THE PROTECTION OF ABSENTEE OWNERS OF PUBLIC CORPORATIONS IN CANADA - A REALISTIC ANALYSIS OF THE PROBLEMS AND SOME THOUGHTS ON SOLUTIONS

by

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This paper is essentially concerned with the rights and interests of absentee owners - the public minority shareholders vis-a-vis the corporate directors and controlling shareholders. The author believes that a strict legal analysis of the problems inherent in this human and social relationship is not likely to be very enlightening. A wide contextual approach is instead used. This is hoped to be achieved by discussing in a comprehensive manner the many specific problems inherent in the relationship between absentee owners and controllers of corporations. The author hopes to stress that fairness is to become the ultimate criterion to which all business transactions must be judged. The paper will therefore include a discussion on the concept of fairness as perceived by absentee owners. The conclusions of this paper is that there must be an external agency that is capable of regulating in a substantive way, the activities and investment decisions of corporate controllers. An external agency that will help to incorporate fairness to redefine the relationship of absentee owners and corporate controllers.
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INTRODUCTION

Absentee owners of public corporations, perhaps, can be broadly defined as people who purchase stock knowing that somebody else is controlling the corporation. These absentee owners are likely to include you and I, the ordinary people of modern society. The recurring issues of modern company law seem to concern the relationship of absentee owners and those in control of the public corporations. Fundamentally, we are concerned with the rights and interests of absentee owners vis-a-vis the corporate directors and controlling shareholders. I believe that in the context of our modern society a strictly legal analysis of the problems inherent in this human and social relationship is not likely to be very enlightening. In order to amass all the necessary analytical tools for a critical examination of our social, economical and legal mechanisms that seek to define this relationship of absentee owners and corporate controllers, a wider contextual approach seems necessary.

All these suggest an enormous undertaking. In order that the discussion can be conducted within manageable length, I hope to concentrate on essentials. The value of this paper, if there is any, is that it is intended to present a contextual and comprehensive analysis of the relationship in our modern day context; and hopefully, as a result of this effort, a new conceptual direction for company law might be found. Perhaps, more realistic regulatory mechanisms can also be devised as a result of this effort.

Part I of this paper is devoted to an analysis of the much documented separation of ownership from control to determine what constitutes control of a corporation and who may in effect exercise them. The exercise will no doubt reveal that not all shareholders are real absentee owners, in the
sense that, the separation of control from ownership is complete. Big shareholders can derive effective power or exert subtle influence over management from their ownership of shares. Unfortunately, the law does not acknowledge or regulate this less formal relationship between the management and controlling shareholders and, generally, draw no distinction between controlling and minority shareholders. The law continues to assume that important matters relating to the interest of the corporate entity, which represents the interest of all shareholders, can be properly left to the general meeting of shareholders. What is ironical is that the true nature of the problem is to protect the public minority shareholders against the acts of those who are de jure or de facto in control of the corporation. The result is that a 'director-shareholder' control group are able to pursue their self-interest instead of the corporation's interest. Serious consequences flow from this erosion of corporate integrity. It encourages inefficiency and disloyalty in the corporate decision-making process. Resultant malpractices such as, excess remuneration, unconscionable stock options and pension plans, unwarranted expense-account living, self-dealing, insider-trading, "friendly" dealings between interlocked and parent-subsidiary boards, the taking of corporate opportunity, usually do not amount to criminal fraud and can be achieved with some semblance of legality. Unchecked corporate disloyalty, as Brandeis, author of the famous little book, "Other People's Money", has warned, may lead to the establishment of money oligarchy abusing the process of public financing and undermining industrial democracy. However, the only effective group with legitimate and direct remedies, and willing to restrain and correct corporate controllers are the real absentee owners defined above. Absentee owners rightfully demand that they be treated
fairly by corporate controllers and, frequently, the only effective way to regulate the exercise of corporate power, apart from traditional fiduciary duties, is to require it to be exercised fairly. A major purpose of Part II of this paper is designed to show that, conceptually, fiduciary ideology embodying traditional values and corporate rights is becoming increasingly anachronistic and no longer able to define the relationship of corporate controllers and absentee owners. Fairness is becoming the ultimate criterion to which all business transactions must be judged.

Part III of this paper, after a comparative analysis with United States and United Kingdom, hopes to demonstrate that Canadian courts and securities regulators have fallen far behind in its ability to incorporate fairness to redefine the relationship between corporate controllers and absentee owners. The main thrust of the arguments in Part III is that Canadian regulatory mechanisms must assume a greater sensitivity to the needs and expectations of absentee owners and strive to adopt and incorporate the concept of fairness to define the relationship. We are not doing special favours to investors of public corporations, the truth is that the integrity of the corporate form as an instrument of production must be preserved and enhanced, in order that society can be better served.
PART I

The Separation Of Ownership And Control

In the early days of small companies, the owner and the manager of a business were one and the same. The shareholder controlled the affairs of the company because he was the management. The transformation of the capitalist system as a result of the development of the corporate form, much of the business activity of the community was carried on not by the owners of business enterprises but by their agents and employees. In theory and tradition the owners are still the boss, they provide the capital and hire the management, but largely this is accepted as a fiction and the theory is useful only in its convenience.

In his book, "Economic Analysis of Law", Posner seeks to explain how separation of ownership from control has resulted. In his analysis, a typical business is both a firm and a corporation. The firm is a more convenient and efficient method of organising production than the basic contractual method of organising economic activity. The corporate form is on the other hand a creation of law and business practice to permit substantial amounts of capital to be raised for a venture, since it is a more viable alternative than loan agreements or partnerships. Loans are expensive and increase the chances of failure, partnerships lack permanency, the corporate form has none of these disadvantages and offers equity interests broken up into shares of relatively small value which can be, in the case of public corporations, traded in organized markets. The corporate form thus greatly broadens the market for investment capital. The corporate form also encourages passive investment. The control of
the firm resides in a management group which gives orders to those who buy the firm's inputs and produce and market its output. The management group consists of people who are experienced in the business and involved in it on a full-time basis. In contrast, the average shareholder is ignorant in the running of the business and his interest in the corporation is no more than a fair return on his investment. Posner concludes that separation is efficient and indeed inescapable, given that for most shareholders the opportunity costs of active participation in the management of the firm would be prohibitively high.

Thus, Posner explains the separation of ownership and control, the shareholder "owns" the corporation in the technical sense but he does not manage the firm. However, Posner noted that the shareholders are not altogether powerless, their essential power is the power to vote out the existing board and vote in a new one that is more attentive to the shareholders' interest. Corollarily, control of corporations has been defined as the "actual power to select the board of directors or its majority." In order to identify the totally powerless shareholders we need to determine who and how control over the corporation is exercised.
Who Controls the Corporation?

Observing the continuing trend that beneficial ownership of stock tends to divide and subdivide and with the proportion of voting shares held by the largest shareholders decreasing, the proponents of the managerial school of thoughts, such as Berle and Means, concluded that economic power in terms of control over physical assets, is apparently tending more and more to concentrate in the hands of corporate management. Furthermore, management can further insulate themselves counting on a sufficient number of general proxies, authorizing them to act on their discretion to counteract any attempt to challenge their leadership. Thus, A. Berle suggests that although theoretically it is possible for someone outside management to mobilize the army of small stockholders, aggregate their votes, and displace the existing directors, but the task is so difficult and it has happened so rarely that the possibility may be discarded.

Berle and Means believing that at least 20% of stock ownership is needed for ownership control and using this as an absolute index, surveyed the 200 largest nonfinancial corporations in the U.S.A. and came to the conclusion that at least 44% of these were management controlled. Larner, updating the studies of Berle and Means and using 10% of stock ownership as the demarcating line, suggests that a firm may reach a size so great that, with a few exceptions, its control is beyond the financial means of any individual or group.

To the marxist economists, the technique is too crude and is not an adequate substitute for a factual inquiry to determine the locus of control. An European marxist economist, De Vroey, suggests that ownership can be divided into economic and legal ownership. Economic ownership denotes the power to control the means of production, and
legal ownership only entitles a holder to participate at the voting system. Legal ownership can be linked to the power of economic ownership only through participation at the voting system and having enough voting stock to avoid defeat. The widespread dispersion of stock ownership is only a widespread dispersion of legal ownership and not economic ownership.\textsuperscript{20} Thus, widespread legal ownership is no obstacle to concentrated control when large shareholders may be able to link their legal ownership to economic ownership and assume control. A popular opposing view to the managerialist opinion is:

"That the greater the degree of dispersion and fragmentation of share ownership, the smaller is the proportion of the entire voting stock which is in practice needed to exercise effective control".\textsuperscript{21}

Another commentator, C.S. Beed, has suggested that 1 to 5 percent of voting stock ownership is enough to exert effective control.\textsuperscript{22} Thus, the incidence of management control is arguably much lower than what the managerialists believe it to be. For the purpose of this paper, it is significant to note that not all shareholders are powerless as a result of the separation of ownership and control. In fact, a corporation could be "shareholder controlled" if the management and the majority shareholders are the same people. A corporation can also be subjected to "working control". This exists where an individual shareholder or group has less than a majority of the stock, but has sufficient affinity with or influence over the board of directors of the corporation so that existing directors will use their power to name a management slate to send out proxies to the rest of the shareholders along lines suggested by the holders of working control.\textsuperscript{23} Working control between such shareholders and management is resulted when a substantial percentage of shareholders always follow the lead of the management through sheer inertia, and when another proportion of shareholders can be counted on to do nothing.\textsuperscript{24}
The managerialist's view of control also suffers another drawback in that it overlooks the other rights and powers associated with share ownership. The other crucial right associated with legal ownership of shares is the right to transfer them. In a capitalist society, effective power lies with those who have the ability to conceive and carry through schemes for the profitable allocation of capital. Thus, even if large shareholders do not enjoy majority voting power or close working relationships with management they can still exert informal pressure at the board, translating their wishes into corporate policies. Their power lies in the fact that they can choose to oppose management by joining proxy fights; they can slump share prices by bulk selling, thus harming the corporation; and wield decisive power at take-over situations by agreeing to sell holdings to the bidder.

The conclusion to be drawn from the foregoing discussion is that the separation of ownership from control is only a question of degree. Not all shareholders are left totally powerless. Corporate powers are in effect exercised and shared by large shareholders who may enjoy total control if the corporation is "shareholder control", or "working control" if large shareholders and the management are closely associated, even if a large shareholder like an institutional investor does not enjoy either form of control, it can still exert informal pressure on the management because of the sheer size of its holdings. Thus, the real absentee owners to whom the separation of ownership and control is complete, are the minority shareholders, the small public investors that are likely to be professionals; retired pensioners, white-collar workers, salesmen and housewives. It is the interest of these groups of public minority shareholders that this paper is focusing its attention on. Unfortunately, the law does not acknowledge the less formal relationship between management and controlling
shareholders and continues to insist that all shareholders are a homogeneous group with identical interests. What is ironical is that the true nature of the problem is to protect the public minority shareholders against the acts of those who are du jure or de facto in control of the corporation, who for the purpose of this paper shall be regarded heretofore as the corporate controllers.

