in which laws take part. In an era when CSR has never been more relevant, Canadian for-profit corporations will soon recognize the ability to deviate from the shareholder wealth maximization norm that accompanies the shareholder primacy model under the direction and encouragement of Canadian common law.

The above analysis also recognizes the existence of external motivations that may pre-empt and/or inform the law. Several notable studies have considered corporate behaviour and factors that contribute to altering that behaviour beyond the direct implementation of hard laws. These works are important in the study of corporate self-governance, but there are always challenges in addressing an issue that spans across several disciplines and is broached in several theories and approaches within those disciplines. Thus, while Canada's corporate governance laws and norms have shifted away from those of its southern neighbour, maintaining a sensible understanding of the limits and opportunities that hard and soft laws can play in influencing corporate behaviour is important. Scholars have pointed out that in the past several years, "an array of stakeholders have turned to firms, rather than governments, to address enduring environmental problems including forest degradation, fisheries depletion, mining destruction, and even climate change."[849] An underlying awareness must be maintained as to how corporate law is part of a larger coordinative mechanism that continuously interacts with other dynamic pressures on the road to transformational corporate governance reform.

That being said, regulatory requirements have undeniably brought about significant

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[849] Auld, Bernstein, & Cashore, *supra* note 279 at 414.

improvements in shaping corporate behaviour.[850] Put in a legal context by Sarra, "rules or standards of corporate stewardship evolve in the context of the larger public policy and regulatory framework of corporate law, securities law, and a highly developed scheme of credit enforcement and bankruptcy law, which provide the normative 'muscle' to encourage particular kinds of governance behaviour."[851] Sensitivity to external pressures is important, but understanding the finer aspects of the law dealing with stakeholder interests, director accountability, and the broader corporate legal framework guiding a nation's corporations is fundamental and imperative for achieving greater sustainable development. Laws may be part of a larger, dynamic social phenomenon at play, but the power of ill-placed laws to limit opportunities and hinder growth is indisputable.

While the common law continues to balance the needs of shareholders versus other stakeholders, the rise of innovative new corporate structures forming on the sidelines that embed stakeholder interests and CSR into their governance structures, along with more aggressive social mandates, can be a useful tool. The central argument of this section is to point out that the legal features of the benefit corporation simply do not reach far enough to warrant its adoption in Canada. A meaningful alternative – one with governing features that are markedly different from the mainstream corporation and yet have the capability of gaining traction in corporate practice – should be the goal. Taking into account Canada's existing laws, the growth of CSR, and future trajectory of Canadian governance, the benefit corporation – if it were to be implemented in

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[850] See e.g. Robert A Kagan, Neil Gunningham & Dorothy Thornton, "Explaining Corporate Environmental Performance: How Does Regulation Matter?" (2003) 37 Law & Soc'y Rev 51 (the authors explore variations in regulatory compliance in select industries to better understand how and to what extent regulation matters in shaping corporate behavior. They found that "regulatory requirements and intensifying political pressures brought about large improvements and considerable convergence" in the facilities they studied which also resulted in several facilities going "beyond compliance" measures in their corporate actions.).

[851] Sarra, *supra* note 101 at 42.

Canada – fails to offer a meaningful alternative legal model of governance, and instead may obscure potential entrepreneurs and pose a threat to clarifying the law. If its value lies solely in the branding opportunities for businesses as do-gooding enterprises, then let us at least be honest about that fact, and call it for what it is – a watered-down version of the privately regulated B Corporation certification with state support.

As seen in Chapter 5, given the somewhat split personalities of Canadian governance in terms of its treatment by the courts and the securities commissions, there is some confusion as to where Canada stands as a whole in terms of corporate models, in the academic sense. Since the benefit corporation only offers solutions in the corporate law sphere, Canada's legal position in that realm is clear. The Canadian corporate governance model is more stakeholder-based, and more flexible to stakeholder interests and broader corporate purposes, and not one that requires the maximization of share value. Social entrepreneurs seeking to house their social businesses should be aware of these features in Canadian corporate law. Canada should not have to look southwards for direction in the area of innovative corporate standards. Doing so will result in losing sight of Canada's own corporate culture and norms, as developed or underdeveloped as they may be. Tensions within the common law and securities regulators, as well as within the theory and practice of Canadian governance indicate that mirroring early stage American hybrid innovations is premature.

6.2 In Search of the Winning Ticket

The emergence of hybrid corporate models that bridge the gap between for-profit and non-profit legal characteristics signals the growing demand for social change. Canada is poised to become a leader of transformational corporate governance reform on two fronts: through the reformation of its existing laws regulating mainstream corporate governance practices, and potentially in the creation of hybrid laws that can meet growing demands to legally house and govern social purpose businesses and enterprises. While the search for hybrids that may become the winning ticket to creating disruptive social innovations continues to elude Canada, there are legitimate arguments that hybrids may not be the appropriate solution for those seeking social change. These arguments are explored in Chapter 7. For those that see the potential value of hybrids in stimulating the Canadian social economy, there are three high-level actions that can be taken to promote the development of hybrids in Canada: (1) continued growth for existing hybrids; (2) support for emerging hybrids that enable traditional NPOs and charities to use the market as an engine to disseminate social products and services; and (3) the creation of new out-of-the-box hybrids, such as ones that link corporate economic interests with social output and appeal to the relevant players in the for-profit sector. Each of these actions is considered in turn.

6.2.1 Continued Growth for Existing Hybrids: Cooperative Ownership

As one of the oldest corporate structures in the world, the cooperative ownership model allows members the flexibility to pursue social, environmental and/or economic mandates in a particularly collaborative manner. The International Cooperative Alliance (ICA), described as "the voice of the cooperative movement," defines the cooperative as "an autonomous association of people united voluntarily to meet their common economic, social and cultural needs through a jointly owned and democratically controlled enterprise."[852] The role of owner and stakeholder are closely connected in a cooperative. A member is an individual who shares ownership of the cooperative and who is also a user of the cooperative in some way. This arrangement is distinct from that of a shareholder in an investor-owned corporation. While the shareholder owns shares

[852] International Co-operative Alliance, "Co-operative Identity, Values and Principles," online: ICA <http://ica.coop/en/what-co-op/co-operative-identity-values-principles>.

in the business, the shareholder may never be a user of the business. Cooperatives, then, may be regarded as "associations of people" whereas standard for-profit corporations are "associations of capital."[853] By pooling their resources and working together, members can satisfy a common need through the cooperative. Joint ownership means that all members are at least notionally equal decision makers, using a democratic system of one member, one vote. Members share the benefits of the cooperative, based on how much they use its services.

The ICA has outlined the hallmarks of cooperative ownership as follows**:** (1) voluntary and open membership; (2) democratic member control; (3) member economic participation; (4) autonomy and independence; (5) education, training, and information; (6) cooperation among cooperatives; and (7) concern for community.[854] Because of its institutional flexibility, the cooperative is highly adaptable to meet a variety of community development needs. Cooperatives can be created for a wide range of purposes and activities – from purely commercial to charitable. While primarily driven to achieve member benefit, cooperatives can make community benefit their first priority, or they can combine member and community benefits as they choose. Success is not only defined as profitability, but by other yardsticks as well – such as the improved well-being of the members and the communities that they inhabit. The ability to quantify value beyond simply economic return in response to members' needs is one of the strengths of cooperative ownership.[855]

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[853] British Columbia Co-operative Association, "The Co-op Advantage," online: <http://www.bcca.coop/content/ advantage>.

[854] International Co-operative Alliance, "Statement on the Co-operative Identity," online: <http://www.ica.coop/ coop/principles.html>.

[855] For further discussion on the linkages between sustainability and cooperative ownership, see Hagen Henrÿ, "Sustainable Development and Cooperative Law: Corporate Social Responsibility or Cooperative Social

Due to its ability to encompass multiple mandates, it is critical for the foundational objective of the cooperative to be consistently examined. While the values of a cooperative are the values of its members, scholars have pointed out that cooperatives likely house both individualistic and collectivistic minded members.[856] A part of the membership may expect the need for economic benefits to be top priority. Another may prefer cooperative management that considers other stakeholder interests as well. To satisfy the expectations of all the owners, "cooperatives must employ strategies that have their basis in individualistic view of ownership and business objectives, as well as in more collaborative and collectivistic views of ownership and business objectives."[857] The cooperative's success will depend on how well these foundations are built within the enterprise.[858]

Internationally, the United Nations has "recognized and reaffirmed the role of cooperatives in economic, social, and cultural development and in the achievement of social policy objectives."[859] The UN General Assembly declared 2012 to be the "International Year of Co-operatives" in order to highlight the importance of cooperatives to economic development

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Responsibility?" (10 July 2012) University of Oslo Faculty of Law Research Paper No. 2012-23, online: <http://ssrn.com/abstract=2103047>.

[856] See e.g. Iiro Jussila, Juha-Matti Saksa, & Pasi Tuominen, "Distinctive Features of Cooperative Ownership: Implications for Strategies of Customer Owned Co-ops" (October 2006) Presented at the 22nd International Cooperative Research Conference, Paris, France, online: <http://research.lut.fi> at 4.

[857] *Ibid.* at 4; see also Peter Davis, "The Governance of Co-operatives Under Competitive Conditions: Issues, Processes and Culture" (2001) 1:4 Corporate Governance 28.

[858] Canadian Co-operative Association, "How to Start a Co-op," online: <http://www.coopscanada.coop/en/coopdev/StartCoop>.

[859] United Nations, Department of Economic and Social Affairs, Division for Social Policy and Development, Social Perspective on Development Branch, "International Day of Cooperatives," online: <http://www.un.org/esa/socdev/social/intldays/IntlCoops/>.

and social innovation around the world.[860] Nevertheless, while for-profit corporations, charitable and NPOs are commonly known and generally contemplated by many entrepreneurs looking to house their social businesses, it seems that outside of those situated in certain sectors such as agriculture and housing, entrepreneurs have either been unaware of or less inclined to adopt the cooperative form.[861] Entrepreneurs may cite a lack of control, complicated decision making process, or limited availability of additional capital as significant reasons why the cooperative model is not ideal for their business. Equally so, mainstream corporate legal scholarship has paid comparatively little attention to cooperative ownership. This omission is curious given that the ICA reports that cooperatives have over 1 billion members worldwide and "provide over one hundred million jobs around the world, 20 per cent more than multinational enterprises."[862]

As corporate reformers desperately seek answers to the big sustainability question hanging over shareholder primacy, why is there such a great disconnect between them and advocates of the cooperative form, who claim to hold the answers?[863] The missing link between cooperative design and its widespread success is being addressed head-on by the ICA. Despite the cooperative's long history, the ICA contends that the model is being utilized well below its potential, and believes that "with appropriate support and greater understanding and recognition,

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[860] *Ibid.*

[861] For example, the cooperative structure is not a prevalent one in Canada, where there are reported to be only 8,400 cooperatives, compared to approximately 85,000 charities, 65,000 non-profit organizations, and over 2.4 million for-profit corporations. Co-operative Secretariat, "About Cooperatives in Canada," online: <http://www.coop.gc.ca>; Key Small Business Statistics July 2010, online: <http://www.ic.gc.ca>. See also Co-operatives UK, *supra* note 515; 2012 International Year of the Co-operative, "About NCBA," online: <http://usa2012.coop/about-ncba>.

[862] International Co-operative Alliance, "Co-operative Identity, Values and Principles," *supra* note 852.

[863] See, however, Henry Hansmann, "All Firms are Cooperatives – And So Are Governments" (2013) 2 Journal of Entrepreneurial and Organizational Diversity 10.

[cooperatives] could contribute much more."[864] At the start of 2013, the organization published a manifesto entitled "Blueprint for a Co-operative Decade" with the "unashamedly ambitious" vision for 2020 to be the year when the cooperative form of business "is an acknowledged leader in economic, social and environmental sustainability, the model preferred by people, and the fastest growing form of enterprise."[865] The ICA aims to elevate member participation and governance while positioning cooperatives as "builders of sustainability."[866] It pinpoints a main stumbling block in the cooperative movement being a lack of clarity as to how cooperatives are defined and distinguished, and cites a particular need to "establish an 'irreducible core' of what it means to be a cooperative."[867] The Blueprint outlines a multifaceted plan to secure the cooperative identity and increase its awareness, such as through cooperative education,[868] the engagement of young people,[869] and tapping on social media,[870] among other mechanisms. The Blueprint hones in on two important areas needing improvement: (1) "ensur[ing] there are supportive legal frameworks for cooperative growth"[871] and (2) "secur[ing] reliable cooperative capital while guaranteeing member control."[872]

The particular challenge facing the ICA with regard to cooperative legal frameworks is

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[864] International Co-operative Alliance, "Blueprint for a Co-operative Decade" (January 2013) at 3.

[865] *Ibid* at 39.

[866] *Ibid.*at 6.

[867] *Ibid.* at 30.

[868] *Ibid.* at 24.

[869] *Ibid.* at 11, 12, 23.

[870] *Ibid.*

[871] *Ibid.* at 26.

[872] *Ibid.* at 32.

that legal issues are very jurisdiction-specific, particularly as to how cooperatives within jurisdictions are treated in comparison to other available corporate structures.[873] Recognizing the difficulty in addressing these issues, the ICA has elected instead to provide high-level possible or indicative actions, such as:

(1) creating an international network of registrars and regulators;

(2) developing guidelines on how to apply the ICA Cooperative Principles;

(3) providing assistance to national parliamentarians, legislators, and policy-makers through a comparative study on the ways laws apply to cooperatives in different jurisdictions; and

(4) integrating the cooperative agenda into global development organizations;[874]

among other things. The ICA would also be well served by employing its 270 member organizations in 96 countries[875] to garner greater support in identifying and addressing these jurisdiction-specific legal challenges. Issues may include cooperative treatment under tax laws, competition and anti-trust laws, and other regulations.[876]

Securing reliable capital to finance the start-up of a cooperative business has historically been a stumbling block for entrepreneurs. Cooperative capital may come from several sources, including member and non-member investment and loans from banks, non-profits, and governmental sources.[877] However, cooperatives have limited access to most traditional sources

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[873] *Ibid.* at 26.

[874] *Ibid.* at 30.

[875] International Co-operative Alliance, "ICA members," online: <http://ica.coop/en/ica/ica-members>.

[876] International Co-operative Alliance, *supra* note 864 at 29.

[877] James R Baarda, "Current Issues in Co-operative Finance and Governance: Background and Discussion Paper" (April 2006), University of Wisconsin-Madison, online: <http://uwcc.wisc.edu/info/governance/baard.pdf>.

of capital.[878] Lending institutions tend to (formally or informally) impose a set of conditions on those seeking financing to ensure they are a desirable investment. Generally, these institutions seek applicants that are low risk and high return, with minimal consideration for any value created beyond the economic level. These requirements make it difficult for cooperatives, whose capital has been classified as "more patient,"[879] and while cooperatives can pay interest on capital, under the ICA's third Cooperative Principle, members receive "limited compensation, if any, on capital subscribed as a condition of membership."[880] The ICA acknowledges that "[w]hen compared with company equity capital, cooperative capital does not offer to investors comparable economic benefits," putting cooperatives at a notable disadvantage.[881]

In response, the ICA has offered several ways in which access to cooperative capital may be improved. In addition to increasing access to existing funding sources, the ICA suggests creating a modern generic financial instrument designed specifically to address cooperative needs, using group structure arrangements as a way to address cooperative capital accumulation, and creating a cooperative specific index to measure growth and performance.[882] These ideas are both innovative and ambitious, and it is unclear from the ICA Blueprint how they may be carried

[878] Nevertheless, there are new sources of capital being provided through the emergence of microfinance and private equity financing instruments devised from within the socially responsible investing (SRI) movement. International Co-operative Alliance, "The Co-operative Model in Microfinance: More Current and Pertinent than Ever," online: <http://ica.coop>.

[879] Jeffrey Katz & Michael Boland, "One For All and All for One? A New Generation of Co-operatives Emerges" (2002) 35 Long Range Planning 73; J. Nilsson, "Organizational Principles for Co-operative Firms" (2001) 17 Scandinavian Journal of Management 329.

[880] International Co-operative Alliance, *supra* note 862.

[881] International Co-operative Alliance, *supra* note 864 at 32. See also Amanda Wilson, "Financing the Co-operative Movement: For Better or For Worse?' The Dominion (5 April 2010), online: <www.dominionpaper.ca>; Baarda, *supra* note 877 at 62.

[882] International Co-operative Alliance, *supra* note 864 at 32.

to fruition.

The cooperative ownership model has been given new impetus from the UN's support and ICA's aggressive plans for growth. The fusion of owner and user roles in cooperative ownership enforces an unassailable stakeholder-based style of governance that cannot be replicated in for-profit companies**.** Cooperatives provide a legal structure that is ideal for communities wishing to achieve economic self-determination and regain control of local economies. Furthermore, research indicates that the survival rate of cooperatives is significantly higher than that of traditional businesses.[883] As advocates mobilize in hopes of generating significant momentum behind the cooperative movement, it is likely there will be much more to be seen from this model and its contributions to sustainability in the years to come.

6.2.2. If Implementing a Hybrid, Properly Invest: BC Community Contribution Company

Transformational corporate governance is not isolated to the for-profit sector. Unlocking the market potential from the non-profit sector is another way to combat the negative effects of shareholder primacy, infuse social value within communities, and foster greater sustainable development. As seen in Chapter 4, Canada has begun to experiment with the implementation of a hybrid specifically targeted to address a potential untapped non-profit sector resource in British Columbia and Nova Scotia, with the added benefit of observing how hybrid models have fared in the United Kingdom. It remains to be seen whether the *CBCA* public consultation by Industry Canada will lead to the adoption of a federal version of the BC C3

[883] Johnston Birchall & Lou Hammond Ketilson, "Resilience of the Co-operative Business Model in Times of Crisis" (19 June 2009) International Labour Organization, online: <www.ilo.org>. According to Co-operatives UK, between 2008 and 2011, while the UK economy as a whole shrank by 1.7 per cent, the co-operative economy grew by 19.6 per cent. In the same period, the number of cooperatives increased from 4,820 to 5,933. See also e.g., a 2008 Quebec study found that 62per cent of new co-operatives were still operating after five years, compared with 35 per cent for other new businesses. After 10 years, the figures were 44 per cent and 20 per cent respectively. Canadian Co-operative Association, 'Co-op facts and figures," online: <www.coopscanada.coop>.

model.[884]

There has been little by way of success in the BC C3 to date. The government has thrown no financial backing behind the model – understandable when public funds are limited but also a contributing reason for why the hybrid has not taken off. Unlike the UK, which invested a significant amount of time, money, and infrastructure to ensure the CIC gained particular traction among its nation's leading social entrepreneurs, the BC provincial government has made quite clear there is no funding available to be spent on the C3 model beyond the drafting of legislation, which presumably would be enough for entrepreneurs to take note. Unfortunately, after three years of being made available to the public, only 35 C3s are in existence to date (see Appendix A for a current list of BC C3s).

Why hasn't the BC model been as successful as the UK CIC, which is being heralded as "one of the fastest growing community-oriented enterprises"[885]? Some differences are apparent. The UK implemented considerable marketing surrounding the start of the CIC. The government committed to creating a form of "brand awareness" in the entity, whereas the BC provincial government has not. The importance of brand awareness cannot be overstated. Indeed, the B Corporation movement seems to have based its entire survival and success on brand awareness. Brand awareness in hybrid alternatives means that would-be entrepreneurs are cognizant of the corporate entity options available to them, and ultimately that their potential customers are also cognizant of a general meaning attributable to those entities. In the NPO, for example, Henry Hansmann points to its main purpose being in the public awareness that NPOs have a

[884] Industry Canada, *supra* note 21.

[885] CIC Association, *supra* note 514.

nondistribution constraint, and thus the consumer derives a level of comfort in supporting it. Public awareness is crucial to Hansmann's argument, but he presumes this awareness already exists. For a hybrid to have any level of success equating to the numbers found in the for-profit corporation, charity and NPO, cooperative ownership model, or the UK CIC, there must been efforts dedicated to creating a level of brand awareness that educates the public on what features make that hybrid worthwhile. An entrepreneur will be reluctant to sign onto a new hybrid if doing so requires an additional cost of educating the public on its purpose.

Since the BC government chose to implement the C3, it would have done well by ensuring that a critical mass of entrepreneurs had been ready to sign onto the hybrid at the onset of it being made available to the public. For the B Corporation branding, the creator B Lab timed its initial rollout with the signing of 80 companies as 'founding' B Corporations. In the UK, access to a pool of social finance was made exclusive to 'early adopters' of the CIC model.[886] Unfortunately, the BC government's failure to regulate, educate, and promote the C3 is a disappointing start for the hybrid, leading to the premature conclusion that hybrid is ineffective as a social value creation tool. There must be influential initial backers for any new hybrid to gain traction and success in the social enterprise arena.

There are of course other reasons that may lead to the failure of a model. While financial backing translating to brand awareness is imperative, the hybrid, first of all, must be one that has an attractive design. The community service cooperative, for example, which has existed in British Columbia since 2007, has proven to be a somewhat forgotten model, only kept

[886] See e.g. Community Interest Companies Association, online < http://www.cicassociation.org.uk/>. Thank you to Stacey Corriveau for this point.

alive by the people involved in the 12 or so that are in existence.[887] The community service cooperative has the same legal status as an NPO and it can apply for charitable status, it also cannot issue investment shares and has an asset lock. It is unclear whether the lack of use by the public is due to a failure of promotion or education, or perhaps the combination of legal features make the model unattractive from a business perspective for entrepreneurs. It is likely a combination of these factors, among others. The design of a hybrid must itself be enough to organically gain interest from opportunity-seeking entrepreneurs. Brand awareness goes a long way to providing this, but there must be worthwhile financial and/or social incentives to draw in social entrepreneurs so as to be a self-perpetuating model, where after the initial promotion of the hybrid for brand awareness soon becomes unnecessary as social entrepreneurs take note.

For the BC C3, its future remains unclear but there are legitimate fears that the model will land in the scrap heap of dormant law. If the provincial government sincerely wants the C3 model to succeed, on the belief that in the long run it will benefit the community and advance the social economy, there needs to a level of commitment beyond simply drafting the laws in the hopes that "if you build it, they will come." For any nation wanting to tap into hybrid success, at minimum there must be a serious focus on generating a level of brand awareness and reaching a critical mass of supporters to perpetuate the success of the model going forward. This lesson and others are explored in Section 7.2.

6.2.3 Enact Meaningful New Hybrids

Canada can choose to be an influential player in the development of hybrids, particularly those hybrids that can provide a realistic option for social enterprises that operate in

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[887] British Columbia Co-operative Association, "Co-op Legislation," online: BCCA <www.bcca.coop/content/legislation>

the for-profit sector. Ideas regarding how to accomplish this objective are developing, and should continue to be explored.[888] In addition to the models described in this dissertation, there is considerable space for nations to contemplate establishing new yet-to-be-seen forms of hybrid structures to better address growing demands from both for-profit and non-profit sectors. Ideas for innovative new models are being circulated. For example, a group of Canadian professionals and academics have put together a proposal urging their provincial governments to adopt a "deliberate corporation" model, where the disbursement of dividends is made dependent upon the achievement of measurable, non-monetary goals.[889] Opportunities are available to seriously push for a redesign of how the non-profit sector is financially supported, whether from a grassroots level or as a result of legislative reforms in reaction to the market. As a dynamic and evolving phenomenon, it is still undetermined whether hybrids will have any significant role in the evolution of both the for-profit and non-profit sectors. With any new innovation, there are potential ripple effects.

The hybrids explored in this dissertation are existing alternatives appearing in Anglo-American nations, but it is important to recognize that with any new hybrid, the possibilities are endless. Drafters do not need to beholden to the past. With risks noted and eyes open, there is always the opportunity for paradigm-busting, well-researched, and well-thought out models to come into being that could become the winning ticket for social change. Take for example the

[888] See e.g. Jason Dudek & Alex Zieba, "The Deliberate Corporation: Moving Beyond Social Business" online: Deliberate Economics <http://deliberateeconomics.com>.

[889] *Ibid.* A team in the UK is also exploring the establishment of a Social Enterprise Limited Liability Company (SE LLC), where investor returns would be capped at 10 per cent, among other governing features. See Claudia Calahane, "What is the Perfect Legal Structure of a Community Interest Company?" (4 April 2011), online: <http://socialenterprise.guardian.co.uk>; see also Arthur Wood, "New Legal Structures to Address the Social Capital Famine" (2010) 35 Vermont Law Review 45.