When the managerial group of a corporation is closely connected with the controlling shareholders, the opportunities to deal unfairly with the rest of the real absentee owners are virtually unlimited within the corporate power structure. In his book, "The 20th Century Capitalist Revolution", Professor A. Berle wrote:

"Herein lies, perhaps, the greatest ancient weakness of the corporate system. In practice, institutional corporations are guided by tiny self-perpetuating oligarchies... Change of management by contesting for stockholders' votes is extremely rare, and increasingly difficult and expensive to the point of impossibility. The legal presumption in favour of management, and the natural unwillingness of courts to control or reverse management action some in cases of the more elementary type of honesty or fraud, leaves management with substantially absolute power. Thus the only real control which guides or limits their economic and social action is the real, though undefined and tacit, philosophy of the men who compose them." 29

What then is this undefined and tacit philosophy of corporate insiders? Professor Dodd, writing as early as in 1934, expresses surprise that there is little discussion by economists of the motives by which the managers of large corporations are governed. 30 Posner later wrote that in classical
analysis, the firm is considered as indivisible unit and the firm always seeks to maximize profits. However, Powner points out that once it is recognised that a firm is actually a collection of individuals, each with its own utility function, the question of what the firm maximizes becomes more problematic.31 We have noted the separation of ownership and control, the root source of conflicts of interest between those in control and real absentee owners lies in the fact that self-interested goals may be substituted for the corporate goal of maximizing profits. Professor Dodd, commenting on the motives of those in control of a corporation, noted that:

"The idea which corporate capitalism sets before corporate managers as one which should motivate their conduct is thus an idea of profit-making on behalf of a group with whom they have an in general no ties of personal association and a very incomplete identity of interests. Such an ideal seems one so little calculated to make a strong emotional appeal to the managers as to give those who are engaged in the endeavour to write that idea into law give much reason to fear that the law which they write will have to depend for its effectiveness primarily upon external compulsion rather than upon the internal harmony between the legal rules and the natural impulses of the group which is expected to govern its conduct thereby". 32

As a concluding remark, it is interesting to point out that the desire of personal financial gain is only one, and perhaps the weakest of the motives which shape an insider's conduct, and many of the non-financial motives such as desire for personal power and prestige may lead management to engage in other goals such as growth and expansion rather than for the purpose of maximizing per share earnings for the absentee owners.33 Thus, the impulse to obtain enrichment through breach of fiduciary duties is strong.
The forms that such breaches usually take are too familiar. They range from excessive remuneration, unconscionable stock options and pension plans, and unwarranted expense account living, to breaches involved in self-dealing, insider-trading, "friendly" dealings between interlocked and parent-subsidiary boards, the taking of corporate opportunity etc. 34
The Importance of the Interests and Expectations of Absentee Owners

How to draw the savings of people into the great streams of investment and at the same time to protect those savings from recklessness has been a problem for statesmanship ever since the advent of large corporate enterprise. In the Canadian context, corporate investments permit individuals to participate in the ownership of business enterprises; it encourages the investment of savings in equity securities issued by productive enterprises as distinct from investments in passive assets such as unproductive land and gold; more importantly it furnishes a means to encourage Canadian ownership of domestic enterprises and assures that the Canadian government can control more efficiently the domestic economy. Also of equal importance is that technological advancement of a society depends on the ability of corporations to invest risk capital in new scientific projects, the flow of equity investment being the life blood of risk capital, is extremely important.

However, for the ordinary public investors when they invest their capital in public corporations they essentially part with control of their property. Therefore, the investors have the right to expect that its management have unquestionable integrity and would use corporate property in a manner consistent with their fiduciary obligations. The position of corporate management has in it a large element of trusteeship and it is to them that the absentee owners look for protection of their interests and investment. Thus, William O'Douglas, a former Chairman of the Securities Exchange Commission once commented:

"The most serious blow to capitalism come in scandalous mismanagement and reckless disregard of the ancient principles of trusteeship. Episodes of the type which have come before public scrutiny dissipate the confidence of the investors, confidence is the bulwark of capitalism as it is of democracy."
It is the same realisation of this stark reality that prompted this tough comment when the 1933 Federal Securities Act was passed in America.

"He who is unwilling to assume the responsibility of a fiduciary has no business to be a fiduciary". 38

As a result, when Mr. W.R. Wyman, chairman of the Investment Dealers Association of Canada announced in 1978 that the proportion of equity investment raised by the association from the total investment has dropped from 11% in 1977 to 2% in 1978, Charles Salter QC, a director of the Ontario Securities Commission, was quick to suggest that the reason why risk capital was disappearing was because of widespread public indignation at squeeze-out transactions that were prevailing in the Capital Markets. 39

How to raise and preserve the standard of integrity of corporate controllers is the main theme of this paper. The interests and expectations of absentee owners - the public minority shareholders, are important because both in law and in theory they are the only effective group with direct remedies to restrain and correct the conduct of corporate controllers. If not, controllers of the corporations would have become an overprivileged class in a democratic society. Their powers threaten industrial liberty and corrupt sound business judgment. Their power to overpay themselves, with legal sanction, would if unchecked, erode the very structure on which they and their corporations survive. It was also thought that the most serious consequence is not the diversion of corporate funds to personal use, but the impact which unduly high executive reward has upon the rest of society. This misallocation gives the business corporation an overpowering bargaining advantage in the national competition for talented manpower which government, schools, the military and other essential social institutions cannot hope to match. 40 Perhaps, this explains why there is a general change of attitude in legislators in U.S.A., Britain and Australia: they
have tended to extend the scope of protection afforded to absentee owners. This is most evident in the increase in requirements for disclosure, a trend that is to be found in many countries. A consultative document prepared by the British Department of Trade on the subject of disclosure of interests in shares reads:

"The policy underlying the present provisions of Company law is that a company, its members and the public at large should be entitled to be informed promptly of the acquisitions of a significant holding in its voting shares, whether or not this is to be used to influence policy or with a view to subsequent acquisition of a controlling interest, in order that existing members and those dealing with the company may protect their interests and that the conduct of the affairs of the company is not prejudiced by uncertainty over those who may be in a position to influence or control the company." 41

From these statements, it is clear that although the law does not regulate in a substantive manner the relationship between controlling and small shareholders, the law has nevertheless relied on disclosure to enable small shareholders to protect their own interests.

Finally, another reason why the expectations of public minority shareholders and investors are important is that: as a practical matter, the power of public opinion is already proving to be an effective restraint on the conduct of corporate controllers. Corporate officials are keenly aware of their vulnerability to adverse public opinion. To prove this point, A. Berle gives the example of a president of a very powerful life insurance company placing a large contract for advertising with a firm organised by his son. No law was violated, the fees were fair, the job well done, and there was adequate disclosure. But, the Superintendent of Insurance of the State of New York insisted on the resignation of the president. The board of directors might have elected to fight out in the courts, or as a quasi-
political matter. But, the precise issue would have been whether an 
executive of a fiduciary institution could properly favour his son. The 
president promptly resigned at the next election meeting. 42 Similarly, 
William C. Newberg, the newly elected president of Chrysler Corporation 
promptly resigned, when a public uproar followed the discovery that he had 
previously owned a financial interest in two supplier companies selling 
parts and materials to Chrysler. 43 Following the incident, the Senate of 
Banking and Currency Committee announced plans to investigate conflicts of 
interest in top level management, and the Securities Exchange Commission 
threatened to revise the rules so as to require that proxy statements 
include a full disclosure of outside interests of executives. 44

Thus, William L. Cary, a former Chairman of the Securities Exchange 
Commission commenting on the observance of ethical standards as a matter 
of business wisdom states:

"Should not management and their counselors anticipate 
not only laws that may result from aroused public, but 
events that will arouse that opinion? If management 
asks whether they may do a particular thing, the wise 
counsellor may say: it seems legally proper but would 
you like all of the details printed in the Wall Street 
Journal?" 45

Perhaps, we are now able to appreciate the wisdom of Mr. Edward Kaiser 
when he astutely chose to surrender his stock options to the bidder for his 
corporation for cancellation, without receiving any payment. The cause for 
such a course of action was that under the takeover agreement between British 
Columbia Resources Investment Company and Kaiser Resources Ltd., the latter 
controlled by Mr. Kaiser, each bidder of an option upon surrender to the 
bidder was to be paid the difference between the option exercise price and 
the price to be paid under the offer. 46 Despite such a move, the exercise 
of Mr. Kaiser's earlier options, months before the takeover agreement was 
finalised, was not spared public criticism.
Noting the power of public opinion, a commentator says:

"Our society has progressed to a stage where we find that the general public feels entitled to know the details of private business lives, and feel competent to pass an ethical judgment on them." 47

Given the greater sensitivity of the public to the requirement of fairness and the apparent power of public opinion, it is perhaps, necessary to analyse the relationship of law and public opinion. On this question, Professor A. Berle has through his series of writings provided more than a thorough analysis. 48 There are two separate conceptual terms important in Professor A. Berle's analysis. Professor A. Berle points out that there is a distinction between "public opinion" and "public consensus". "Public opinion" is a spontaneous fact in the minds of many individuals while "public consensus" is not. Far from being a spontaneous fact "public consensus" is the product of a body of thought and experience, sufficiently expressed in one form or another so that its principles are familiar to and have become accepted by those members of the community who are interested in the relevant field. 49 However, public consensus do not always agree and reach a point of accepting as a doctrine that a particular business practice is good or bad. For example, the "public consensus" of lawyers may be at variance with the "public consensus" held by economists on an identical problem. For example, economists are less likely than lawyers to perceive the problem of insider trading as a moral problem and would seek to justify it with a cost and benefit analysis. Further discussions, debates, and studies are needed until the stage where doctrine solidifies and a wider consensus is reached. 50 The wider "public consensus", therefore, is the body of these general, unstated premises which has come to be accepted, while public opinion is the more specific application of the tenets embodied in the wider consensus to some situations which has come into
general consciousness, usually spontaneously and emotionally.52 Perhaps, not many people would quarrel with the proposition that the "public consensus" of absentee owners and the investing public at large is that they be treated fairly in their dealings with corporate controllers. We have already witnessed in my earlier discussion of the Chrysler affairs, the application and the power of public opinion; in a similar vein, the fair behaviour of corporate controllers at the capital market is the single most important condition necessary to maintain the public investors' confidence in the capital market. Government and legislators have frequently felt the need to ensure fair play at the market in order to accommodate the demands of the public. For example, following the infamous Windfall affairs where the corporate controllers engaged in wash-trading at the stock exchanges and other corporate malpractices, it was found imperative to carry out public investigations in order that recommendations can be made for corrective changes so as to coax the return of public confidence.53 Similarly, the provincial governments of British Columbia and Ontario initiated investigations, when the public suspected insider-trading in the takeover attempt by the British Columbia Investment company for Kaiser Resources Limited. The result of such public investigations may be academic, but they may also lead to the enactment of a relevant statute by the legislature, or the emergence of a new rule through the common law courts. Perhaps, we can now appreciate the wisdom of Professor Berle when he discusses the relationship of inchoate public consensus and settled law. He observes that inchoate public consensus includes settled principles of law, but more importantly, it also includes the capacity to criticize that law. He says:

"From time to time it (the inchoate public consensus) may demand changes in existing law. It also carries capacity to insist that principles heretofore comprised only within the consensus must be added to statute or common law, enforceable by courts as well as by public opinion". 54
Bearing the above consideration in mind, we should now investigate the conceptual basis of the kind of fairness as demanded by absentee owners.
Absentee owners not only interact with corporate controllers within the corporate context in their capacities as minority shareholders, but they are also affected by the market activities of the corporate controllers at the securities market in their capacities as public investors. Both the exercise of corporate discretion by corporate controllers and their market activities under certain circumstances may be perceived as unfair by the absentee owners. What then is the conceptual basis of such a perception is a question we now turn to.