UK CIC, which minted its 10,000th registered CIC in April 2015,[890] and as of June 2016 had over 12,000.[891] Legislators should to work quickly, but they should also be smart. There is a latecomer advantage[892] to be had, where one can learn from the frontrunners of this movement. Ongoing support from leaders in both for-profit and non-profit sectors working in the realm of social enterprises will be crucial for optimal results in the implementation of any new hybrids. New hybrids need to be sensitive to the trajectory of development for existing corporate structures and alternatives and strategically position themselves within that set of options, while also ensuring that the hybrid structure is one that is useful to entrepreneurs. A framework for how this can be achieved is described in Chapter 7.

6.3 The Way Forward

Corporate governance itself is a complicated matter, deriving from various laws, customs, and processes – with significant normative underpinnings – and these continue to be formative years in development of Canada's governance standards. Landmark judgments from Canada's highest court have indicated that corporate directors are not confined to decision making focused solely on shareholders' interests, short-term profit, or share value. The SCC recognized that community and environmental interests, among other stakeholder interests, may also be taken into account. The SCC has found that directors are required "to act in the best interests of the corporation, viewed as a good corporate citizen"[893] and "commensurate with the

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[890] Twitter account of the Office of the Regulator of Community Interest Companies (@TeamCIC), *supra* note 512.

[891] *Ibid.*

[892] Thorstein Veblen, "Economic Theory in a Calculable Future" (1925) 15:1 The American Economic Review 48.

[893] *BCE, supra* note 405 at para 66, 3 SCR 560 [*BCE*].

corporation's duties as a responsible corporate citizen."[894] These findings by the SCC suggest that Canada is shifting away from the American shareholder primacy model. Vagueness in the law has meant that practitioners have advised clients to take a cautionary position with respect to the consideration of stakeholder interests in relation to directors' duties and liabilities, ultimately calcifying the concept into Canadian governance. In addition to tensions in the law, the growth of social enterprises in the business sector, the frequent appearance of CSR in codes of conduct, and a wealth of asymmetrical information from American neighbours have left Canadian directors with open questions on how to balance competing interests in their corporate decision making. Significant questions arise as to the value of sustainable performance when it is pitted directly against increasing shareholder value.

The path to reforming corporate norms and behaviour in Canada may be a challenging one. Thus, while the proper structuring of laws is critical to reform efforts, it is important to also consider the need for normative cohesion. While the shareholder primacy model might appear to be entrenched in the United States, reforms are occurring nonetheless both in corporate legislation and within the social sector. A growing movement is attempting to reclassify the shareholder primacy model, requiring businesses to pursue both economic and social mandates in their corporate decision making. In light of Canadian corporate culture, the trajectory of Canadian common law and the current governance landscape with regard to the rise of CSR and sustainability, Canada may elect to be a leader of innovative corporate forms in the foreseeable future.

This chapter has outlined the high-level beginnings of the path Canada may choose to

[894] *Ibid* at para 82.

take toward fostering sustainability through hybrid corporate models that will allow for more capital to be injected into social outputs. Further development of effective corporate governance norms is necessary in Canada. Canadian corporate legal scholarship must not become stagnant in relation to practical reform efforts. The opportunities to improve corporate behaviour in the shareholder primacy model are there, whether at a grassroots level or through legislative reforms in reaction to the market, and also to allow new models to co-exist alongside both public and closely-held corporations. The hybrid phenomenon is quickly becoming the new wave of corporate reform to which Canada should turn its focus. In light of the apparent lack of a cohesive theory within the counter-hegemonic discourses on corporate law and the potentially divergent language between corporate scholarship and practice, the growth of Canadian research will be essential to the advancement of transformational Canadian corporate law and governance in the future.

CHAPTER 7: Corporate Law as a Tool to Advance Socio-Economic Development

The underlying hypothesis in this dissertation is to test whether the creation of corporate hybrids will contribute to the advancement of the social economy to a greater extent than if such entities did not exist. While one may desire to broadly assume that, yes of course, the implementation of hybrids can only help to advance social progress, this would be an incomplete, and at times incorrect, answer. As previous chapters have shown, there are localized complexities and jurisdiction-specific nuances that may accompany any proposed hybrid, and disregarding those complexities and nuances only increases the chance that hybrid legislation will be underutilized or utilized in a manner to which it was not intended. Any implementation of a hybrid alternative has the possibility of affecting other potential solutions out there in the for-profit and non-profit arenas. To delve into the hybrid realm, one needs to first consider the challenges facing each sector within a particular jurisdiction, and the status of existing reform efforts. How do you transform the singular objective of shareholder wealth maximization in the corporate firm? How do you ensure NPOs have access to capital and can compete with for-profits, without diluting their non-profit purpose? To test the hypothesis, multiple components which formed the basis for the preceding chapters were considered and, much like puzzle pieces, amass together into this final chapter.

In short, hybrid legal structures that govern social value have the potential to advance the social economy beyond the status quo within a certain set of parameters, but there are risks. It is helpful for there to be a pre-existing strong demand for additional alterative corporate models from entrepreneurs. The model must provide a clear alternative to existing laws and not be based on incorrect assumptions about those laws. In addition to a legal justification there must be an economic justification, and considerable governmental support in administering, regulating, promoting, and educating the public on any new hybrid alternative that is made available in order to ensure there is brand awareness and long-term success. This chapter posits that efficiency is not a thing to be feared or vilified by those supporting counter-hegemonic discourses to the neoclassical corporate firm. Efficiency – when defined as achieving maximum productivity with minimum wasted effort or expense – is a worthwhile goal, and the emergence of hybrids may be reflective of efforts seeking to advance society towards a more "efficient" way of life. Nevertheless, without necessary initial support, every hybrid legal structure has a high chance of failure, becoming unused legislation that is ineffective in promoting social change and advancing the social economy, or worse, convoluting existing reform efforts on the mainstream shareholder primacy model. We have seen examples of this. The experiences from hybrids like the American low-profit limited liability company, BC community interest cooperative, and attempted cross-border implantation of the American benefit corporation in Canada provides valuable lessons for future legislators to consider when creating a hybrid to address the needs of their constituents. These lessons are considered in turn to provide a comprehensive framework outlining certain high-level steps that are necessary for the successful strategic implementation of hybrids.

7.1 Why the Hybrid?

It is quite understandable for one to regard the development of hybrids as simply addressing a niche sector of the market. At this point in history, corporate hybrids do not threaten to overtake the mainstream corporate model. They may even seem to be a timid solution to the sizeable challenges of today. Within some sectors, such as consumer products and retail, there may be more elasticity in reaction to competition and consumer preferences relative to other almost monopolistic sectors where embedded practices and ideologies are tied to significant amounts of existing capital and power structures. Nevertheless, as the cooperative movement and the UK community interest company have shown, there is merit in exploring hybrid alternatives as an additional pathway to reform. Much like the saying "from tiny acorns mighty oak trees grow," hybrids are small possibilities that may actualize in the future to become significant change agents within the economy.

Multiple pathways to reform and continued efforts are required in the pursuit of a more sustainable world, and hybrid corporations cannot be written off so early on by skeptics, when examples of successful hybrids have evidenced benefits. There are inherent challenges in measuring social value. Unlike economic value, the units of calculation for social value can be subjective, variant, and dependent upon a number of localized issues. It is far easier to affirm the utility of hybrids when live examples such as the UK CIC – with mandates to provide community interest, the ability to raise investor capital to pursue those interests, and 12,000+ registered CICs[895] in 15 years – strongly indicates an expansion of the social economy despite limited empirical data. The CIC's asset lock feature provides legal teeth to ensure funds go to community interest. It does not seem unreasonable to assume, given the exponential level of CIC adoption, that there has been greater benefit gained with the implementation of this hybrid model than without.

On a smaller scale, hybrids have the potential to influence communities toward positive social change, and address the needs of those holding minimal rank and power in society. This potential, when imagined, can be spectacular in scale. There is a great deal of appeal in the growth of do-gooding enterprises seeking to connect responsible business with the demands of the social economy. But, despite UK's success, a common argument leveled against new hybrid

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[895] Twitter account of the Office of the Regulator of Community Interest Companies (@TeamCIC), *supra* note 512.

forms is whether they are necessary to achieve positive results. And there is validity in this position; there are reasons to be cautious. The earlier chapters in this dissertation explored whether a corporate legal solution to reform the shareholder primacy model was effective, or if non-profit laws were sufficient. This section summarizes these findings, and also addresses whether market forces, tax law, or environmental regulation could play a role in eliciting change more effectively than corporate hybridity, or if parallel reform efforts can coexist.

7.1.1 Moving Beyond the For-Profit Corporation

The question as to whether it is worthwhile to create hybrids as an alternative to the mainstream model rests on a key notion: efficiency.[896] Is it more efficient to create a hybrid to meet certain demands within society, or is it more efficient to limit the focus on improving existing structures? Chapters 1 and 2 have dissected the shareholder primacy model at length, including the theoretical underpinnings and counter-hegemonic challenges, as well as the practical realities and barriers in achieving significant reform. Ultimately, there seems to be an impasse as to how to improve the governance of the corporation in a manner that would significantly move yardsticks. Ideological and practical limitations, including path dependence, make true reformation of this model difficult and almost ensure continuance of the status quo.

The neoclassical economic view of the corporation was founded on the premise that the purpose of the firm was to provide a more efficient way to economize the cost of organizing contractual activities.[897] Efficiency itself is a good thing – it is always ideal to maximize results while minimizing effort and waste. The trouble is that the concept has become convoluted.

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[896] The Kaldor-Hicks definition of efficiency is used here. For more on the definition of efficiency see Section 1.1, especially ftns 47-49.

[897] See Section 1.1 with reference to Coase, *supra* note 25.

Joseph Heath points out that "if one thinks of efficiency only in the most narrow economic terms, the American way may look efficient,"[898] but "fundamentally the United States is not a land dedicated to the pursuit of efficiency. When given a choice between liberty and efficiency, Americans consistently choose liberty, even when it makes life more difficult for them."[899] Heath's point seems revelatory. He states quite bluntly, "It's obviously more efficient to spend a bit of money on environmental protection than to let people get sick and then spend a fortune paying for their medical care."[900] Unfortunately, this common sense notion is easily lost within the management of corporate actions in a shareholder primacy model of governance. Short-term thinking with a singular objective of meeting quarterly earnings targets can actually destroy value,[901] yet it occurs over and over again in the private sector.

As stated prior, it is important that in the midst of ongoing reform efforts of the mainstream model, one does not lose sight of the existing and potential corporate alternatives. There is value in reconsidering the method in which efficiency is regarded and valued by borrowing elements from both institutional law and economics and new institutional economics (NIE). Elements within the two fields that assist as a starting point for understanding why hybrids may play an important role in reshaping the dialogue regarding the division of for-profit and non-profit sectors. Nicholas Mercuro and Steven G. Medema state that "[f]rom the Institutional perspective, law is fundamentally a matter of rights creation and re-creation."[902] The

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[898] Joseph Heath, *The Efficient Society: How Canada Is As Close To Utopia As It Gets* (Toronto: Penguin, 2012) at 20.

[899] *Ibid.* at 17.

[900] *Ibid.* at 30.

[901] See e.g. Graham et al, *supra* note 294.

[902] Mercuro & Medema, *supra* note 28 at 224.

government is seen as playing a central and inevitable role within the process because "[r]ights are whatever interests government protects vis-à-vis other interests when there is a conflict."[903] Significance rests on the issue of whose rights are enabled through law, as well as on the subsequent structures that perpetuate those rights. Thus, "terms such as regulation, deregulation, and government intervention [are] misleading," as the critical issue "turns on whose interests government allows to be realized and who is able to use government for what ends."[904]

The recognition of governmental rights creation also means institutional scholars challenge their neoclassical counterparts on the notion of an ultimate efficient result, arguing that an outcome is efficient only with regard to an assumed initial structure of rights.[905] The way in which a structure is formed "will give rise to a particular set of prices, costs, outputs, and the like, and thus to a particular efficient allocation of resources."[906] In this sense, institutional scholars strongly contend that "[t]here is no independent test by which the law's solution can be said to be the efficient solution."[907] A structural change means a corresponding modification to what is regarded as most efficient. As Warren J. Samuels asserts, "[t]o argue that wealth maximization [or any other efficiency criterion] can determine rights serves only to mask a choice of which interests to protect as rights. Legal decisions or changes can be said to be

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903 Warren J Samuels, "Commentary: An Economic Perspective on the Compensation Problem" (1974) 21:1 Wayne L Rev 113 at 127.

904 Mercuro & Medema, *supra* note 28 at 225.

905 A Allan Schmid, "Law and Economics: An Institutional Perspective" in Nicholas Mercuro, ed, *Law and Economics* (Boston: Kluwer, 1989) 57 at 68-69.

906 Mercuro & Medema, *supra* note 28 at 227.

907 Warren J Samuels, "Maximization of Wealth as Justice: An Essay on Posnerian Law and Economics as Policy Analysis," Book Review of *The Economics of Justice* by Richard A Posner, (1981) 60 Texas L Rev 147 at 155.

efficient only from the point of view of the party whose interests are given effect ….”[908] Because the government and institutional structures are seen as primary sources through which control or power is effectuated, the main focus of institutional scholars is to understand how the governmental allocation of rights within such institutions shapes the performance of the economic system over time.[909]

Institutional scholars take a critical look at the measure in which neoclassical efficiency is calculated. For institutional scholars

> The definition of ‘output’—of what it is that one is to be efficient about—requires an antecedent normative specification as to the appropriate performance goal for society. Social output (the aggregate well-being of society), consumptive output (the value of goods from the consumer point of view), and productive output (the value of goods from the producer point of view, i.e., profits) are three examples of the alternatives that are available. The value-laden choice of a particular definition of output as the maxim, which in effect is the choice of a particular social welfare function where many are possible, will drive the decision as to what constitutes the efficient allocation.[910]

The recognition of alternative efficient solutions, as well as the contingent nature of any “efficient” result on a presumed rights structure and definition of output, exposes the inherent normative elements embodied within the shareholder primacy model. The term “shareholder primacy” itself leaves little doubt as to which corporate actor is perceived as having the greatest legal and normative rights. Having share value as the principle measure of interest amplifies how “[t]he determination of a particular efficient solution involves a normative and selective choice as to whose interests will be accommodated, who will realize gains, and who will realize

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[908] *Ibid* at 154.

[909] Mercuro & Medema, *supra* note 28 at 224-6. See also Warren J Samuels, “Normative Premises in Regulatory Theory” (1978) 1:1 The Journal of Post Keynesian Economics 100 at 102-4 (the ideas in the preceding quote from Mercuro & Medema are attributed to Samuels’ 1978 piece).

[910] Mercuro & Medema, *supra* note 28 at 228.

losses."[911] Alternative legal models that allocate rights differently, or include other methods of calculating output, will invariably point to different 'efficient' outcomes.

NIE is also valuable to consider as it "consists of answering new questions, why economic institutions emerged the way they did and not otherwise; it merges into economic history, but brings sharper [microanalytic] … reasoning to bear than had been customary."[912] NIE asserts, among other things, that "institutions do matter" and "the determinants of institutions are susceptible to analysis by the tools of economic theory."[913] There are several elements within NIE that overlap with behavioural approaches; many NIE scholars reject formal rational behaviour, and advocate models based on Simon's bounded rationality,[914] among others. The institutional component of this field may provide that crucial missing link between neoclassical and behavioural approaches that is needed for a structural reform of the existing governance model. NIE may help to answer the question, "why [do] less than optimal arrangements persist over time[?]"[915] And more importantly, how can these suboptimal arrangements change?

Walter W. Powell has argued that "the full power of the institutional perspective has yet to be realized due in part to ambiguities in some of the initial contributions to this line of work and to the fact that a somewhat stylized version of institutional theory—a restricted

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[911] *Ibid.* at 229.

[912] Kenneth J Arrow, "Reflections on the Essays" in George Feiwel, ed., *Arrow and the Foundations of the Theory of Economic Policy* (New York: New York University Press, 1987) 727 at 734.

[913] R C O Matthews, "The Economics of Institutions and the Sources of Economic Growth" (1986) The Economic Journal 96:384 903 at 903.

[914] See Simon, *Administrative Behavior*, *supra* note 145 and Simon, *Models of Man*, *supra* note 145.

[915] Walter W Powell, "Expanding the Scope of Institutional Analysis" in Walter W Powell & Paul J DiMaggio, eds, *The New Institutionalism in Organizational Analysis* (Chicago: University of Chicago Press, 1991) at 183.

institutionalism—has thus far been explicated."[916] NIE's emphasis on environmental factors, power imbalances, political influences and economic arrangements are only some themes that may add considerable value when rethinking corporate governance reform. Admittedly, there is much more still to be developed in NIE; within the field there are several competing voices and ideas. But as Oliver Williamson put it, "the NIE is informative and should be included as part of the reform calculus."[917]

There is friction within the two fields – institutional law and economics had its glory days in the 1920s and 1930s[918] but continues to resonate in law and economics scholarship, whereas NIE (which was coined by Oliver Williamson in the 1970s) has been gaining popularity in academic circles and claims that "its best days lie ahead."[919] NIE seeks to differentiate itself from old institutional theory and offers vibrant discussions to present day issues. This tension may prove useful to corporate governance reformists; elements from both approaches help to clarify and broaden the scope of the issues necessary to consider when establishing a theoretical basis for reform.

The steadfast assumption that shareholder primacy should guide corporate behaviour is deeply embedded in Anglo-American ideological beliefs. The fact that the legal basis for shareholder primacy has been debunked by legal scholars time and again has not lessened its intransigence. Of course, if social entrepreneurs find the for-profit corporation or the NPO

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[916] *Ibid.*

[917] Oliver Williamson, "The New Institutional Economics: Taking Stock, Looking Ahead" (2000) 38:3 Journal of Economic Literature 595 at 610.

[918] John F Bell, *A History of Economic Thought* (New York: Ronald, 1967) at 568, cited in Mercuro & Medema, *supra* note 28 at 208.

[919] Williamson, supra note 917 at 611.

acceptable vehicles for their social businesses, then why prevent this? The corporate form is a flexible model – closely-held corporations ultimately can do anything they want within the confines of rules and regulations that do not limit them from pursuing social mandates. The "for-profit" element in the corporation is a misnomer in Canada, the UK, and the US (except in the US in certain takeover situations, the board is required to act ultimately as an auctioneer). Of course in a public company setting, a board would be hard pressed to justify low profits as shareholders are their main stakeholders. So there are limits to the corporation. The hybrid, therefore, must offer an alternative that can be differentiated from mainstream choices beyond simply targeted marketing, to address the demands of innovative entrepreneurs wanting governing mechanisms that will bolster dual economic and social mandates, signal the importance of these dual mandates to investors and other stakeholders, and ensure the more vulnerable 'social' mandate continues to survive into the future. Potential users should be able to observe the clear delineation between differing legal entities, and policymakers should shy away from models that may only add confusion to an already problematic normative understanding of the corporation. This is a legitimate concern with respect to the possible implementation of the American benefit corporation in Canada. Hybrids should help innovate businesses, not further entrench misinformed legal assumptions about the mainstream corporate model.

Further to the above, skeptics could note that, if entrepreneurs are not choosing to pursue both economic and social mandates even though they already can using the existing corporate model, why would they choose to form hybrids? The argument is that if entrepreneurs really wanted to pursue dual mandates within their business, there would be more of these hybrid forms already because the laws allow for them; and if there are only a few in existence, it is unlikely there will more even if a new hybrid form is introduced. This position is understandable, but is at risk of simplifying a complex problem and foregoing an opportunity as a result. Certainly, the explosion of social enterprises across the world suggests the former, that entrepreneurs indeed want dual mandated businesses. In the UK, the Department for Business Innovation & Skills (BIS) Small Business Survey found, in a randomized pool of 5,115 small and medium-sized business (SMB) employers, 27% viewed their business as a social enterprise, defined as "a business that has mainly social or environmental aims."[920] This is over a quarter of sample set, which if considered proportionally attributable to the 5.24 million UK SMBs in existence,[921] then one gains a general sense of the potential magnitude of social enterprises.

Next, social entrepreneurs are likely not going to want to reinvent the 'legal' wheel. They may be business professionals and leaders in their own right, but most are not legal experts, nor do they seek to be. As a social entrepreneur, the legal options should be clear. The circumstances in which an entrepreneur is willing to seeking out independent legal advice, or even go so far as to attempt to redesign their legal governance structure on their own, are rare and place too heavy a burden and cost on individual entrepreneurs to come up with inventive ways to govern themselves. Social entrepreneurs are eager to get down to business. As put by Dan Pallotta: "I am not an academic. I am an activist and an entrepreneur with all the passion and impatience those roles imply."[922] The expectation that entrepreneurs are to each spend the time to legally redesign their governance structure to enable dual mandates, and further, to somehow inform and educate their stakeholders on these one-off changes, is highly inefficient.

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[920] UK Department for Business Innovation & Skills, "BIS Research Paper No 214 – Small Business Survey 2014: SME Employers 2014 (March 2015), online: <https://www.gov.uk> at 35.

[921] *Ibid.* at 112.

[922] Pallotta, *supra* note 15 at xv.

Indeed, the difficultly in doing so led to Pallotta's book, *Uncharitable*,[923] as well as a chorus of complaints from social leaders as to the problems facing in entrepreneurs wanting a clear road map on how to legally support what they want to do.[924]

This is not to say that entrepreneurs are incapable of designing their own one-off legal structure, and certainly many have elected to pursue social and environmental goals beyond any legal or other standards they have imposed upon themselves. The suggestion that social innovators would be incapable of harnessing the power of business for good due to lack of legal infrastructure they could themselves employ seems almost dismissive of their capabilities. So, it is important to clarify here that it is not so much that social entrepreneurs would be incapable of designing their own infrastructure, but that it is far more efficient for a clear, off-the-shelf hybrid alternative to be made available than to expect every social enterprise to design its own one-off supporting infrastructure. If the assumption is that rational behaviour is self-interested, which capitalism assumes,[925] it is fair to say that when creativity has the carrot of significant financial gain, such a carrot will spur far more effort and innovation than when the carrot is about establishing rules that one wanting to enforce upon itself. The question should be whether offering a favourable hybrid alternative can spur innovation more so than if entrepreneurs were left to their own devices, as they are now. The evidence from the UK suggests yes, but the answer is far more nuanced as it depends upon a number of factors which we will consider in Section 7.2.

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[923] *Ibid.*

[924] See e.g., Wingrove, *supra* note 17, Corriveau, *supra* note 814, Draimin, *supra* note 473.

[925] See e.g. Posner, *supra* note 171 to 173.

This author's experience leading a project to design legal infrastructure supporting the dual mandate of Tyze Personal Networks Ltd., a Vancouver-based technology company providing online tools for people during illness and disability (Tyze), affirms the efficiency argument and position that social entrepreneurs likely prefer not to devise their own governing structures. Tyze's eagerness to go through the process of seeking out legal support for social mission infrastructure should be regarded as unique – the CEO Vickie Cammack has a history of working in the non-profit sector and leading innovative solutions to social problems. She wanted Tyze to be an example for budding social enterprises. At the conclusion of the project, a variety of options were explored and some implemented, but the takeaway was that one-off designs could not serve as a permanent solution for social enterprises wanting hybrid legal infrastructure. Some issues included (1) the time and cost commitment, (2) the ability for companies to choose their own legal features, thus diluting the significance, and (3) a lack of awareness and understanding from clients, investors, and other stakeholders as to what additional legal steps enterprises would be willing to take to ensure their social mandate, among others.

In furtherance to the second point above, that the ability of an entrepreneur to design its own governing mechanism to support its social mandate may dilute its significance, may be reflective in available empirical data. In particular, in the UK BIS Small Business Survey, when the BIS applied a more stringent definition of 'social enterprise' to businesses identifying as such, the percentage was considerably lower than those that self-identified. The BIS defined social enterprises as companies that "should not pay more than 50 per cent of profit or surplus to owners or shareholders and should not have less than 75 per cent of turnover from trading," and required employers to agree that their business has "primarily social or environmental objectives, whose surpluses were principally reinvested for that purpose in the business or community rather than mainly being paid to shareholders and owners."[926] Under this definition, only 5% of businesses met the BIS standard for being labeled a 'social enterprise'[927] as compared to the 27% that self-identified. This example emphasizes an inherent problem in expecting social entrepreneurs to fend for themselves in establishing governing mechanisms to keep their dual mandates in check, while highlighting why hybrid legal structures may be beneficial to the burgeoning field of social enterprises.