In order to understand an absentee owner's conception of fairness within the corporate context, it is useful to adopt Alison G. Anderson's analysis of the corporate form as an example of specialized exchange relationship. To achieve efficiency, society must rely on the specialized production of goods and services and on an extensive system of exchange to make such goods and services available to those who need them. When an individual has a comparative advantage in performing such task because of special skills, information or other resources, others can benefit by hiring him to perform that task. Specialisation, is therefore efficient. The corporate form therefore typifies a special exchange relationship where investors buy corporate stocks relying on the corporate management's specialised skills to manage the corporation.

Unfortunately, as Anderson points out, the integrity of the specialised exchange relationship is threatened by two inherent characteristics of
specialised exchange relationship which are themselves desirable -
specialisation and trust. The grant of broad discretionary power to
management created ample opportunities for its abuse, and trust in
management is inevitable since attempts to limit corporate management's
opportunities of abuse by monitoring and other enforcement techniques
are costly. As a result, the need to maintain the integrity of the
corporate specialised exchange relationship underlies absentee owner's
demand and expectation of fairness. Thus, when corporate management
diverts corporate property and benefits to themselves, when they take
advantage of their strategic position to benefit themselves at the expense
of others, and when managers systematically receive more than a competitive
return for their services, their conduct is unfair for reasons listed below.

Firstly, in specialised exchange relationship, the corporate manage-
ment in effect induced the victim to give him discretion over his property
so that both would be better off, it would be unfair that he then appropri-
ated an unfair share of the gains from the mutually advantageous arrange-
ment. Secondly, investor's sense of fairness is offended when corporate
controller's wrongdoings clearly involves a kind of violation of trust
and a taking-of-advantage of the victim's own cooperation. Thirdly, the
loss is perceived by investors as a result of their detrimental reliance
on a 2-party exchange relationship, or it may be perceived as the imposition
of non-reciprocal risk by one party on another without compensation. Fourthly, Anderson suggests that the corporate controller's conduct also
seems unfair for a reason which is at bottom a concern with efficiency.
She says:

"If specialists take advantage of their skills to cheat, we may be inclined to forego the benefits of specialisation
in order to protect ourselves. Similarly, if individuals take advantage of our willingness to trust them in order to cheat us, we will be forced to spend massive social resources on the prevention and detection of cheating."  61

Fundamentally, and as noted earlier, it will be unfair to the absentee owners when corporate controllers substitute personal goals instead of the corporate goal of profit maximization.

To understand the absentee owners' conception of fairness at the securities market while in their capacities as investors, it is useful to think of the securities market as an economist's paradigm of the perfect market. 62 In such a market there are many buyers and sellers, no market actor has enough power to affect prices materially, all buyers have equal information about all variables, transaction costs are immaterial, all buyers and sellers have freedom of entry and exit, all actors behave rationally, and no government constraints are imposed on the market to achieve extraneous goals. 63 The market must also be fair in the sense that returns are reasonably related to risks, that the actors in the market, such as corporate management have unquestioned integrity, and that the individual investor is not placed at a disadvantage with respect to controlling shareholders or other large shareholders like institutional investors. Also of importance is that an investor can realise his investment at its fair value at any time. 64

Unfortunately, if corporate controllers are able to deal in their own corporate shares at the securities market the above requirement necessary for fair market is difficult to be maintained. The market situation merely offers new scope for corporate controllers with superior knowledge, and with substantial power over their own corporation, to operate the system to their own advantage. Armed with superior information corporate controllers may engage in insider trading. Mismanagement may effectively merge with
market manipulation, when for example a squeeze-out transaction is to be effected through an issuer bid. Market share prices can be artificially deflated by maintaining a low dividend policy in order that when the issuer bid is announced public minority shareholders will be more or less coerced into tendering their shares. This is unfair for two more obvious reasons. Firstly, the bid price usually does not reflect the true value of the shares, and secondly, investors do not have any real alternative to make their own investment decisions. Their freedom to enter or exit from the securities market is impaired. Other unfair practices of the corporate controllers at the securities market will be discussed in more detail later, but briefly they include sale of control at a premium, self-interested defensive actions against takeover bidders etc.

I hope at this juncture we have done sufficient preliminary discussion necessary to equip us for a realistic appraisal of the various problems that may arise in the relationship between absentee owners and corporate controllers, whether in the corporate context or at the securities markets.
PART II

The Relationship of Corporate Controllers and Absentee Owners - Some Problems in that Relationship

A. Introduction

This rather extensive section here is not intended to produce a guidebook for avarice of corporate controllers. Part II is intended to put into a sharper focus some of the issues that may arise in the relationship between corporate controllers and the absentee owners. It shall be observed that many of these issues are clearly issues of human and social relationship, it is therefore unwise to restrict ourselves to a purely legal analysis. In order to understand our problems clearly, we must perceive each problem in its wider context; social and economic factors must be considered.

From the examples of mismanagement and dubious market practices that will be discussed, one will note that most of the conduct complained of does not violate any law. What it does violate is the absentee owners' and, possibly, society's sense of fairness. For instance, it is clearly illegal or criminal for directors to make away with the company's assets for dishonest or unauthorised purposes. However, the degree of illegitimacy is less obvious if directors engage in asset-stripping, lending considerable sums to enterprises which have gone beyond the point of financial recovery, or making investments in loans and advances to subsidiary companies by the director concerned. How are we to regulate such unethical corporate conduct short of infringing the law is a searching question.

Apart from the fact that we are dealing with ethics, another problem that baffles a regulator of corporate controllers is that it is almost impossible to substitute one's judgement in place of a corporate investment
judgment. The inherent uncertainty involved in business and investment decisions occurring within the realm of complex and changing business practices renders the task of judging business decisions extremely difficult, irrespective of whether the "judge" has expert knowledge.

The third problem is that most issues are extremely controversial. The discussions and debates about insider trading, for example, have gone on for the past 40 years. There are always two sides to most of these problems. The development of a public consensus is nearly always subject to debates on divergent viewpoints. The lawyers are more likely to perceive most problems as moral problems while economists are likely to adopt a cold, emotionless analysis based upon cost and benefit. To confound the matter further, social policy needs to be considered in some problems. An apposite illustration is the problem of usurpation of corporate opportunity. The basic dilemma is whether the need to maintain the integrity of a business structure overrides the social need to encourage entrepreneurial incentive.

The fourth main issue is that in our modern day society, the marketplace for corporate shares is becoming the arena where the conflict of interests between corporate controllers and absentee owners is increasingly being sharpened. In this securities context, traditional corporate law is becoming extremely anachronistic. What is also significant is that corporate mismanagement in some situations become essential preliminary steps to manipulate the market in order to realize certain ulterior motives. The question to ask is whether we have laws or administrative regulations that are able to regulate mismanagement that merges with market abuses in a realistic manner.

Perhaps, we now need to ask ourselves how Canadian company law and
securities regulations have sought to tackle these intractable problems. Unfortunately, it is fair to say that Canadian company law and securities regulations have tended to put too much faith in disclosure and market philosophy. Disclosure of certain information may prevent the occurrence of malpractices it is designed to check. However, business practice changes and so do the possible range of malpractices. Furthermore, disclosure does not help when the corporate controllers have enough corporate power to carry through the scheme of mismanagement. It is also ironical that sometimes compliance with disclosure requirements legitimises the particular scheme of mismanagement. Commitment to the market philosophy has led Canadian securities regulators to think that they must not constrain the market unduly. The truth is that the imposition of restrictions on certain market areas (like company directors or controlling shareholders) is not inconsistent with the concept of a perfect market. It is also important for the reader to note that generally, Canadian courts and securities regulators have been slow to incorporate fairness to redefine the relationship between corporate controllers and absentee owners. In our subsequent discussion, I hope to highlight the shortcomings of the present Canadian system of corporate regulation.
B. Corporate Transactions Affected With Management Interest.

This includes all transactions whether direct or indirect between directors or officers and their corporation. Such a problem, in its simplest form, means purchases by an officer from his corporation or sales by him to the corporation. For example, the executive-supplier linkage in the earlier discussed Chrysler affairs or the case where the president of a corporation contracted with the firm of his son. Such problem of self-dealing is usually easy to discern; moreover, there is usually a market which can be used as a standard to measure the transaction's fairness. However, officers (excluding directors) of corporations have been held to strict standards of fiduciary obligations and questions of fairness of the transaction are not allowed to arise. The reasons for imposing a strict rule is that the obvious vice involved is that business is directed to a particular supplier in preference to other suppliers who might serve the corporation better and more cheaply. Furthermore, a corporation has a right to demand its executive employees to act for the corporation with unswerving loyalty.

Directors were once upon a time similarly held to such strict fiduciary duties. However, as time went on, although the strict treatment of officers' fiduciary duties have been maintained until today, a somewhat more liberal approach governs the activities of directors. The reasons for the softening on the strict rule on directors are: firstly, it is generally recognised that it is in the commercial interests of the company that it should have as some of its directors, men who are connected with potential customers or potential sources of supply, secondly, in our modern economic system, close interrelationship exists between many corporations in similar fields and that many persons will hold legitimate financial interests and directorates in various operations; so
allowances must be made.  

Courts therefore began to relax their standard, and held valid contracts between a corporation and a director, or between two corporations with a common director, where it was shown that in making the contract, the corporation was represented by independent directors and that the vote of the interested director was unnecessary to carry the motion and his presence was not needed to constitute a quorum.  

Even this common law rule can be freely avoided if the company's constitution permitted such contracts or if the shareholders ratified the contract.  

This practice was soon abused, and exclusion clauses of a company's constitution went as far as enabling an interested director to vote and attend board meetings as if he were not interested.  

Alarmed by the use of exclusion clauses, the English Legislature, by the 1929 Companies Act, made mandatory the disclosure of the director's interest (Now s. 179 of 1948 U.K. Companies Act.) In Canada, a fairly uniform type of legislation patterned on the English prototype mentioned above is superimposed on the Canadian prototype.  

Such statutes usually require that every director who is in any way interested in a proposed or existing contract with his company declare his interest at the board.  

If such a declaration is made and the director refrains from voting on the contract in question, he is not accountable to the company or its shareholders for any profits realized by him.  

Surely, such a requirement is inadequate to safeguard the interests of public minority shareholders. There is nothing to preclude mutual back-scratching by directors who might tacitly agree to approve one another's contracts with the corporation.  

Brandeis, an American judge, says that this rule ignores the trusteeship principle that a beneficiary is entitled to disinterested advice from all his trustees, and not merely from some;
and that a trustee may violate his trust by inaction as well as by action. Everyone knows that the most effective work is done before any vote is taken, subtly and without provable participation. Also, it is unfortunate that it has been held that if a director's interest in another company consists of the fact that he is in receipt of a salary from it, he is not "interested" in a contract between the two bodies within the legislation. (Cf. Wilson v London Midland And Scottish Ry., (1940) Ch.169) Given this narrow interpretation, the application of the legislation requiring disclosure of interest in contracts or proposed contracts at directors' meetings is limited. Many "directors' contracts" will not even be subject to the rather ineffectual statutory provision. Furthermore, the nature and the extent of disclosure required is far from being comprehensive, requiring only the disclosure of the nature and not the extent of the interest.

The courts also relax their standard by holding that even where a common director participated actively in the making of a contract between two corporations, the contract was not absolutely void, but voidable only at the election of the corporation. From Brandeis' point of view, to hold such contracts merely voidable has resulted practically in declaring them valid. The almost automatic approval of the contract where the director also controls the general meeting militates against shareholder protection. Minority shareholders have rarely the knowledge of facts to do anything. The financial burden and the risks incident to any attempt of individual stockholder to interfere with an existing management is ordinarily prohibitive. Also, in such situations the contract will not ordinarily be regarded as oppression of the minority.