With respect to the third point, the status quo limits social entrepreneurs from having the benefit of brand awareness and the automatic communication of their base virtues. Hansmann's observation in Chapter 3 that one of the main differences offered by NPOs is that they allow the consumer to have assurances that their payments (donations, etc.) are in fact being used to provide the services they wish to purchase. A hybrid legal entity would also provide this signal to stakeholders assuring that the social mandate is sincere, presuming it is promoted sufficiently by legislators to produce brand awareness (more of which is discussed in Section 7.2). One-off governance structures make it particularly difficult for this signal to be conveyed. For this reason and the others noted above, the establishment of a hybrid available to everyone seems far preferred than the expectation that each social enterprise spend individual time designing their own dual mandate into their corporate structure.

If there is low-hanging fruit worthwhile for the picking within the emergence and growth of hybrid corporations, it would be to create a hybrid alternative to the mainstream corporation that entrepreneurs situated within the for-profit sector would be drawn immediately

[926] *Ibid.* at 35.

[927] *Ibid.*

too. Adding more impactful, “put your money where your mouth is” features to the already existing American benefit corporation, for example, would be an improvement that Canada could consider. An appealing feature could be taken from the “deliberate” corporation model, mentioned in Section 6.2.3, which is an idea put forth by some Canadian scholars where the disbursement of dividends is made dependent upon the achievement of measurable, non-monetary goals.[928] These hybrid legal structures aim to address the “social capital famine” by attempting to capture more of business capital and putting in toward social good.

Thus, while there certainly is merit in pursuing solutions through existing corporate legal structures, these reform efforts do not justify *excluding* parallel efforts at creating new and innovative hybrid structures to challenge the mainstream model. Indeed, as seen in Chapter 2, efforts at reducing the negative externalities resulting from the shareholder primacy model have existed for decades, and some efforts have been met with considerable success. The stakeholder approach to management, for example, has shown that the consideration of stakeholder interests is ultimately better for the longevity of the company and can improve its bottom line.[929] Other counter-hegemonic discourses have been less effective.[930] These discussions can and should continue, but do not negate the potential value in considering alternative parallel routes at reform.

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[928] Dudek & Zieba, *supra* note 888; see also *supra* note 889.

[929] See e.g., Eccles, Ioannou, & Serafeim, *supra* note 597.

[930] See e.g., “Progressive Corporate Law” in Section 2.1.2.

7.1.2 Market Forces Are Not Enough

A similar argument against the implementation of hybrids as those made in the previous section is the notion that market forces alone are sufficient to improve the role of business in advancing the social economy. Those proponents see the corporation merely as a shell in which the demands of the market and its shareholders are reflected. For example, corporations will respond to growing consumer demands for more sustainable products in order to remain profitable to its shareholders. There may be some legitimacy in this position; David Lubin and Daniel Esty report how sustainability is an "emerging megatrend" that may soon "force fundamental and persistent shifts in how companies compete."[931] Proponents of the "market forces" argument believe that capitalism itself will one day sooner or later rectify issues of unsustainability, social inequality, and other risks that are recognized and valued by the public. Certainly, the growth of CSR and SRI has been effective in tempering some of the negative externalities that arise under shareholder primacy. But as Section 2.1 discussed, CSR trends have been consistent with rational, profit-seeking management decision-making. SRI remains a minor figure in the capital markets. There are legitimate fears that the commodification of CSR means significant limitations in ever producing substantive change.

From a historic standpoint, the corporate behaviours that initiated the GFC as discussed in Chapter 1 should be evidence enough that the reliance on market forces is an uncomfortable and weak position to hold. Shifts in thinking in the wake of the GFC from even the staunchest free market supporters is a signal of the immense fallibility in trusting the market to promote social change. Market forces cannot be relied upon to ensure corporations help to advance the social economy, and in fact, are often seen by environmental policy scholars as a fundamental

[931] David A Lubin & Daniel C Esty, "The Sustainability Imperative" (May 2010) Harvard Business Review 2.

impediment to sustainability. The limits to social change within the framework of the market have often fueled the justifications behind the non-profit sector and even its expansion. In fact, the trouble may be that corporate hybrids (in the foreseeable future) do little to nothing in combating the juggernaut of destructive capitalism.

If market forces are not enough, and indeed as seen in Chapter 1, excessive reliance on market forces has led to normatively bad outcomes time and again, how does this strengthen the case for the creation of new hybrid corporate forms, given that hybrids are optional and profit maximization is not legally mandatory? Simply, hybrids offer another way to combat negative market forces. If consumers can be viewed as voters that vote with their wallets, hybrids aim to offer these voters more choices. Hybrids do not offer direct solutions to the regulatory issues that foster short-termism and destructive capitalism, but attempt to grow a kind of business that seeks to do things differently, guided by bettering the world. In this way, hybrids participate in the market discussion by offering different goods and services, having innovative business plans where one profitable area subsidizes charitable works, and potentially disrupting the market. More on the potential for disruptive innovation from hybrid goods and services is discussed in Section 7.3. In any case, if lasting change on a broader scale is expected, then in addition to reforming regulatory rules, other pathways such as hybrids should be considered.

7.1.3 Challenges with Tax Law Reform

The act of reforming or changing tax laws may be an effective way to bridge the gap between the for-profit and non-profit sectors, but there are notable challenges. The philosophical and political debates surrounding appropriate taxation policies can permeate community dialogues and be punctuated at times within media. To recap, no existing hybrids to date have any tax benefits attached to them. In Canada, there are conflicts in how the courts and the CRA are choosing to address NPOs qualifications in relation to tax exemptions. The courts have tended to be more lax with restrictions to commercial businesses within NPOs, whereas the CRA has aggressively indicated that any business activities operating beyond a cost-recovery basis or having an unreasonably high accumulated surplus are viewed as likely indicators of a for-profit purpose.[932] The BC Centre for Social Enterprise estimates that approximately 75% of existing NPOs in Canada are violating the no-profit rule, and the CRA has concurred with that estimate.[933]

There is clearly a problem in the regulation of tax exemptions within non-profit sector as it currently stands. The CRA has historically chosen to turn a blind eye on NPO business activities, and any attempted crackdown is met with great resistance, particularly if it is done on a selective basis. There were cries from the non-profit sector for notable biases in issuing "political activities" tax audits to charities that spoke out against the Harper government.[934] Threats of audits create immediate advocacy chill within NPOs.[935] CRA interpretations have put NPOs, particularly charities, in a vulnerable position, as there is a higher risk that an NPO's tax-exempt status will be legitimately challenged under the new guidelines. But if approximately 75% of NPOs (around 60,000+ NPOs across Canada) are violating CRA rules, then how are tax regulators expected to address this issue? Any serious attempt at policing such violations would

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932 See CRA, *supra* note 455.

933 Stacey Corriveau, "Empowering Non-Profits to Unleash Maximum Impact: The Destination of Profits Test in Canada" BC Centre for Social Enterprise (September 2012, updated March 2014), online: BC Centre for Social Enterprise <http://www.centreforsocialenterprise.com> at 3.

934 Erin Flegg, "Charities Push Back Against Harper Government Repression" Vancouver Observer (12 February 2014), online: <http://www.vancouverobserver.com>.

935 *Ibid.* See also Dean Beeby, "Conservative Government Steps Up Scrutiny of Charities Political Activities" (10 July 2014) *The Globe and Mail*, online: The Globe and Mail <http://www.theglobeandmail.com>.

create serious negative ripple effects to the social economy. The non-profit sector is stuck in a place where it is struggling to expand and innovate due to shrinking funds and other political and economic pressures.[936] Many within the sector are unhappy with the economic constraints that have been placed on them, and cannot figure out how to move forward.[937]

Beyond the non-profit sector, there is always the possibility of exploring tax incentives to promote social good in the for-profit sector, but several tax deductions already exist for businesses. In Canada, charitable deductions as well as deductions for a variety of business-related expenses are available. To extend tax benefits beyond the status quo, the question becomes one of legitimacy and efficiency. In this author's view, it is not more efficient to increase tax benefits to corporate entities for the sake of creating greater social good. There is no reason to take away from the public purse in order to persuade the growth of corporate activity that can readily occur on its own with the desire to satisfy public demands for particular social goods. There are a host of calculable problems in attempting to create a hybrid-type of corporation through tax incentives. Of course, corporations would be advised to take advantage of such incentives, and it would change the tenor of CSR activities – almost assuring a profit-motivation behind them. Tax incentives only perpetuate the shareholder primacy model of governance within the corporation.

The main limitation in utilizing tax laws to advance the social economy through business is that tax laws operate ancillary to the heart of the corporation. The fundamental nature of an organization cannot be changed with tax incentives and the creation of a true dual mission

[936] See Section 3.2, "Practical Realities: Financial Impediments and Advocacy Chill."

[937] See e.g. Pallotta, *supra* note 15.

company cannot be achieved through tax laws. It can make a for-profit corporation more inclined to pursue particular actions to gain greater tax advantages, but it does not transform the governance of the corporation in any way. The fact that tax reform does not go to the core design of the corporation may not be an issue to some, as the reality is that any organization will (or should) be prudent in utilizing all the tax benefits available to them. And indeed, tax benefits could become “the tail that wags the dog” for social enterprises, but there are two arguments to consider in this scenario.

The first is that these benefits are unpaid public tax dollars. The economic justification for spending these unpaid tax dollars is if they allow for greater returns to the public. Quantifying unforeseeable benefit in this case is challenging, if not impossible. Tax benefits are not necessary to cultivate an already growing demand for social innovation. Social entrepreneurs do not need more reason to connect business with social good, what they need is a conduit to establish their business without running against existing governance rules and norms. Corporate social responsibility and progressive capitalism exists without the need for a tax carrot.

Nevertheless, tax incentives or penalties, depending on if you want to wave a carrot or a stick, could be effective in lessening externalities, such as rewarding companies for reaching particular targets in waste management, for example. Coase suggested that, beyond being reciprocal in nature, externalities are also amenable to efficient resolution without tax or regulatory measures being imposed, at least if markets operate without frictions[938] – but of course they do. This leads to the second argument, which is that implementing tax policies to bring about social innovation as opposed to the implementation of hybrids is not an “either/or”

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[938] Coase, *supra* note 25 at 19.

argument. Corporate hybrids can work with existing tax laws to reform the way in which capital flows. Pluralistic attempts at reform can be quite efficient, and tax reform – in whatever manifestation to improve and advance the social economy – does not conflict with the implementation of hybrids and likely would work quite well in conjunction with them. The possibilities are not limited in pursuing parallel and mutually beneficial pathways to reform.

7.1.4 Partnering with Environmental Regulation

Another concern with the establishment of corporate hybrids is that it may shift the responsibility of curbing negative corporate behaviour away from where it ultimately should lie, which is with environmental regulation. This is an argument similarly leveled at the CSR movement. Proponents assert that the focus should be placed on the paucity of environment regulation and rectifying it, and not necessarily on corporate philanthropy or the development of alternative corporations.[939]

Most certainly, environmental regulation should be a strong presence in ensuring proper corporate behaviour, and in fact, if such regulation were able to transform the internal governance system of the corporation, all the better. However, reliance on such regulation is simply not enough. Nor is improved environmental regulation mutually exclusive to the search for alternative and innovative solutions. While environmental regulation has developed and grown in many countries over the past half century, particularly to "curb pollutants, protect endangered species, and restrict the exploitation of nature's scarce or finite resources," Benjamin Richardson and Beate Sjåfjell have noted that "all states have struggled to discipline humankind's environmentally wanton behaviours because those behaviours, especially through

[939] See e.g. Section 5.1.3 for some practitioners' views on the matter.

industry and the marketplace, also deliver material prosperity and sustain the states themselves."[940] States hold significant limitations in achieving any form of transformative change required to alter corporate behaviours that result in negative environmental externalities. Richardson and Sjåfjell have pointed out that much of a state's political capital relies on ensuring sustained economic growth rather than environmental stewardship. This "dyadic state" has meant that the efficacy of environmental law has been limited and standards have "hardly extended to the financial economy or corporate governance."[941] Richardson and Sjåfjell note that

> The function of environmental law…remains limited to mitigating the worst excesses of the dominant model of economic development rather than fundamentally challenging or transforming it. It is rare for a major project, especially one that promises jobs and other economic benefits, to be vetoed in the name of protecting nature. The efficacy of environmental law has been undermined by the convergence of several negative factors, including its political-economic context and its methods of governance, in addition to more fundamental characteristics of humankind's evolutionary disposition.[942]

Others such as Thomas Lyon have noted that regulation "is a slow moving progress" that can take years and "[o]ften a galvanizing disaster is required before a legislature will act."[943] Lyon points out that the burden of proof in showing causal connections between emissions and social harms makes it extremely difficult for regulators to promulgate rules without facing serious legal challenges from parties affected.[944] He also identifies high implementation costs, inefficient regulatory instruments, less managerial flexibility, increased compliance costs, and

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[940] Richardson & Sjåfjell, *supra* note 333 at 12.

[941] *Ibid.* at 19.

[942] *Ibid.* at 13.

[943] Thomas Lyon, "The Pros and Cons of Voluntary Approaches to Regulation," Reflections on Responsible Regulation Conference at Tulane University (1-2 March 2013), online: <http://murphy.tulane.edu/>.

[944] *Ibid.* at 5.

pressures from special interest groups as significant limitations to environmental regulation.[945]

Additional forces at play tend to operate with more subtlety than legal rules in influencing corporate behaviour.[946] Environmental regulation itself cannot adequately explain the differences in environmental performance across organizations. For there to be effective change, both internal and external pressures need to motivate a corporation to do better. Empirical research has shown how "social license" pressures – particularly from local communities and environmental activists – have been found to compel some organizations to move toward higher compliance standards than others.[947] But at the same time, economic counter-pressures tend to impose limits on "beyond compliance" investments. [948] Robert Kagan, Neil Gunningham, and Dorothy Thorton note that:

> Regulation still matters greatly, but less as a system of hierarchically imposed, uniformly enforced rules than as a coordinative mechanism, routinely interacting with market pressures, local and national environmental activists, and the culture of corporate management in generating environmental improvement while narrowing the spread between corporate leaders and laggards.[949]

Lyon and John Maxwell have remarked upon the growing use of voluntary actions and programs to address environmental concerns.[950] The EU Research Network on Market-based Instruments for Sustainable Development identifies three voluntary programs:

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[945] *Ibid.* at 4.

[946] See e.g. Gunningham, Kagan & Thornton, *supra* note 397.

[947] See e.g. Kagan, Gunningham & Thornton, *supra* note 850.

[948] *Ibid* at 84.

[949] *Ibid*.

[950] Thomas J Lyon & John W Maxwell, "Mandatory and Voluntary Approaches to Mitigating Climate Change" (19 March 2003) Geneva Papers, online: <http://webuser.bus.umich.edu/>.

(1) Unilateral commitments by industrial firms, sometimes referred to as business-led corporate environmental programs;

(2) Public voluntary schemes, in which participating firms agree to standards that have been developed by public bodies such as environmental agencies; and

(3) Negotiated agreements created out of a dialogue between government authorities and industry, typically containing a target and a timetable for reaching that target. Negotiated agreements may take on the status of legally binding contracts if legislation empowers executive branches of government to sign them.[951]

There has been a distinct shift from mandatory to voluntary approaches to environmental regulation in recent years. Lyon points out two views to such development – those that consider voluntary approaches more efficient institutional forms than traditional regulation, and others that are concerned that they are "weak substitutes" for regulation.[952] In examining the existing empirical evidence, he suggests that in most cases, "first-order impacts on environmental performance have been modest, and in some cases they have served to delay the implementation of mandatory regulations."[953] Nevertheless, these activities may be useful "when scientific information is imprecise, political will is lacking, or regulatory capabilities are weak."[954]

While the limitations noted by experts may seem disheartening, they do not negate the importance of continued advocacy for stronger and more effective environmental laws. They do mean, however, that proponents must be pragmatic about the realities in finding pathways to reform, and recognize that environmental regulation alone will not be sufficient to champion change within large corporations in the political and economic climate in which we live. There

[951] European Union Research Network on Market-based Instruments for Sustainable Development, "Voluntary Approaches," undated.

[952] Lyon, *supra* note 943 at 1; see also Allen Blackman, Thomas P. Lyon, & Nicholas Sisto, "Voluntary Environmental Agreements when Regulatory Capacity is Weak," (2006) 48 Comparative Economic Studies 682.

[953] Lyon, *supra* note 943 at 1.

[954] *Ibid.*

must be a partnering of efforts if transformative change is ever to be realized.

7.1.5 Easing the Non-Profit Dilemma

Chapter 3 described how NPOs are correcting a form of both "government failure" and "market failure" by offering public goods in addition to those provided by government, thereby satisfying a residual demand.[955] NPOs also arise as a response to issues of asymmetric information facing consumers.[956] These demands are real, and yet the challenges in meeting those demands are mounting. NPOs have become stunted. They compete for scarce financial resources that are often earmarked or require significant labour costs to maintain. This financial pressure has quieted voices from within the non-profit sector, and many legitimately fear a form of advocacy chill.

Social enterprises have become a reactionary response to the financial pressures facing NPOs. Offering a "for-profit" arm or subsidiary to their organization, these NPOs set out to generate a surplus that can feed their non-profit activities. The challenge in embarking on these for-profit activities is dependent on the jurisdiction, but as seen in the section above, more often than not these activities occupy an uncomfortable grey area in legislation and regulation. A social entrepreneur would need to be comfortable in operating within grey areas of the law which are vulnerable to changes in tax interpretations and regulatory audits, and some of the challenges in tax reforms are outlined above in Section 7.1.3. If implemented correctly, corporate hybridity can offer a partial solution to the non-profit dilemma. The theory of corporate hybridity is exciting to consider – it is the practical implementation that is difficult.

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[955] *Ibid.*

[956] Hansmann, *supra* note 427.

For NPOs to be willing to make the shift to corporate hybridity, the incentives must be there. As there are currently no corporate hybrids that offer any tax incentives, an NPO would have to forego tax exemptions for the benefit of issuing shares, generating a profit, and potentially issuing dividends. The cost-benefit analysis is one that would need to make sense for those currently situated in the non-profit realm. The UK offers live testament as to how corporate hybridity can work and work well, with the successful growth and expansion of its community interest company. In Canada, a hybrid alternative, if timed along with the tightening regulation of the CRA, could offer relief for a number of NPOs that are finding the profit-making component of their social enterprise side considerably more worthwhile than the tax exemption. The right hybrid could offer a conduit for expanding the business side, and reach a greater number of people in need for the goods or services being offered.

The ICA has noted that "[w]e are living in a time of great change, where popular attitudes and motivation are changing."[957] They believe concerted action is needed, otherwise "the moment will be lost."[958] While contributing reform efforts are possible within corporate and non-profit law, and while market forces and tax laws can help influence social change (but can just as easily harm, as they are merely instruments), none of these options replicate the fundamental component of dual mission governance within the hybrid. Thought leaders must begin to turn their focus onto this emergent field of social enterprise law. Next is a framework to assist in elevating innovative practices through new hybrid legal structures.

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[957] Blueprint, *supra* note 864 at 33.

[958] *Ibid.* at 2.

7.2 Framework for Strategic Implementation of Hybrids

With a clean slate where anything is possible, how does one begin? Chapter 4 canvassed the array of hybrids that have been emerging on the international stage in the last several years, and Chapters 5 and 6 looked in particular at hybrids forming within Canada. Each of these hybrids carries with it lessons that are beneficial for future legislators to consider when creating a hybrid that may meet the needs of their constituents. Below is a compilation of these lessons that offer a framework for the strategic implementation of hybrids into the future.

7.2.1 The Need Must Be Accurately Identified

First, it is important to accurately understand the problem that is that is trying to be solved. Many of the concerns expressed in Section 7.1, particularly Section 7.1.1, regarding the efficacy of hybrids in the face of flexible existing models, are warranted and should be addressed at these initial stages. Legislators need to determine if they are addressing demands that are tending to generate from the non-profit or for-profit arenas. Each of the hybrids described in Chapter 4, whether purposefully or not, is geared toward the needs and demands of a particular sector. It is important that at the initial stages of crafting a hybrid, there is a 360 degree evaluation as to who the potential stakeholders are and how their demands can be clearly identified and addressed. If social entrepreneurs are frustrated with their options, it is necessary for legislators to understand where the frustration arises from, and if there are particular needs within the community that are being unmet and why. Cross-sector and cross-jurisdictional dialogue is particularly important at this stage. Conducting focus groups with relevant stakeholders, one-on-one interviews, and the collection of qualitative and quantitative data within the particular sector will frame the context in which a particular need is being unmet. Potential solutions to achieving unmet needs – including the possible implementation of hybrid legal forms – should be addressed within focus groups, to gauge the level of interest and whether such solutions are perceived as feasible by stakeholders.

It is also crucial at this stage for reformers to be cognizant of the fact that there most likely will be several opportunities to improve existing laws without having to create an entirely new form of enterprise – and these opportunities more often than not should be capitalized on. The creation of an innovative alternative to existing models is an arduous path – if implemented correctly, it takes a significant investment of time and money. Low-hanging fruit is worthwhile to pick. If there is the opportunity to amend existing laws within a model to achieve a material social payout, there is no reason to bypass the opportunity at this stage.

7.2.2 The Law Must Make Sense

Once the problem is accurately identified, and immediate avenues for rectifying it are explored and found to be insufficient, it is imperative for there to be a canvassing of existing laws. As seen in our Canadian experiment, assumptions as to what is required by law versus what is assumed in practice can be at odds. If the focus is on offering an alternative to the for-profit corporation, then it is important to understand what is broken in the for-profit model, and how it can be rectified. Chapters 1 – 3 explored the problems with both the for-profit and the non-profit sectors. As seen in Chapters 5 and 6, in Canada, the creation of the benefit corporation model as an alternative to the mainstream for-profit corporation model would not make legal sense. The innovative appeal of the benefit corporation in the United States is that it requires consideration of stakeholder interests in its corporate decision making, among a few other features that were analyzed in Chapter 5. Juxtaposed against Canada's existing corporate laws, and the added benefit is marginal or nil and only amplifies a false assumption that hard Canadian corporate laws require shareholder primacy. In addition to the fiduciary duties of directors to consider the "best interests of the corporation" and the oppression remedy, there is ample evidence that Canadian laws (despite moves from the securities regulators) support a more stakeholder-based model when compared to the United States. Jurisdictions are ill advised to adopt a hybrid without real consideration as to their existing hard law offerings. If existing alternatives allow for "hybrid" type qualities – and indeed, almost all do to a certain extent – then there must be further probing as to how to create a hybrid that can govern dual activities beyond what already exists.

After all, there is no point in creating a new hybrid model that only superficially adds onto what already exists within the laws of a particular jurisdiction. There must be a difference in the core fundamentals of the new hybrid entity. The benefit corporation provides a clear example of how its design features, when compared against Canada's existing laws, are only superficial in difference and would risk obfuscating those important progressive similarities if implemented in Canada. Therefore, one must understand what the laws say, and if actual practice deviates from those laws. The hybrid should be strategically situated within existing offerings and stand out as a true alternative to the mainstream.

7.2.3 Economics and Incentives Must Make Sense

The stage that may be the most challenging for drafters of hybrid legislation is regarding the incentivizing elements of the hybrid. Legislators need to understand why an entrepreneur would choose a hybrid over another existing alternative. For-profit corporations have a considerable level of freedom with regards to their purpose. A drafter must consider why an entrepreneur would choose to actively express the social value component of their business in a legal manner under a hybrid form, when they can already do so publicly in any case, in any manner they wish. As for those currently situated in the non-profit realm, tax exemptions would need to be outweighed by the considerable value found in operating as a free market enterprise with greater access to capital. There must be reasons in place that will foster traction in industry otherwise laws may lie unused and dormant. The American low-profit limited liability company and the British Columbia community services cooperative are two examples of hybrids that have fallen in the trap of low interest from entrepreneurs. The BC community contribution company may also be heading in that direction. The saying, “if you build it, they will come,” does not hold water in the hybrid realm.