The dilemma is clear, the board of directors is hardly a sufficiently disinterested body to judge the fairness of a transaction. On the other hand, it is impossible to require shareholders' approval for every director's
transaction. As a result, interlocking directorates become very much a feature of capitalism and a most potent instrument of business combination and consolidation described by Brandeis as the root cause of many evils. As it tends to disloyalty when one director serves two or more corporations, it also causes inefficiency for it removes incentive and destroys soundness of judgment. Interlocking directorates also provide less obvious affiliations of companies short of a legal relationship, existing as legally distinct entities. The resulting unified group of companies offer ample opportunities for abuses of fiduciary duties permitting a total disregard of public minority shareholders' interest and causing serious losses to creditors. For example, assets can be hidden and moved from company to company covertly. Business facts can be concealed from investors; under such circumstances, high financiers can with impunity manoeuvre and manipulate other people's money to their own preferment. Brandeis also argues that interlocking directorates permit the eventual establishment of financial oligarchy, which causes loss of industrial liberty, depress competition and exacting heavy tolls on society.

Unfortunately, these observations are not mere academic postulations. The investigatory report into the affairs of Prudential Finance Corporation Ltd., traces the cause of the failure to the direct result of losses incurred on investments in loans and advances to subsidiary companies and companies controlled by one of its directors, Brien, who owned a controlling interest in Prudential. To cover up the losses and insolvency, inflated assets exceeding their face value by almost $1 million had been sold to Prudential by a company owned by Brien. Canada's sixth largest sales and finance company, the Atlantic Acceptance Corporation, collapsed
under very similar circumstances. Atlantic's chairman had substantial personal interests in the borrowing firms of Atlantic's fund, lending considerable sums to enterprises which had gone beyond the point of financial recovery.²⁵

Since the law takes no cognizance as to how control over a corporation is really exercised, and companies are continuously treated as separate legal entities, when in practice they are not, the gap between the law and reality is quite wide.²⁶ However, the evils of interlocking directorates are increasingly being recognised. Legislators and securities regulators in some situations flatly forbid reciprocal ties between corporations of particular types, where the possibilities of impropriety and the allurements of temptation are too great, for instance, in the relationship between a mutual fund and its brokers and between the mutual fund and companies in which it invests. Section 107(1) of the 1978 Ontario Securities Act prohibits a mutual fund to invest in any person or company which is a substantial security holder of the mutual fund, of its management company or of its distribution company.²⁷ It is also interesting to note that if there is any management solicitation of proxies, item 3 of the information circular required to be sent to shareholders requires directors and senior officers to give particulars of any material interest each may have in any matter to be acted upon at a meeting of shareholders, other than the election of directors or the appointment of auditors.²⁸ More generally, item 8 requires insiders to disclose their interest in any material transactions since the commencement of the last fiscal year of the corporation.²⁹

Disclosure generally suffers from the drawback that it does not prevent substantive violation, that is when a director or control-group has enough power to carry through the mismanagement. Disclosure does not
cure the harm caused to the corporation or absentee owners. It seems that an external agency other than the board of directors or the general meeting is needed to supervise transactions affected with director's interest, if such transactions cannot be declared void in the first place.

C. Officers' And Directors' Compensation

It is an open secret that directors and officers may make use of their power to pay themselves enormous salaries or commission. Ample illustrations can be drawn from the Anglo-Canadian and American corporate affairs to show how easy it is for directors to organise retirement benefits or incentive schemes for senior employees, by which a certain percentage of company profits has been secretly or semi-secretly directed to their own benefit.

The problem is further complicated by the fact that legislators believe that there will be more incentives for corporate officers if remuneration is linked to the firm's performance. As a result, revenue laws have sanctioned certain tax benefits encouraging the reward of corporate officers via the stock option route (see eg. Canadian Income Tax Act 1979-80 s. 7(1.25)). In defending such a practice in the wake of widespread criticism, Henry Ford II argues that stock options present opportunities for gains that are tied to the corporate performance, therefore, generating incentives for management. It establishes a propriety interest which aligns the executive personal interest clearly with those of stockholders. Finally, he thinks stock options are absolutely necessary to retain talented management.

However, it has been forcefully argued by Griswold and J.A. Livingston that actual corporate practices clearly revealed inconsistencies with the "incentive" philosophy. Insider sales reported to
securities regulators are frequently found to be made in order to raise cash to take up stock options. This is clearly inconsistent with the notion that stock options enable insiders to acquire a stake in the company. Furthermore, large proportions of stock options go to people who are already extremely well off. Also, instead of granting the option to buy stock at a fixed price, the option may provide a formula based on market value when the option is exercised, thus, effectively removing the incentive for management to improve the company's performance in order to maximize the benefits of the stock options at the time of exercise. In a blatant case, the special committee of stock options of a corporation cancelled options at a fixed price when the stock market price plummeted and reissued them at a substantially lower price. The committee, some of its members being direct beneficiaries of their decision, argued that because of the drop in the price of the stock, the options would "fail to serve their intended purpose" as an incentive. As Griswold cynically suggested, just how this fits in with the general "incentive" philosophy is far from clear.

Apart from inconsistencies with the "incentive philosophy", many shareholders who vote upon a stock option plan have no real appreciation of the amount of dilution that can result from the plans they approve. Stock options are also inherently discriminatory, benefiting only a selected few. The essential moral objection to stock options is that management are permitted to reap substantive profits without financial risk, and constitute giveaway programmes. Finally, in a takeover situation, both the exercise of stock options before the takeover offer was made, or the tendering of options to the bidder pursuant to a takeover, suggest a possibility of insider trading. The basic problem is that so little is known about stock options - who gets them, the amount
of the actual benefit that is thus obtained, complication caused by the provisions, the relationship of this benefit to the person's other income and wealth, and the actual amount of "incentive" which is provided by the stock options. Thus, it becomes difficult even to pass an ethical judgment on it, let alone to regulate it.

The law, unfortunately, has taken a very unrealistic approach to regulate such a complex problem. In the Province of British Columbia, the remuneration of officers is generally left to be determined by the directors. Article 13.1 of the Table A articles attached to the B.C. Company Act provides that the remuneration of officers, whether by way of salary, fee, commission, participation or otherwise, shall be determined by the directors as they "think fit". Such a provision ignores the fact that directors are frequently also officers of the corporation; they are thus permitted to fix their own compensation. This is a problem of some magnitude as many corporations adopt the policy of electing boards largely composed of persons who also hold executive positions in the company. In Ontario, directors' powers to pass on officers' remuneration is subject to confirmation by the shareholders. (Ontario Business Corporation Acts, Clause 2(1)(e)) However, this does not provide an effective check, since the company might be controlled by a director-shareholder group. Even if there is a sufficient body of neutral shareholders their ability to analyse stock option plans or other schemes of benefits may be limited. Furthermore, if it is in the form of stock options, there is no way shareholders can determine the dilution of their shares, the actual incentives provided and its value, shareholders are really hardly a body qualified to do this task.

Regarding directors' remuneration, neither the B.C. Company Act
nor Table A appears to make any provision for the remuneration of directors; but, both the Ontario and Federal legislations specify procedures through which directors' remuneration is to be determined. The Ontario statute provides that, subject to the Act and the articles, directors may pass by-laws to regulate their remuneration (clause 21 (1)). Such a by-law must fix the remuneration and the period for which it is to be paid. Unlike other by-laws, it must be confirmed by the shareholders before it takes effect (clause 22 (2)). Perhaps, the requirement for confirmation by the shareholders is in deference to the principle that, since the directors' powers held by them on trust for the company they cannot, without the consent of the company, fetter their future discretion. The Canada Business Corporations Act provides that subject to the article, the by-laws, or any unanimous shareholders' agreement the directors of a corporation may fix their own remuneration (section 120). However, the general requirement for shareholders' approval is rather academic. The case of Harris v. Harris (1936) S.C. 283 will illustrate why this is so. In this case the managing directors used their controlling votes to give themselves additional remunerations both retrospectively and in the future. Although there is the "fraud on minority" remedy, the court was not willing to hold an abuse of voting power as amounting to a fraud on minority.

The provisions of Company Legislation for disclosure of management's remuneration will help to eliminate some of the most startling cases of this kind. The power of publicity is not inconsiderable. However, the general requirement of disclosure of directors' and executives' remuneration as aggregate sums does not enable the shareholders to evaluate whether individual directors and officers are being paid excessive amounts. In addition, unless disclosure is required of the total amount of remuneration received, direct and indirect, financial statements will not give a full
and accurate picture of what is being paid to directors and officers. It would seem that the preferable approach is to require disclosure of the total remuneration, both direct and indirect, received by each director and officer, or at a minimum, disclosure of the numbers of directors and officers receiving remuneration falling within specific monetary units as it is being required by the British 1967 Companies Act. (see section 8).

The disclosure requirements under the Ontario Securities Act make subtle improvements. They require that total remuneration for directors, for the five highest paid senior officials and for all officers earning more than $50,000 annually be disclosed in the information circular necessary for proxy solicitation (Ontario Securities Regulations, Form 30 item 6). Remuneration was defined as amounts required to be reported as income under the Income Tax Act. On this requirement, Alboini noted that they were obviously not as far-reaching and controversial as the initial proposals. The initial proposals would have called for individual disclosure of the "remuneration" for each director. Similar requirements of disclosure was proposed for the three highest paid senior officers if their aggregate remuneration exceeded the unstated minimum amount. Remuneration was widely defined to include salaries, fees, bonuses and other forms of compensation and, most importantly, all personal benefits or so-called perquisites. Given such extensive disclosure requirements, it is no wonder that the proposals were not accepted in its entirety.

What is fair compensation is no doubt a matter that is properly left to the company concerned. But, it is obvious that directors and executives cannot be entrusted to determine fairly their own remuneration. The shareholders may not be a sufficiently disinterested body, especially if they
are closely connected with the management. The neutral shareholders may be powerless or ill-equipped to perform a supervisory role. Perhaps, what is needed is an external agency capable of investigating into corporate affairs to determine whether excessive and unfair amounts of compensation have been paid. An agency capable of investigating any direct or indirect payment or any other benefit resulting from the use or receipt of any of the services, facilities, or other assets not only of the corporation but of its subsidiaries. Although, the Canadian Department of National Revenue and Taxation may sometimes play an important role in controlling board remuneration, all too often, companies look first for any compensation device which promises a tax break and, having found it, rationalize its use. Furthermore, the Department, like any other bureaucracies, suffers from the shortage of resources. For example, the Department, in an effort to avoid additional overburden on an existing paper overburden, has tended to shy away from squarely raising the taxability of fringe benefits as a matter of principle. In what appears to have been a reasonably sound business approach to the collection of tax, the Department has concluded that the amount of net additional tax (if any) which might be collected under a full-scale program of strict enforcement of the Income Tax Act would not be warranted in view of the additional costs of ensuring compliance.