The reality is that for a hybrid form to become the “winning ticket,” the legal features of that hybrid are important but there are also other factors beyond the legislation that play a critical role in its success. For entrepreneurs seeking seed money to fund their enterprises, it is not ideal to have to expend energy educating potential investors on the hybrid legal requirements before even getting into the merits of their business plan. While savvy presenters could incorporate the hybrid legal model into their dual mission pitch, having an unfamiliar legal structure more often than not will put a hybrid entrepreneur at a disadvantage relative to their corporate competitor. Many in the cooperative movement have commented on this problem (and ironically the cooperative is the oldest legal form), because financial institutions simply do not seem willing to educate themselves on cooperative finance.[959] These sorts of challenges mean that considerable effort should be made to foster the non-legal components of growing hybrid success.

7.2.3.1 Invisible Hand as a Helping Hand

Self-interest and altruism – strange bedfellows and yet this is the goal of a hybrid legal form, especially when catering to the for-profit sector. How to find a way to govern the profit-

[959] See Section 6.2.1 at ftns 877-881.

making ability of entrepreneurs while also helping society, and ensuring the continuity of this dual mission. As seen in Chapter 4, the UK CIC and BC C3 have implemented asset locks and dividend caps in addition to community purpose requirements; the American benefit corporation offers no economic limitations but rather incorporate a public benefit purpose into the company's articles. And again, none offer tax incentives.

In many ways, incentive placement in hybrid design is like the tale of "Goldilocks and the Three Bears" – finding the right combination of economic and social governance and incentives so that everything is "just right." Too many economic limitations and the hybrid will likely be deemed unattractive by many would-be entrepreneurs, and too few economic incentives beg the question as to why entrepreneurs would bother to shift to a new hybrid form when a plain vanilla corporation would do just fine. New models of hybrid entities are continually being contemplated by social innovators. As noted in Section 6.2.3, a group of Canadian professionals and academics have put together a proposal urging their provincial governments to adopt a "deliberate corporation" model, where the disbursement of dividends is made dependent upon the achievement of measurable, non-monetary goals.[960] The idea of tying together a form of economic reward with social value output is a valuable one that should be strongly considered for any new hybrid structure. The right combination of economic and social governance must be achieved in order to gain the support of entrepreneurs interested in pursuing a hybrid form.

7.2.3.2 There Must Be a Critical Mass of Early Adopters and Supporters

Along with the right combination of economic and social design features in the hybrid, the initial rollout of the hybrid model should have a critical mass of early adopters in order to

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[960] Dudek & Zieba, *supra* note 888.

generate a form of momentum that may potentially lead to widespread success.[961] There should also be some level of social backing by key thought leaders in the field. The B Corporation movement began with 80 founding companies. These companies had been approached by B Lab prior to launching the B Corporation certification, and had agreed to provide their support. These companies were well established and respected in their industries. The benefit of this initial support is profound. In addition to having the founding companies tease out any problems with the potential structure of the hybrid, their support presumably signaled that the model was robust and worthwhile for others to adopt. The proponents of the American low-profit limited liability company provide an example of how failing to ensure support from key stakeholders may lead to dormant law. The L3C was designed to ease rules regarding program-related investments, and the IRS's lack of recognition and support in the model has led to its demise. All stakeholders should be made aware of the proposed hybrid and interests should be taken into account prior to any finalization of the hybrid. Ideally, early adopters and supporters are recognizable names that are willing to champion the model going forward.

There are other ways of gaining this critical mass early on. As aforementioned, the CIC Regulator offered early signers of the CIC model with exclusive access to a pool of social finance.[962] NPOs that had been struggling financially saw the available finance as a real incentive to switch gears and become an early leader of the CIC model. There are several options that legislators and social innovators can do gain a significant group of supporters. Without this

[961] For more on factors that can accelerate the spread and adoption of a new concept or idea within a community or organization, see the often cited book by Everett Rogers, *Diffusion of Innovations,* 5th ed (Free Press, 2003).

[962] See Community Interest Companies Association, *supra* note 886; see also Office of the Regulator of Community Interest Companies, "Corporate Plan 2008-2011 and Business Plan 2008-09: Community Interest Companies", online: British Library, Management and Business Studies Portal <http://www.mbsportal.bl.uk> at 18 regarding the importance of creating greater general awareness of the CIC.

initial buzz, there is the real risk of dormancy. The rollout of the C3 model was minimal at best, and after three years in existence, there are only 35 C3s in BC.[963] While there may be weaknesses in the legal design element that make the model unappealing to many people in either the for-profit or non-profit sectors, the fact that the CIC has been wildly successful in the UK (and the BC C3 essentially mirrors the CIC version) indicates there is more involved than flaws in the design, and the lack of an initial conglomerate of backers once the model became available should be viewed as a missed opportunity in solidifying the BC C3 brand.

7.2.3.3 Marketing and Brand Awareness

In addition to a critical mass of early adopters and supporters, there must be a base level of marketing and brand awareness to support the model. This marketing can be as extensive as the B Corporation, benefit corporation, and UK CIC, or it can be the bare minimum as seen in many of the other hybrids. It is likely that the growth and relative success of the first three models in their jurisdictions had much to do with the awareness campaigns that were put in place. B Lab in particular has focused on promoting and educating the merits of the B Corporation certification to the public, with the premise that more companies will be attracted to adopting the certification if the public sees value in it. If governments are sincere about fostering the success of hybrids, they must properly invest in these areas of education, marketing, and promotion.[964]

7.2.3.4 Vehicle Must be Self-Perpetuating

Once there has been a critical mass of supporters, and a rollout period whereby the model is made known to potentially interested parties, there should not be an ongoing need to

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[963] See Accelerating Social Impact CCC, *supra* note 529.

[964] More on the necessities of proper investment is discussed in Section 6.2.2.

convince an entrepreneur to adopt a particular model – the merits should be obvious once an entrepreneur becomes aware of the features of the model, and the growth of the model should, ideally, take a life of its own. There is no point in devising a model that entrepreneurs need to be goaded into adopting. There should be a natural draw where entrepreneurs see the design benefits of the model and know whether or not it would work for them. Once a critical mass is achieved and the support is there, the design itself must be attractive enough to be self-perpetuating.

7.2.4 Question of Regulation

Finally, there is the question as to whether a new hybrid needs to be regulated beyond the usual channels available within the for-profit and non-profit sector. The UK CIC Regulator's office has played an important role in promoting and legitimizing the CIC brand, by producing formal annual reports outlining achievements and challenges, reviewing individual CIC community interest reports, and identifying delinquent CICs when necessary.[965] The Regulator's office has been valuable for CIC brand awareness and also to guide CICs as they navigate uncharted territory in CIC legislation. There have been numerous positives in the establishment of the CIC Regulator's office, and the office has attributed much of CIC success to the central role that the Regulator has played in fostering the development of CICs throughout the country.[966]

In the case of the BC C3, it would have not made sense to have established a C3

[965] See Section 4.1, particularly at ftns 507 and 508; and Section 4.2 at ftn 527.

[966] See e.g., Office of the Regulator of Community Interest Companies, "Operational Report, First Quarter 2013-2014," online: <http://gov.uk>, which claims the following: "Our Regulator, Sara Burgess, has been extremely busy this quarter out and about raising awareness of CICs and the CIC brand. She travelled all over the UK… [and her] visits are obviously paying dividends as the numbers of CICs continues to rise with a growth of 441 this quarter resulting in over 8000 CICs on the public register."

Regulator as the BC government made it clear from the start that there was no cash in the coffers to fund any pet hybrid project.[967] Legislation would be drafted and to the extent the number of C3s would grow, it was anyone's guess. Under these conditions, which differed significantly from the UK CIC rollout, the legislators put the onus on the public to educate themselves and garner interest. Two years after the C3 model was made public, there have been entities attempting to illicit a buzz, such as Accelerating Social Impact CCC,[968] but the numbers remain disappointingly low. It is open for debate whether the establishment of a central office would have made a difference, but without the other components – an initial critical mass of early adopters and supporters, brand awareness, etc. – appointing a regulator would have been fruitless. There of course is always the possibility of establishing a regulator after a benchmark number of C3s is reached.

The question boils down to one of cost and commitment. Of course, establishing a central office to solidify a hybrid's identity is a huge step in garnering a solid base of support and building momentum. The endeavour does have a cost, and also requires a level of commitment from government. There is a risk that if a hybrid does not gain traction in practice, there will be no point in appointing a regulator to regulate – but this is a circular argument as one may argue that having a central office/regulator will help a hybrid model gain the necessary attention. Thus, with respect to regulation, it depends quite a bit on the type of hybrid at issue, and whether its design features are particularly important in legitimacy, or are onerous and/or susceptible to corruption. The UK CIC Regulator's office is a good example of how regulating a new hybrid can be done, but jurisdictions do not have to feel the implementation of a hybrid necessitates that

[967] As indicated by the legislators at the time to this author.

[968] Accelerating Social Impact CCC, *supra* note 529.

level of commitment. More often than not, existing infrastructure can be more than sufficient to regulate hybrid models until such time as a unique form of regulator is warranted.

7.2.5 Consistently Ask: What is the Ultimate Goal?

Once the legal and non-legal aspects of the hybrid are established, it is important to consistently ask the initial question – what is the problem being solved? What is the need that is being met? It is ideal to ensure that the proposed hybrid solution continues to address the problem and adapt when necessary. The UK CIC Regulator keeps a good record of registered CICs including their original entity (such as whether they converted from a non-profit), industry, location, size, etc., as well as identifying big picture issues and challenges and how they are being addressed. This data is very valuable in assessing the benefit in which the hybrid is expected to illicit and whether or not any tweaks to the design, or if other non-legal support mechanisms, are necessary.

7.3 Innovative Potential

It is early in the process – as a dynamic and evolving phenomenon, it is still undetermined what, if any, significance hybrids will have on sustainable practices and socio-economic growth. As noted previously, there is a high likelihood that the development of hybrids as simply addressing a niche sector of the market. But this final section of this dissertation seeks to promote a different and somewhat novel perspective by suggesting that this growing trend in corporate law may actually increase the amount of "disruptive innovations" entering the marketplace, providing a back door mechanism for reformers seeking transformative corporate change.

The concept of disruptive innovation was first coined by Joseph L. Bower and Clayton

Christensen in 1995.[969] While the concept is often used to refer to technological advances, it is not isolated to that industry. Bower and Christensen first classified innovations into two categories: sustaining and disruptive.[970] Sustaining innovations are incremental improvements to products and services that provide better quality or greater functionality to consumers in the higher tiers of the market.[971] Companies are drawn to sustaining innovations because they have been proven to be profitable. Companies attain the greatest profit margins when they charge high prices to the most demanding and sophisticated customers at the top of the market. The issue with this practice, however, is that companies unintentionally open the door to disruptive innovations. Because lower tiers of the market offer "lower gross margins, smaller target markets, and simpler products and services," they are unattractive to other firms moving upward in the market, "creating space at the bottom of the market for new disruptive competitors to emerge."[972]

A disruptive innovation allows a new population of consumers to access a product or service that was previously only available to wealthy or skilled consumers. Disruptive innovations "improve a product or service in ways that the market does not expect…first by designing for a different set of consumers in the new market and later by lowering prices in the existing market."[973] In fact, Christensen and a group of other scholars went on to describe a subset of disruptive innovations that specifically address social change. These innovations share

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[969] Joseph L Bower & Clayton Christensen, "Disruptive Innovations: Catching the Wave" [1995] 73 Harvard Business Review 43.

[970] *Ibid.* at 45.

[971] *Ibid.* at 44.

[972] Clayton Christensen, "Disruptive Innovation" online: <www.claytonchristensen.com/key-concepts>.

[973] *Ibid.*

five qualities; specifically, they:

(1) create systemic social change through scaling and replication;

(2) meet a need that is either overserved (because the existing solution is more complex than many people require) or not served at all;

(3) offer products and services that are simpler and less costly than existing alternatives and may be perceived as having a lower level of performance, but users consider them to be good enough;

(4) generate resources, such as donations, grants, volunteer manpower, or intellectual capital, in ways that are initially unattractive to incumbent competitors; and

(5) are often ignored or disparaged by existing players for whom the business model is unprofitable or otherwise unattractive and who therefore avoid or retreat from the market segment.[974]

Disruptive innovations may include sustainable products or services that are made more affordable to the bottom tiers of the market, eventually displacing unsustainable products that presently dominate, as well as other goods and services that promote a more inclusive society while operating within planetary boundaries. Christensen et al cite specific examples such as affordable insurance, walk-in medical clinics, and microlending.[975]

Could hybrids become the best organizational structure to promote disruptive innovations that promote social change? Hybrid businesses may have an advantage in developing innovative products and services that open up the bottom tiers of the market, addressing social needs that are unmet through traditional corporate practices due to low margins or other profit-driven limitations. They may serve as a live experiment putting to test ongoing research informing business leaders that long-term vision, sustainable purposes, and multi-stakeholder

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[974] Clayton M Christensen et al, "Disruptive Innovation for Social Change" [2006] 84 Harvard Business Review 12.

[975] *Ibid.*

collaboration are essential for the long-term success of the firm.[976] Despite mounting evidence, modern corporations still find it incredibly difficult to be unchained from pressures to hit quarterly earnings targets.[977] Corporate hybrids should free businesses from this type of short-termism. Investors in hybrids will be made aware of the social mandates embodied within these entities and the particular legal limitations regarding financial upsides, if any, meaning that hybrid investors, by nature, will be social investors.[978] Thus, the pressure for greater return at the expense of sustainable practices seems to be heavily dampened. It is therefore not unreasonable to project that hybrids are better positioned to produce sustainable products and services that become disruptive innovations in the marketplace.

There are, of course, risks for any jurisdiction introducing a new hybrid into the roster of corporate alternatives. Hybrids may take away resources traditionally used by charitable and non-profit organizations, and there is ongoing concern of "private sector intrusion into public service delivery."[979] There is the risk that mainstream corporations may feel they have little obligation to consider social issues or environmental concerns, which are now supposedly left for hybrids and non-profit organizations to address (but of course, these corporations may already hold the view that environmental concerns should be resolved solely by the public sector, among other reasons). Corporate regulators may also be motivated to hold similar views. Hybrids may end up satisfying a niche market that, once saturated, is ineffectual at promoting change. These are all risks that legislators must be aware of when implementing hybrids into their statutory

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[976] See e.g., Barton & Wiseman, *supra* note 293; Eccles et al, *supra* note 929.

[977] See e.g. Graham et al, *supra* note 294.

[978] If hybrids becoming increasingly popular, it is of course conceivable that traditional non-social investors will look to this new market.

[979] Office of the Regulator of Community Interest Companies, "Annual Report 2011/2012" <www.bis.gov.uk> at 7.

laws.

Nevertheless, the growth of international hybrids signifies that there is something amiss with the shareholder primacy norm embodied in the mainstream model. Hybrids are quickly filling a driving legal need to house social purpose businesses and enterprises. Legislators must examine the environment and design hybrids that significantly differentiate them from other alternatives, provide meaningful legal features to ensure dual economic and social mandates can coexist, and also meet the particular needs of social entrepreneurs to make the model attractive. With proper strategic implementation, hybrids may become the new corporate legal tool that fosters ongoing disruptive innovations in the market. The potential for hybrids to elicit transformative change in the marketplace cannot be discounted, and must continue to be explored.

CONCLUSION: Corporate Law for a Changing World

Corporate social responsibility, socially responsible investment – the ideal would be that these "responsible" movements one day capture all corporations and their behaviours. Just as nations desire all citizens to be "good citizens," these organizational entities that frame our daily lives and bring us together on a domestic and international scale *should* be required to act as "good corporate citizens." It is not unreasonable. It should be a basic requirement for corporate existence.

The barriers that prevent counter-hegemonic approaches from reforming the mainstream corporate model are difficult to overcome. There are many countervailing forces at work in the effort to promote sustainability in business and corporate law. The legal basis for shareholder primacy has been proven a myth by several legal scholars,[980] and yet it continues to pervade on normative legs. But there are fragments within society that offer a puzzling counterpoint to the model. The rise of social enterprises and the social entrepreneur seeking to use business as a force for change – how as a society can we tap into *that* source of reform, into *that* market? Perhaps in addition to reforming the mainstream corporation, there needs to be something to stimulate alternative pathways to advancing the social economy and achieving social justice.

Should hybrids be adopted? This question is unanswerable when stated so broadly. While the emergence of corporate hybrids has occurred on a global scale in reaction to the rapid growth of self-identifying 'social enterprises,' the question of whether hybrid legislation should be adopted within a particular nation's jurisdiction is in many ways, a localized one. The question cannot be answered without considering a jurisdiction's specific laws, customs, existing

[980] See e.g., Stout, *supra* note 382.

governance models, norms, political and economic issues, as well as researched projections on the hybrid corporate offering in contemplation, among other things. A model that has succeeded in the UK apparently does not in British Columbia, Canada – why? There are numerous reasons. A lack of brand awareness, lack of public education, no regulator, no early critical mass, etc. – some of these reasons serve as important lessons for future policymakers to consider. If a government genuinely desires new hybrid legislation to provide an opportunistic framework for social businesses going forward, legislators must be strategic and be willing to properly invest in the model otherwise it may not be worthwhile.

In order for our species to survive, corporations will not only need to "do no harm" – be more responsible, more sustainable – but commit to seeking innovative solutions to the world's global challenges. Corporate law is a tool that is capable of altering how corporations deploy products and services for the benefit of humankind and the planet. Ignoring those capabilities only strengthens the status quo and ensures limited pathways to reform. With a long road ahead, and unforeseeable contributing factors, one cannot discount the level of impact hybrids could bring to the future if utilized correctly. Hybrids on an international scale are beginning to fill a driving legal need to house social purpose businesses and enterprises. Collaborative efforts among legislators and those situated in both the for-profit and non-profit sectors must examine the environment and design hybrids that significantly differentiate them from other alternatives, consider whether these hybrids are capable of providing meaningful legal features that ensure dual economic and social mandates are able to coexist and thrive, while also meeting the particular needs of social entrepreneurs to make the model attractive. The incentives must be there. With proper strategic implementation, hybrids could become the new legal tool that fosters the growth of social innovations within the public sector. But of course, there are risks. Hybrids could thwart mainstream reform efforts. They could circumvent resources traditionally used for the non-profit sector, and they may simply promote a neoliberal agenda and the shrinking of government responsibility. Without strategic implementation and brand awareness, the odds are likely that hybrid corporate legislation will be left unused – a lost opportunity. These are legitimate concerns that policymakers must consider in the drafting and introduction of any new legal entity within a jurisdiction's corporate landscape.

The path to transformational corporate governance in Canada and throughout the world is a challenging one. While the proper structuring of laws is critical to reform efforts, it is important to also consider the need for normative cohesion. While the shareholder primacy model appears entrenched, reforms are occurring nonetheless both in corporate legislation and within the social sector. A growing movement is attempting to reclassify the shareholder primacy model, thus allowing businesses to pursue both economic and social mandates in their corporate decision-making. In light of Canadian corporate culture, the trajectory of Canadian common law and the current Canadian corporate governance landscape with regard to the rise of CSR and sustainability, Canada may well be a leader of transformational corporate governance in the foreseeable future for both mainstream and alternative pathways, but there remains much to be done. The emergence of legally 'good' corporations suggests that humanity is looking for alternative ways to combat the dominant corporate model. This backdoor method of infiltration may prove critical – it sidesteps path dependence and other significant barriers to reforming the modern day corporation, by carving a new path. Hybrids always have the high chance of becoming dormant unused law, and some have. But the clear intent behind the hybrid corporate movement cannot be discounted. There is a desire for change toward a future where corporations serve social change agents, utilizing their power and impact to create a circular economy, taking into account social and planetary boundaries, and working with governments to support social justice without corruption and improving lives. This dissertation seeks to contribute another step in that long and hopeful journey.

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APPENDICES

APPENDIX A

List of BC Community Contribution Companies as of April 2016

1. Accelerating Social Impact CCC Ltd.
2. Buy Social BC CCC Ltd.
3. Buy Social Canada CCC Ltd.
4. C3 Pro CCC Ltd.
5. Cedar Rock Enterprises CCC Ltd.
6. Cedrick's Coffee House CCC Ltd.
7. Crowdgift Canada CCC Ltd.
8. Fair Money CCC Ltd.
9. Feeding Change Foods Canada CCC Ltd.
10. Good Ventures CCC Ltd.
11. Green Zebra Urban Markets CCC Ltd.
12. Grist Mill CCC Ltd.
13. Harmony Habitat Sustainable Building Solutions CCC Ltd.
14. Institute for Marketplace Transformation CCC Ltd.
15. International Nursing Alliance CCC Ltd.
16. Journey Home Community CCC Ltd.
17. Natural Lifestyle Creations CCC Ltd.
18. Open Door Ventures CCC Ltd.
19. Paladin Recovery Centre CCC Ltd.
20. PHS Community Initiatives CCC Ltd.
21. Road Warriors Speed Enthusiasts Xtreme Custom Enthusiasts CCC Ltd.
22. Roadway Oil Spill Response Team CCC Ltd.
23. Salt Spring Events CCC Ltd.
24. Skin of the Salmon CCC Ltd.
25. Social Enterprise Institute CCC Ltd.
26. Surbl Not For Profit CCC Ltd.
27. Tri-Jubilee CCC Ltd.
28. Urban Aboriginal Task Force CCC Ltd.
29. Urban Matters CCC Ltd.
30. Valuenomics CCC Ltd.
31. Velofemmes Canada CCC Ltd.
32. Volinspire CCC Ltd.
33. Weshop Online CCC Ltd.
34. World Housing CCC Ltd.
35. ZShips International CCC Ltd.

APPENDIX B

Methodology for Chapter 5

Potential participants for Chapter 5 were selected based on several factors, including: (1) reviews of online profiles from prominent Canadian law firms where the senior practitioner is identified as a specialist in corporate governance, among other things, (2) appearances on "Best Lawyers in Canada" lists, "Lexpert" rankings, "Who's Who Legal," "Chambers Global," and other equivalent lists, (3) colloquial understandings as to who the leaders are in Canadian corporate governance, (4) recommendations from executive members of the Canadian Foundation for Governance Research, and (5) recommendations offered by participants on other senior practitioners appropriate for the study. Participation was limited to those practising in Toronto, Vancouver, and Calgary. This was mainly due to manageability of content, with a focus on the major financial centres of Canada that practice in common law jurisdictions.

Invitations to participate were sent to over 100 senior legal practitioners via email, where 32 indicated interest. Questions were emailed a day or more in advance to give practitioners the option of reviewing questions beforehand. Interviews were conducted over the phone with the exception of one practitioner who supplied written answers. Comments by the practitioners were made on a not-for-attribution basis. Practitioners were informed that any identifying characteristics within their comments would be stripped from this chapter and were invited to speak freely. Gendered language (such as "his" or "her") has been stripped in order to preserve confidentiality, thus plural pronouns were used. Discussions were conversational and not beholden to the interview questions, with the interviewer taking significant liberties to ask for further elaboration or follow-up questions based on practitioners' answers. Many practitioners provided stories and personal accounts in addition to their responses, and several referenced or provided supplemental material prior to and/or following their interviews, including journal articles, either authored by themselves or others, firm news bulletins, web-links, or any additional thoughts they had. Unfortunately, while some interview questions were included addressing corporate hybrids, many practitioners did not feel they had enough information or knowledge to be able to comment. There thus was not enough overall empirical data collected overall from the practitioners in order to provide comprehensive insights. With permission from each participant, interviews were recorded and later transcribed, with over 1,000 pages of transcriptions culminating into the following summary of findings.

The contents within Chapter 5 are not meant to be treated as findings from a quantitative study. This chapter provides a qualitative study akin to a fireside chat with a group of knowledgeable and experienced experts to gain a deeper understanding of Canada's governance framework. Throughout the interviews, one was easily struck by the level of thoughtfulness and candor behind practitioners' answers. As one practitioner noted during their interview, "there is a gulf between what people hope something is, think it should be, and what it is…that may, to some extent, account for some of the difference in views you are going to hear." In carefully parsing the comments made by practitioners, every effort was made to preserve the essence of practitioners' words, and to capture the intent behind them in the context they were given.

Several practitioners referred to a number of legal terms, important cases, and significant transactions in their comments. In order to improve flow and readability, certain legal definitions and details on particular cases and transactions are provided in the footnotes. It should be noted that participants spoke for themselves and not necessarily for the organizations with which they are affiliated. Their participation should not be construed as an endorsement of the findings in this dissertation.