D. The Usurpation of Corporate Information and Opportunity

The success and failure of a commercial enterprise must surely depend on its ability to take advantage of information and opportunities relevant to its interests. Directors and officers are bound to come into contact with information or opportunity, whether in their private or official
capacities, which are useful to the company. Since directors and officers are fiduciaries of the company they should transmit the information or opportunity to the company in order that the company may benefit as a result. Therefore, it seems natural to assume that fiduciaries should not be allowed to use their discretion to reject the use of such information or opportunity on behalf of the corporation only to take advantage of it in their personal capacities. Directors and officers are important elements of the commercial apparatus of a firm, not only that their exercise of discretion must not be tainted with self-interest, they must also be encouraged to pursue single-mindedly the interest of the corporation. In short, there is a policy need to preserve the integrity of a commercial enterprise. Professor Weinrib puts it succinctly:

"More basic is a realisation of the economic importance of fostering incentive by protecting the entrepreneur's business apparatus. A sophisticated and commercial society requires that its members be integrated rather than autonomously self-sufficient."
It seems that the objectives of ensuring untainted exercise of discretion and active transmitting of corporate opportunities and information can be easily and effectively achieved by a broad definition of corporate opportunity or information and strictly prohibiting management from using them in their private capacities. However, there are at least 2 policy considerations that militate against such a development in law. As earlier discussed, interlocking directorates are accepted as a necessary feature of modern day commercial realities. The practice of a person holding more than one directorship of companies in the same line of business or of similar interests is not uncommon. A strict prohibition would certainly eliminate this practice if directors are not allowed to allocate in a reasonable way the use of information or opportunity in preference of one company over the rest.

The second conflicting policy consideration is the need to encourage the profit-making incentive of the individual entrepreneur. The encouragement of co-operative mechanisms of business enterprise and the protection of commercial structures must be balanced against the need to cultivate entrepreneur incentive. Thus, especially in the field of mineral exploration, from which many of the more interesting Canadian and American decisions came, the courts must constantly reconcile the social need of discovering and exploiting the resources with the aggrieved party's interest in the integrity of his enterprise. The law is clearly an inappropriate instrument to elucidate the broader problems of policy which underlie the whole fiduciary concept in this context. Thus, the way the law has dealt with the usurpating of corporate opportunities has been extremely unsatisfactory. It is against this background that produced the much criticized Supreme Court of Canada's
The Peso case will be discussed in greater details because it raises issues directly relevant to our discussion of the relationship between corporate controllers and absentee owners. In 1959 Cropper, the respondent, was instrumental in incorporating a company known as Tanar Gold Mines Ltd. which two years later transferred its assets to the appellant, Peso, a company in the formation of which the respondent also played a major role. Subsequent to this the appellant company went public and acquired other claims, the purchase and development of which imposed heavy strains on its finances. During 1962, an offer was made to the appellant to purchase mining claims, some of which were contiguous to claims already owned by the appellant. The then board of directors of the appellant company rejected this offer. The major reason given for rejecting the offer was financial inability. Subsequently Cropper, in conjunction with two other directors and the company geologist, formed a company to purchase and exploit the claims. In 1963, the control of Peso changed hands and the new management requested Cropper to transfer the claims which Cropper as one of the directors of Peso had earlier rejected. When this was refused, the new management of Peso initiated an unsuccessful action claiming a declaration that Cropper held the shares, in the company formed to exploit the above claims, in trust for Peso.

We recall that policy considerations required that a fiduciary must not allow his exercise of discretion to be tainted with self-interest and that the integrity of the business enterprise needs protection. As a result, common law has developed 2 rules based upon fiduciary principles. The first rule requires that a fiduciary cannot put himself in a position
where his interest and duty conflict. The second rule requires that a person shall not profit from his fiduciary position; this is to prevent a person from actually taking advantage of his position.62 The application of these rules created two grounds of liability.63 There is presently a debate as to whether there are two separate rules or alternative forms of a single rule. It is, however, beyond the scope of this paper to discuss this question.64

The Court of Appeal dealt with some important issues, which were either partially or completely ignored by the Supreme Court. It is therefore necessary to deal with both judgments simultaneously.65

The first aspect of the case that interests us is that the legal basis for disagreement between Norris J.A. and the majority judges in the Court of Appeal was a basic policy disagreement as to the advisability of making more stringent the fiduciary principles regulating the activities of directors.66 Bill J.A., representing the majority of the court, considered that the "complexities involved by interlocking subsidiary and associated corporations" are such that it would not be "enlightened to extend the application of these principles beyond their present limits."67 Mr. Justice Norris, on the other hand, insisted that it is precisely such complexities involved by interlocking subsidiary and associated companies which necessitated that the fiduciary principle be more strictly enforced in order that "such complexities may not be used as a smoke-screen or shield behind which fraud might be perpetuated."68

The second interesting aspect of the case is that the majority in this case set themselves the task of delving into the bona fides of directors' actions. As a result, the court was rightly criticized for making this attempt in such a situation as it can do no more than guess in judging individual motivations and actions.69 Since it is almost an
impossible task to determine if financial inability, the major reason for rejecting the offer, could have been overcome if the directors had put in the effort to raise further capital. They should have instead applied the equity rule in a rigid manner. Both the trial judge and Bull J.A. found the decision to reject the offer was made "in the best faith and solely in the interest of the appellant, and not from any personal or ulterior motive on the part of any director, including Cropper". 70

As a result, the no conflict of duty rule was held not to operate once the Peso Board had bona fide decided not to purchase the claims, since the company no longer had an interest in them. 71 In Professor Prentice's opinion which also happens to be a widely shared opinion, the rejection of the business opportunity in Peso did not eliminate the conflict of interest problem, as the decision to reject had the dual characteristic of not only depriving the company of the business opportunity, but also of facilitating its subsequent exploitation by the directors, the very persons who made the decision to reject on behalf of the company. 72 The use and purpose of the no-conflict rule as a device for controlling and purifying the exercise of a discretion is completely defeated. 73

The majority decision can therefore be seen as a significant departure from the Regal (Hastings) Case (1942) 1 All E.R. 738, where the equity rule was strictly applied. Gower, commenting on that case, says:

"To allow directors to decide that the company shall not accept the opportunity and then to accept the opportunity themselves might impose too great a strain on their impartiality." 74

A strict application of the no-conflict rule seems harsh in certain circumstances, to relax its application seems to violate the spirit of the rule and is likely to draw severe criticism. The truth is that the law is unable to elucidate the broader problems of policy, of the need to
balance the conflicting policy considerations of encouraging intre-
preneurial incentive and preserving the integrity of a business enter-
prise.

The third interesting and relevant aspect of Peso that concerns us
is that it was held that directors are able to seek ratification at the
general meeting (either antecedent or subsequent) to avoid liability to
account for profits for their conduct of usurping corporate information
or opportunity, as had been held in Regal's Case. In Professor
Baxt's opinion, Lord Russell's comment in Regal that ratification was
possible had been a most troublesome statement in corporate jurisprudence.
The main objection is that if usurpation of corporate opportunity or in-
formation is ratifiable, the minority shareholders are precluded from
bringing a derivative suit. In the opinion of Professor Beck:

"If directors are entitled to vote as shareholder on
matters in which they are interested and this, along
with the control that the proxy machinery gives to
them, can mean that the procedure that is designed
to protect the shareholders may be used to sanction
corporate wrongdoing."

Professor Beck's view is shared by Professor Prentice who says:

"It could be argued that the calling of such a meeting
would be otiose where the directors reject the business
opportunity as they, in all probability, control the
majority of the shares and can vote in their own favour.
To compel the directors to summon a meeting in these
circumstances would be excessive obeisance to formalities."

Thus, the majority consensus is that so long as the conduct of usurping
corporate opportunity and information remain ratifiable the interests of
the real absentee owners are far from safeguarded. As a solution,
Professor Baxt has argued strenuously for ratification to be restricted
to an independent body of shareholders as is required in some juris-
dictions in the U.S.A. Furthermore, it is of interest to note that
it is difficult to reconcile the judicial views of Regal and Peso on questions of ratification with established cases like *Menier v. Hoppers*' *Telegraph Works* (1874) L.R. 9 Ch. App. 350, or *Cooks v. Deeks* (1916) 1 A.C. 554 and other cases in its line. Both cases and its line of authority had held that no matter how much support the perpetrators of a corporate fraud, or even some lesser misdeed, will obtain at the general meeting at which they seek ratification, the minority shareholder will still be able to bring an action if they are seeking to restrain the taking of corporate property. And in *Cook v. Deeks* the "property" only needs to belong to the company in "equity". Professor Gower has made an attempt to reconcile the cases but this effort has been criticized.\(^{80}\)

The fourth aspect of Peso that prove equally disturbing and merits attention is the restricted scope of the applicability of the no-profit rule. Norris J.A., in his dissenting judgment, only requires that the onus is merely to prove that the information could have been acquired by the director in the course of the execution of his duties. This burden would be satisfied where the transaction is in the same line of business as that of the company.\(^{81}\) Norris J.A. was able to do this by relying particularly on Lord Wright's judgment in *Regal* in which the governing principle was stated in somewhat broader terms than in the other judgments.\(^{82}\) Bull J.A. did not agree. He relied on Lord Russell's judgment in *Regal* to require that the impugned transaction must be entered into "by reason of the fact, and only be reason of the fact, that they were directors and in the course of the execution of that office."\(^{83}\) This principle was in the present case rigidly applied to permit the directors to escape liabilities. Bull J.A. opined that once the claims were rejected, the subsequent purchase, although based on knowledge they had obtained as directors, could not be said to have been only in their capacity as
directors "in the execution of that office". Thus, it follows that the subsequent use of knowledge acquired as directors is not, of itself, sufficient to bring the no-profit rule into play.

There are two general aspects of the Peso decision that merit mentioning. Firstly, fiduciary principles like the non-conflict rule, have always been used to control the exercise of discretion, in order that the integrity of a business enterprise can be preserved. However, since there is no legal duty on the part of corporate controllers to transmit in an active manner all the useful information or opportunities there are situations where corporate controllers can usurp a corporate opportunity without necessarily having to exercise corporate discretion to reject it in the first place. In this respect, the no-profit rule, requiring that a person shall not profit from actually taking advantage of his position, has a useful and important role to play. However, we have already noted in Peso that the no-profit rule has been given a restricted application. The point to note is that, while judges are more willing to use the no-conflict rule to control discretion in order to preserve the integrity of a business enterprise, judges are uncertain as to whether the no-profit rule should be used to achieve the same goal. A uniform judicial response to the no-profit rule is lacking. As a practical matter, the jurisprudence of the no-profit rule is littered with dissents, reversals on appeal, and inconsistent holdings.

Secondly, the courts appear wary of the fact that stringest fiduciary obligations may kill entrepreneurial incentive and inhibit directors from holding more than a few directorships, and thus cut down the flow of entrepreneurial talent. However, there are positive and encouraging signs that the courts are beginning to adopt a more realistic approach in deciding corporate opportunity cases and seem willing to tighten up directors' and officers' fiduciary duties. The two notable cases are Industrial Development Consultants Ltd. v. Cooley (1972) 2
All E.R. 162 and Canadian Aero Services Ltd. v. O'Malley (1973) 40 D.L.R. (3d) 371. These cases showed how Anglo-Canadian courts begun to elucidate with the flexibility demanded by business context the factors which are pertinent to the resolution of the conflicting policies, and with the necessary stringency to remind fiduciaries of their duties.

The basic facts of both cases are similar. In both the companies concerned had been eager to obtain, and in negotiation for, highly remunerative work in connection with impending projects. In both it was unlikely that they would have obtained it, but in each there was a director whose expertise the other party was anxious to obtain. Accordingly, the directors concerned resigned their offices and later obtained the engagements, in Cooley directly, in Canadian Aero Service indirectly, through a company formed for the purpose of entering into a consortium with another. In both the directors were held liable to account for the profits which they made. 87

The significance of the Cooley's decision is that the learned judge referred to the defendant as having only one capacity in which he was carrying on business and that was as the plaintiff's managing director. 88 Hence, this fiduciary relationship imposed a duty upon him to pass on information which was of concern to the plaintiffs and was relevant for the plaintiffs to know. 89 This, Professor Prentice noted, would impose an affirmative duty to transmit all relevant information to the company. 90 This was so held despite the fact that the plaintiff was unlikely to receive the contract; and that the fiduciary obligation survived the defendant's resignation. 91 This decision also has important implication for the business practice of interlocking directorates where the companies involved have competing interests. A director in such a situation would
be faced with an impossible dilemma if he acquired information which might be of benefit to either of the companies.\textsuperscript{92} Also of important significance is that a proprietary remedy was ordered; it is clear from the nature of the order given that the breach of duty by Cooley was not ratifiable, thus, bringing it in line with cases like Menier or Cook. Even though it is difficult to see how the Gas Board's proposals as information in Cooley's case could be treated as property of the plaintiff because it was given to the defendant privately, and that Gas Board's refusal to engage the plaintiff can hardly be said to infer to the information such status as to bring it within the categories of "assets of which he (ie. the managing director) has control, or the facilities which he occupies." \textsuperscript{93}

The significance of the case of O'Malley is that the emphasis has been placed on the breach of the duty, rather than on the effect on the company. Ethics of directors and officers were given more recognition; on this, Lasking J. says:

"An examination of the case law...shows the pervasiveness of strict ethics in this area of the law. In my opinion, this ethic disqualifies a director or senior officer from usurping for himself or diverting to another person or company with whom or with which he is associated a maturing business opportunity which his company is actively pursuing..." \textsuperscript{94}

Lasking J. asks the broader equitable question of whether on consideration of all the facts, the interests of the corporation justly call for protection. This sweeps aside the legal question of whether there is a property right in information. What is most significant for one purpose of this paper is that an element of fairness is introduced to resolve the difficulties of resolving conflicting policy considerations we earlier emphasized. Instead of laying down rules, Justice Laskin laid down guidelines similar to a policy statement:
"The general standards of loyalty, good faith and avoidance of a conflict of duty and self-interest to which the conduct of a director or senior officer must conform, must be tested in each case by many factors which it would be reckless to attempt to enumerate exhaustively. Among them are the factor of position or office held, the nature of the corporate opportunity, its ripeness, its specificness and the director's or managerial officer's relation to it, the amount of knowledge possessed, the circumstances in which it was obtained and whether it was special or, indeed, even private...." 95

On balance, the development seems encouraging; however, a major problem remains. The point on ratification is not expressly resolved. However, it is encouraging to note that, the British Columbia, Ontario and Federal Acts have made statutory provisions for the derivation action.96 In essence, each jurisdiction provides that a shareholder may, with leave of the court and subject to certain conditions precedent, initiate an action in the name of or on behalf of the corporation. Despite such improvements, the absentee owners need to possess capability to detect breaches of fiduciary obligations and have the necessary resolve and resources to move the law into action. Furthermore, the sections require the court to make judgments about the management of the corporation's affairs. It is still an open question whether Canadian courts are willing to accept such an active role: that of actually managing the affairs of a company.97
E. Sale of Control

So far our discussion of the problems that arise in the relationship between corporate controllers and absentee owners seems to be confined to the corporate context. However, the reader will soon discover that we are beginning to focus on this relationship within the context of the public securities market, and within the context of both the corporate structure and the public securities market.

When a controlling block of shares is being sold, whether the transaction is effected at the stock market or privately, what is being sold is not merely the shares, but the power to direct the use of, and exploit assets of the corporation. As a result, controllers selling their control can demand a premium over the market price of the shares. However, more and more ordinary shareholders are indignant at such a practice for a myriad of reasons.

Firstly, it is argued that the sale of control at a premium is intrinsically illegitimate. Since it can be perceived as nothing less than a bribe to pervert the incumbent controllers' choice of successor.
This may result in conflict of interest problem as corporate controllers are arguably fiduciaries of the corporation, and must always act in its best interest. Some commentators are extremely suspicious of permitting sale of control at a premium since this might harm the corporation or minority shareholders, especially when control is sold to purchasers who would damage the business - those who might loosely be called looters. It has also been argued that conceptually, each share in the capital of a company is the same as every other share of the same class and entitles the holder to an aliquot interest in the company. Therefore, as a matter of fairness or ethics, a purchaser who paid a premium for a controlling interest in a public company should offer the same deal to the remaining shareholders. In the Canadian 1973 merger report, the minority opinion of the committee is that when a controlling shareholder sells his control, the thing he is really selling is corporate assets and the right to control the use of those assets and these assets belong to all the shareholders, not merely the controller. These are in the opinion of the minority of the committee valid arguments to be made on a conceptual basis that any premium on the sale of control should be shared by all shareholders. It must also be noted that within the realm of a market, fairness is perceived only if all sellers are guaranteed an equal opportunity to sell. This has been expressly recognized in the U.K. as one of the four principal objectives of the City Code and the exact wording of that objective is:

"Where control of a company has a value in itself, the control premium should be shared by all shareholders. Control should not therefore be acquired by discriminatory purchases. This means that all shareholders in a company subject to a takeover should have the opportunity of receiving the same price for their shares".
In Professor Andrew's opinion, the vitality of a free market, and the purposes that it serves, are enhanced rather than impaired by the prescription of minimal rules within which the participants must make and implement their choices.  

On the other hand, the majority of the Canadian Merger Report opined that shares of a corporation are a form of personal property and that the owner should be entitled to dispose of them by private agreement on whatever terms he may deem fit. It was also argued by others that the alleged abuse of uncontrolled transfer of shares at a premium such as looting and corporate squeezing are problems resulting from abuse of the control position. They can arrive at any time and do not require any transfer of control. If subsequent harm to the corporation does occur, the liability should be borne by the person who caused it, i.e. the buyer, unless such harm was reasonably foreseeable to the seller. Posner suggests that economic efficiency has been unduly impeded by placing too much emphasis on creating 'corporate democracy' and not enough on creating an efficient market for corporate control. Thus, he says:

"There would be another obstacle if proposals were adopted which forbid a controlling shareholder, in selling his shares, to change a premium for the control of the corporation that the sale bestows on the purchaser..."

Given the divergent views on this issue, it is unfortunate that Anglo-Canadian corporate law is unable to address itself to the issue. Common law insists that the existence of a fiduciary obligation is only owed to the corporation in the sale of their shares. Such a specific obligation might exist only turning upon the special facts of each case. Perhaps, the underlying policy reasons for such a legal premise are that, firstly, the notion of the corporation as a separate entity
would be a convenient medium for describing corporate abuses; secondly, to speak of the corporation rather than the shareholders being injured ensures against a multiplicity of actions, and to keep many minor business disputes out of the court.  

Thus, it was interesting when in a Canadian case, Farnham v. Fingold, concerning sale of control by the director-shareholder group, the plaintiff shareholder predicated his claim on the basis of fiduciary duty owed to the minority shareholders and not to the company. Unfortunately, the Ontario Court of Appeal considered the statement of claim as completely novel and refused to apply or extend the principle in the American case, Perlman v. Feldman, that majority shareholders and directors stood in a fiduciary relationship to the corporation and to the minority shareholders as beneficiaries thereof. In refusing to recognize fiduciary duties owed to minority shareholders, insurmountable difficulties are placed in the path of minority shareholders seeking legal redress. Firstly, minority shareholders cannot claim directly against the controlling shareholders. In a derivative action the basis of liability must necessary base on injury to the corporation and recovery must go to the undeserving new control group rather than the injured minority shareholders. If there is legal recognition of fiduciary duties owed by the majority to the minority, the basis of liability would not rest on the proof of pecuniary damage to the company but direct prejudice to the minority. Furthermore, such an action would allow former members of the company to claim damages, provided they were members at the time the wrong was committed. Such considerations apparently did not appeal to or cross the minds of the Court of Appeal judges when they dismissed the action on the ground that these matters were properly the subject of a derivative action rather than a class
action which requires leave of the court under section 99 of the Business Corporation Act. 116

It is indeed unfortunate that the notion of the injury to the corporation prevented Anglo-Canadian Courts from addressing the complex and yet interesting issue. This notion, in the opinion of Professor Gibson, may deal satisfactorily with management's obligations to manage the company and to respect its property, but it fails entirely to deal with relations between the company and the shareholders. 117 What is more important in the modern day context is that it fails to deal with relationships between shareholders. 118 For instance, in this context the sale of control at a premium by a controlling shareholder. Essentially, the position in Canada appears to be that, short of unusual circumstances, such as fraud or a breach of a fiduciary obligation, a control block owner is free to obtain and retain whatever he can get for his shares. 119

On the other hand, the Ontario Securities Commission, being more attuned to the need of maintaining public confidence in the capital market appears to be more sympathetic to the interests of public minority shareholders and to their demand for fairness at the market. The commission was noted to have on several informal occasions expressed its view that, as a matter of fairness or ethics, a purchaser who paid a premium for a controlling interest in a public company should offer the same deal to the remaining shareholders. 120 Although such a requirement does not expressly alter or change the relationship of controlling shareholders and minority shareholders, it nevertheless implicitly recognizes that all shareholders at the market place ought to be given equal treatment. As a result, the 1978 Ontario Securities Act imposes a
follow-up offer in a takeover offering the same price for the rest of the shares if a premium has been paid. However, there are three conditions which must be met before a follow-up offer is required under subsection 91(1). This considerably narrowed its scope. Firstly, the take-over bid must be made in reliance on the private agreement exemption. Secondly, the follow-up offer is only limited to existing security holders of the same class and finally, only if the amount paid exceeded a 15% premium of the market price. Nevertheless, this is to be welcome, as in other provinces such as British Columbia, there is no legislation that deals with sale of control. In comparison, the United Kingdom City code has a rule that is far more extensive. It deems a person or persons acting in concert seeking to buy control (defined to be 30% of the voting rights of a company) whether through the market or otherwise as constituting a take-over bid. If successful, rule 34(1) mandates that they must make an unconditional offer to buy out the remaining shareholders at the highest price paid by the offeror and persons acting in concert for shares of that class within the preceding 12 months. It is significant to note that a comparable offer is also required to be extended to the holders of any other class of equity share capital whether such capital carries voting rights or not. It is also of interest to note that although it is impossible to guarantee that a purchaser who brings this obligation into operation will have the resources to carry it through, the Panel on Take-overs and Mergers can secure the fulfillment of this objective by putting pressure on merchant bankers associated with the bid or by facilitating an alternative take-over.

Given our discussion, I hope the reader agrees with me that it is difficult to say whether in the context of the sale of control at a premium the absentee owners are prejudiced in their rights as a share-
holder or in his capacity as a seller at the marketplace. Perhaps, this is one instance where it shows that it is unwise to perceive securities regulation and corporate regulation as two distinct fields and one should not intrude into the other. Also, I hope to take note of the fact that if absentee owners are actually investors, their demand for fair treatment at the marketplace will continue to cause strain on fiduciary principles, since they would not recognise that majority shareholders or directors owe fiduciary duties to minority shareholders. Our later discussion of the problems of insider-trading and going private transactions would provide further illustrations.

F. Going Private Transactions - The Elimination Of Public Minority Shareholders

Going private transactions are essentially corporate manoeuvres designed to eliminate the public minority shareholders, so that a corporation can revert to its status as private company. A going private transaction can be effected by an amalgamation arrangement, consolidation, and by an issuer bid or insider take-over bid at the stock market. Whatever form or method that is chosen, the consequences are the same. The interest of the minority shareholder of a participating security of the issuer of that security may be terminated without the consent of that holder and without the substitution therefore of an interest of equivalent value in a participating security of the issuer or of a successor to the business of that issuer or of another issuer that controls the issuer.125

The motives for insiders to conceive and implement a squeeze-out scheme are as complex as the methods chosen to effect the objective, they could be financial or non-financial or the financial aims simply reinforce the non-financial and vice versa. For instance, the insider may wish to obtain
similar freedom of action as enjoyed by a private company; and financially, the status of a private company will result in cost savings as the costs required to comply with disclosure requirements of public companies are eliminated. Other advantages include a better tax position, better ability to raise capital if there is a generally depressed equity market.

Charles Salter, in his memorandum about going private transactions noted that many economists support going private transactions by taking the view that corporate amalgamations and reorganisation are beneficial economically. However, such economic justification must be balanced against the fact that in the process minority interests are unfairly prejudiced and victimized. Also, if economic efficiency is based upon facility to transfer control to persons who can use it more productively, this would not apply to squeeze-out transactions, because oftentimes in an amalgamation squeeze-out one company is merely a shell incorporated solely for the squeeze-out, and furthermore, a squeeze-out generally increases the equity position of the control group and insulates them from changes in control.

For the public investors going private transactions are inherently unfair. The first objection is its inherently coercive nature. In an issuer bid if a sufficient number of the publicly held shares are tendered, there will no longer be an active market for the remaining shares. As a result, public minority shareholders usually have little choice but to sell. Furthermore, the issuer or insider take-over offeror may announce its intention to follow the bid with a compulsorily acquisition scheme under s. 199 of the Canadian Business Corporation Act or a cash amalgamation squeeze-out to force in the remaining shares. Since the right to sell shares is the only way an absentee owner in his capacity as
investor can express displeasure with the management, even this negative remedy is made ineffectual in a squeeze-out transaction.

One American commentator argues that presumed coercion of public minority shareholders in going private tender offers lacks realism since there must be shareholders who are glad to receive a price higher than the depressed market price. However, for reasons that we will examine, aggrieved shareholders do not seem to be pacified simply because the tender offer price is higher than the market price. Firstly, in most cases corporate funds are used to buy back securities at a price which, although a premium over current market price, is still less than book value or appraised value of the assets of the company. Accordingly, corporate funds are being employed for the benefit of the majority who retain equity ownership at the expense of the minority. Secondly, shareholders cannot help but intuitively feel that insiders who have been managing the business and who know more about it than they do, suddenly appear in the role of a buyer, is oppressive and exploitative. Finally, the public investors believe that it is unjust for companies to come to the equity market at a time of buoyant stock prices and then be allowed to buy back these shares when the market is depressed. This seems to threaten the integrity of the whole process of public financing.

It is a general theme of this paper that the courts are poor protectors of the interest of absentee owners. It is essentially powerless to deal with multistep transactions where motives play such an important part. For instance, a company could adopt a dividend policy which although harmful in the short term to controlling shareholders has a negative effect on the market price of the security. After a reduction in the market value of such security, the controllers would be able to implement a form of squeeze-out at a time when minority shareholders may be
more willing to sell and at a cheaper price. The court is not only powerless to intervene in the dividend policy of a company, if the legal rights of minority shareholders are not infringed, it is also beyond its jurisdiction to determine the fairness of the issuer bid or an insider take-over bid. However, the courts do have a role to play if after the issuer bid or insider take-over bid the controllers follow it up with corporate squeeze-out schemes that either require approval by a special majority of shareholders or the approval of the court.

One such method is through the use of the statutory right of compulsory acquisition found in section 199 of the B.C.C.A. and in like provisions of certain provincial statutes, they are modelled on s. 209 of the 1948 U.K. Companies Act. The provision expressing the statutory right of compulsory acquisition usually provides that where holders of at least 90% of the shares involved have accepted a take-over bid, the bidder should be entitled as of right to acquire within a limited time the shares of the remaining holders, with a right of appeal to the courts conferring on a dissenting minority on any question of value or oppression. Gower noted that of all the considerable numbers of reported cases appealing to the court by dissenting share-holders objecting to the terms of the compulsory acquisition, all were unsuccessful except one. These cases make it clear that the onus is normally on the applicants to affirmatively establish the unfairness of the terms and that it is a very heavy one to discharge. As Maugham J. pointed out, the court is likely to regard the scheme as fair simply because it has been accepted by 90% of the shareholders concerned. Unfortunately, this view was similarly taken by the Supreme Court of British Columbia in Re Dad's Cookies Co. Ltd. As a result, controllers can force their will on minority and in fact have the right to expropriate their shares. However, in the English case of
Re Bugle Press Ltd.\textsuperscript{138} and the Canadian case of Re Esso Standard (Inter-America) Inc.\textsuperscript{139} the courts rejected the respective schemes, when it was found that the offeror and the offerees of the take-over bid were the same persons. In the Re Bugle case, the court described the scheme as a "barefaced attempt to evade that fundamental rule of company law which forbids the majority of the shareholders to expropriate shares of the minority."\textsuperscript{140}

Two recent Canadian decisions in Maple Leaf Mills\textsuperscript{141} and Westeel-Rosco\textsuperscript{142} place in doubt the ability to use the amalgamation squeeze-out method in order to take a public corporation private under the Business Corporation Act and the Canada Business Corporation Act respectively. The case in Maple Leaf Mills was that, as a matter of corporate law, an amalgamation was not possible under the Business Corporation Act where the purpose was to eliminate the share interest held by minority shareholders. Similarly, the court in Westeel-Rosco was not prepared to permit the interests of the minority shareholders to be expropriated. Where the Canada Business Corporation Act provides a statutory right of compulsory acquisition, an alternative was not available to the defendant.\textsuperscript{143}

However, courts are not so ready to intervene where other techniques of squeeze-out are employed. For example, in the United Kingdom there are only 2 reported cases in this century in which the courts have refused to confirm schemes for reduction of capital on the ground of unfairness and in both cases it was because the shareholder had not been treated in strict accordance with their class rights.\textsuperscript{144} In the recent Ontario case of Re P.L. Robertson Manufacturing Co. Ltd.\textsuperscript{145} the court approved an arrangement involving a reorganisation of authorized capital and a consideration of shares the effect of which, in part, was to
eliminate the minority by virtue of the reverse split as long as it was
fair and reasonable. Fair compensation was taken to equate the best
interests of dissident shareholders. 146

Even if courts have the discretion to disapprove of certain corporate
methods of squeeze-out, they are ill-equipped to do so. For the court
procedure is ill-fitted to enable them properly to pass judgment on the
economic merits of schemes and to make the valuations and necessary
accounting investigations before they can do so. Here, Gower noted they
are naturally reluctant to substitute their opinions for those reached by
large majorities of the members. 147 Furthermore, courts are primarily
concerned with legal rights of the parties, provided these rights are not
infringed it is difficult for them to intervene effectively, however
inequitable the results may be. 148 Gower is of the opinion that if unfair­
ness is always to be prevented, the role of the courts needs to be replaced,
or, better still, supplemented by an administrative agency. 149

Given this state of affairs and the increasing public disapproval
of going private transactions, it is more than welcome that the Ontario
Securities Commission has begun to play a more active role in the protection
of absentee owners. A policy statement 3-37 has been used to regulate
an issuer bid or an insider take-over bid as well as other transactions
designed to eliminate the interest of public minority shareholders such
as cash amalgamation squeeze-out. 150 However, in applying policy 3-37, the
Commission gradually shifted its concern from disclosure to the fairness
of the issuers, inviting the public to subscribe for their shares and
subsequently designing a transaction for the purpose of eliminating the 
public shareholders. The outcome is the imposition of a majority of 
the minority votes condition before a scheme of reorganisation with the 
aim of squeezing-out the public minority can be approved in the Cable 
casting decision. Unfortunately, commentators perceive this as an un­ 
warranted intrusion into corporate laws, rather than a desirable move to 
close the artificial gap between corporate and securities law.

G. Insiders' Motives And Takeovers

Mergers and takeovers, unfortunately, afford particular opportunities 
and temptations to insiders of the corporation taken over to obtain 
special benefits for themselves or pursue self interested goals. Man 
is an extremely complex being, even a complete socio-economic analysis of 
human behaviour is inadequate if it ignores the political component 
of human behaviour. As a result, it must be noted that corporate 
insiders are not all mere seekers of financial rewards. Desires for power 
may lead management to engage in acquisition for expansion, even if some­ 
times the profitability of such expansion is open to doubt. They may, 
for instance, involve themselves in competitive bids, where a long, 
bitter and expensive battle may result. Shareholders inevitably are the 
ones that have to bear such expenses. Similarly, identification with the 
enterprise and the desire for security may lead management to oppose 
takeover bids even where such an action would be desirable on economic 
grounds and in the interest of absentee owners. Management are frequently in­
dignant to takeover attempts by outsiders, not only because its job 
security is threatened but the potential purchaser actually implies that 
the company may be worth to him more without management's old, experienced
hand at the helm than with it. Since emotions are more intense, the offeree directors' business judgment as to whether the bid is beneficial to the interest of the corporation and the terms fair to the shareholders is unlikely to be impartial.

The legal right of management to oppose take-over attempts is not only recognised by Anglo-Canadian Courts, but in an early English case, Peel v. L.N. Ry. it was suggested that not only directors are entitled to oppose a bid, they are also permitted to do so at the expense of the company. The only restriction is that this must be done in the interests of the company. The Jenkens Committee recommended that the matter should be put beyond doubt by persisting that they should have a right to be reimbursed in respect of 'expenses properly incurred ... on behalf of and in the interests of the members of the offeree company in connection with a take-over offer'. Such practices are not objectionable if management were bona fide in their belief that the proposed bid is harmful to the corporation, but if they are motivated by personal interests, then, shareholders are not only deprived of an opportunity to make their own decisions with regard to a bid, but actually have to bear the cost incurred by the management defending their own job security. Every defensive measure by offeree directors gives rise to potential conflict of interests between directors and shareholders. In the United States, traditional corporate legal standards permit directors to exercise substantial discretion in rendering daily business decisions without fear of judicial interference at the insistence of dissatisfied shareholders. Consequently, American courts in applying the "business judgment" doctrine will not compensate aggrieved shareholders for losses resulting from questionable director decisions, however unlikely the chances of success might have been at the
Since it is extremely difficult to prove that directors acted contrary to the corporation or shareholders' best interests and in furtherance of selfish interests, the application of the business judgment rule in most cases results in a favourable decision for corporate directors. Reliance on the business judgment rule presumes that since a director's interest in maximum profits corresponds to his shareholders' interest in maximum return on their investment, directors will always act to further the corporation's and consequently the shareholders' best interests. This assumption fails, however, when applied to directors' tender offer defense decisions, since directors have a stake in the preservation of their independent power, they are clearly tempted to defend against a tender offer even though their defense decision might harm the corporation and its shareholders. The application of the business judgment rule does not recognize this inherent conflict of interest. However, there are signs of change in the States. This can be discerned in the case of Cheff v. Mathes 41 Del. Ch. 494, 199 A. 2d 548 (sup. ct. 1969). Its decision illustrates judicial recognition that a director's inherent selfish motives render the deferential business judgment standard inappropriate in the tender offer defense area. After determining that the target company's directors faced a conflict of interests in deciding to purchase the hostile bidder's control, the Cheff court expressly shifted to those directors the burden of proving the propriety of their decision. The court, however, accepted the proof of a reasonable belief that the bidder posed to the continuity of the target company. In a subsequent case, Condec Corp. v. Lunkenheimer Co., 43 Del. Ch. 353, 203 A. 2d 769 (Ch. 1967) the court, however, refused to apply the burden of proof shift mandated by Cheff, but nonetheless required a higher substantive showing on the part of the
directors. (592) Nevertheless, the court was later to find that the
directors of the target company had not engaged in any direct, objective
investigation or professional consultation that justifiably would lead
them to believe that the takeover attempt represented a reasonable threat
to Lunkenheimer's continued existence and justified their issuance of
shares to a friendly company to defeat the takeover attempt. (593).

Similarly in a recent Canadian case, Teck Corporation Ltd. et al v.
Millar\textsuperscript{168} the court citing the American authorities of Condec Corpn. v.
Lukenheimer Co. and Cheff v. Mathes held that directors ought to be allowed
to consider who is seeking control and why. If they believe that there
will be substantial damage to the company's interests if the company is
taken over, then the exercise of their power to defeat those seeking a
majority will not necessarily be categorised as improper.\textsuperscript{169} Thus, manage­
ment can have at their disposal a wide range of techniques in defending
take-over bids. Fast changes in the company's charter intended to obstruct
a delay of an offeror's ability to gain control of its operation after an
offer can be made.\textsuperscript{170} A special dividend can be quickly declared, stripping
the company of all excess capital.\textsuperscript{171} Shares are issued by offeree directors
to themselves or more likely to a friendly purchaser. Public relations
campaign is organised through newspaper advertisements, press conferences,
press releases and shareholder meetings, criticizing the offeror and to
outline unfairness of the take-over bid.\textsuperscript{172} Litigations are commenced,
accusing the raider of anti-trust violation etc.
The most dangerous defensive device used by directors is the use of their power to allot shares in order to thwart a take-over bid, since this would also facilitate the directors' indefinite continuation in office by depriving other holders of a meaningful voice in the company.\textsuperscript{173} Canadian corporate law has traditionally through the development of the "proper purpose" doctrine required that the only purpose of issuance of shares was taken to be the raising of capital, and its exercise for any other purpose, even if the directors honestly believed it to be in the corporation's interests, was held to be void.\textsuperscript{174} However, as Anisman noted the Canadian federal proposals suggest that the statutory formulations of directors' duties in the Draft Act and in the Ontario Business Corporation Act replace the "proper purpose" doctrine with regard to directors' power generally.\textsuperscript{175} This approach in effect permits offeree directors to fortify their position by issuing shares to themselves or to an ally so long as they can indicate some reasonable basis for the belief that harm would result to the corporation should a take-over bid succeed. It is also unfortunate that the earlier 1973 Merger Report recommending that certain actions of the board of directors of the target company during a take-over bid not be permitted without majority approval by the target shareholder, has not been accepted.\textsuperscript{176}
The temptation of directors to ignore interest of shareholders in a takeover bid is great, their power to defence against a bid requires close supervision of their conduct, a requirement whose fulfillment is seriously lacking in Canada. In contrast, a principal objective of the Panel on Takeovers and Mergers in the United Kingdom is to ensure that directors of a company for which an offer has been made should not do anything to frustrate the offer by the exercise of their powers of management before shareholders have had an adequate opportunity to consider it, and should secure independent advice on it.177 It is also significant to note that the Panel at all times maintains a close scrutiny of all takeover bids to ensure that it can achieve its objectives.

It is also important to be aware of the fact that management may support a takeover bid which runs counter to its nonfinancial interest, if it is provided with sufficient side-payments in the way of employment contracts and the like, this practice is referred to as the "Golden Handshake".178 To deal with this problem, securities regulators have mainly through disclosure provision sought to ensure that shareholders of the offeree company are aware of the potential conflict of interest and to indicate the degree of reliance which may be placed on a recommendation of the directors, for receipt of any payment or a promise of continuation in office may influence their judgment.179

Both item 10 of the Take-over Bid Circular and item 7 of the Director's Circular of the Ontario Securities Act require to be stated:
"...the particulars of any arrangement or agreement made or proposed to be made between the offeror and any of the directors or senior officers of the offeree company, including particulars of any payment or other benefit proposed to be made or given by way of compensation for loss of office or as to their remaining in or retiring from office, if the take-over bid is successful." 180

Item 7 of the Director's Circular went further by providing that it must also be stated whether any directors or senior officers of the offeror or any subsidiary of the offeror and identify such persons. Perhaps it should be pointed out that under the previous Ontario Securities Act, a director's circular was required only if the directors of the offeree company recommended to the shareholders acceptance or rejection of the takeover bid. 181 This necessarily means that if directors and officers chose to remain silent, the special benefits they received from the offeree company for their corporation never need to be disclosed.

These disclosure provisions are, however, an unsatisfactory attempt to deal with the problem of the "Golden Handshake" practice. The practice can in effect be sanctioned if there is adequate disclosure. This is surely a far cry from the fiduciary principles that a fiduciary must not allow his interest to conflict with his duty, and that he must not profit from his fiduciary position. Although such practices are not prohibited in England, it is at least required that the payment must be approved by a special meeting of the holders of the shares to which the offer relates and others of the same class. 182 Also, any such sums received by the director on account of the payment are deemed to have been received by him on trust for any persons who have sold their shares as a result of the offer. 183

The scope of the disclosure provisions is also limited. Due to the particular drafting of the actual disclosure provision 184 it might be
argued that information on side-payments need be disclosed only if the payment is conditioned on the success of a bid. Also, on the transfer of control of a holding company, a payment for loss of office or a subsidiary is apparently not covered. More importantly, the disclosure requirements cover only "payments or other benefits proposed" as compensation for loss of or regarding continuation in office. The higher prices officers or directors might obtain from the sale of their shares as shareholders are apparently not covered. The shareholders may have recourse in common law to try to hold directors liable to account for their profits. However, the offeror to ensure the support of the offeree directors can circumvent the directors' liability for payments by either conditioning the offer on shareholder approval, or by retroactively ratifying after the bid when he holds a majority of the shares. Furthermore, even if the shareholders succeeded in holding directors and officers liable to account for their profit to the company, recovery will be to the company, and will not recompense a shareholder who has sold his shares and suffered loss because of a director's breach of fiduciary duty.

In contrast, United Kingdom legislations clearly recognize that directors may be in the same conflict of interest situation if they receive extra payment in the form of higher prices for their transfer of shares, the intended payment must be disclosed with the terms of the offer to purchase shares and approved by a special meeting of the holder of the shares to which the offer relates. In other words, the payment to him has to be accounted for, even though it is expressed to be in respect of his shares or, ostensibly, is totally unconnected with his loss of office. If the above requirements are not met, any sum received by the director must be held in trust for persons who have sold their
shares as a result of the offer. This is clearly meant to provide a statutory exception to the rule that directors are fiduciaries of the company, not the individual members, to eliminate the ironic result when recovery goes back to the company and benefits the successful bidder rather than the actual shareholder victim.

On the whole, the point that emerges is that as far as takeover situations in Canada are concerned, there is a serious gap in the regulation of the behaviour of corporate insiders, such as officers or directors. Legislation might be passed to better regulate corporate insiders but there is no agency in Canada that is willing and able to exercise close scrutiny of management conduct as that of the Panel on Takeovers and Mergers, and which can generally ensure that the spirit as well as the letter of rules be observed. The truth is that when dealing with problems when motives play an important part, disclosure provisions and fixed legal rules are not likely to be very effective.

H. Insider Trading

The issue of insider trading has been debated for more than 40 years now. Canadian legislatures have generally passed extensive legislations designed to deal with insider trading and administered by securities regulators. However, the problem of insider trading merits discussion because it permits further elucidation on the relationship of corporate controllers and absentee owners and the conceptual basis of fairness at the capital market.

Insider trading occurred when an insider deals in securities of his own corporation on the basis of confidential price-sensitive information not yet publicly known. Theoretically, this would enable him to buy in
advance of favourable disclosures and to sell at a high price before announcement of unfavourable developments. The essential objection is that because of the non-disclosure by corporate insiders, the market does not have information that would affect the price, wealth transfer between the corporate insiders and the public investors that result would not have been occurring, if the information had been made public.

Although there is widespread support for and adoption of insider trading legislation, some criticisms remain. The academic leader of the opposition is Professor Manne. He argues that long term investors suffer no loss from insiders' trading. For example, when a director buys on the market in the knowledge of a forthcoming bid for the company, the seller of the shares would probably have put his share up for sale anyway and the price he gets may in fact have been slightly raised by the fact that the director is in the market as a buyer. Manne also argues that beneficial effects result from insider trading. Firstly, the rewards of insider trading should be properly regarded as compensation for the entrepreneurial achievements of insiders which would otherwise be a necessary expense of the corporation. Secondly, insider trading activities increased capital market efficiency since they channelled material information to the market. Speculators and brokers watch for unusual trading activity and buy or sell on the basis of price movements and rumours. If undisclosed material information exists, it would not be in the interest of other traders to exclude those who possess the information from the market. Their exclusion, to the extent that their trading would have made a difference in the price, increases the volatility of prices and the riskiness of the market for all other traders. The unavoidable conclusion is that in expanding the war
against insider trading investors do not actually benefit, such effort may be having the opposite effect. Finally, Professor Manne argues that there is no substantial relationship between rigorous insider trading legislation and public confidence in the securities market.

However, Posner disagrees with Professor Manne's argument. Gains from insider trading should not be properly regarded as reward for management, since insider trading does not reward efficient management as such. It rewards merely the possession of confidential information, whether favourable or unfavourable to the corporation's prospects.

Posner says:

"One can thus imagine cases where managers would have an incentive to take steps to accelerate the demise of their firm, possibly at significant social cost. Nor is the objection to insider trading met by forbidding only short selling on the basis of inside information. Managers would have an incentive to manipulate the disclosure of information about the firm in a manner calculated to produce sharp if temporary spurts in the price of the firm's stock. Their energies would be deflected from managing the firm so as to maximize its present worth to managing publicity about the firm so as to maximize the volatility of its stock."

As to the argument that insider trading activities increase market efficiency, Posner points out that this must be balanced against the loss of efficiency that is created when managers conceal information or disseminate misinformation, as they would have greater incentive to do so were insider trading permitted.

Despite all the arguments that might be harnessed for and against insider trading, the bottom line must be the effect of insider trading on investor's confidence on the integrity of the market place. From the public investors' perspective, deliberate non-disclosure of price-sensitive information is just as wrong as deliberate misrepresentation.
Secondly, we must not overlook the fact that insiders are holding a position of trust in a company and it is contrary to good business ethics that such a person should use confidential information for his personal profit, and to the disadvantage, immediately of other investors not having that opportunity. This may not only cause harm to the latter, but they are exposed to a risk that is incalculable, and that may cause them to lose confidence in the securities market as a place in which they invest their funds. When this happens, Professor Getz noted that the delicate mechanism that the market provides for enabling capital to flow to the point of highest return will be damaged or distorted, and the performance of a vital economic function will be impaired. As a result, the need to protect the integrity of the market place and to preserve fair competition among the investors in the corporate market, has taken on a life of its own and will question insider trading even if neither the corporation nor its shareholders are hurt. Thus, Posner's suggestion that Professor Manne's compensation argument can be made more strongly with regard to certain stock options for which there is no divergence of interests between managers and shareholders is also refutable when viewed against the overriding need to maintain the integrity of the market place. To substantiate this opinion, let us look at the recent British Columbia Resources Investment Corporation's takeover of Kaiser Resources Ltd., where it was alleged that the timing of the exercise of stock options by employees of Kaiser Resources Ltd. just before the imminent transaction constituted insider trading. In his report investigating the matter, Professor Getz clearly took the view that even if no one is hurt, the fact that the insiders' ability to time the exercise of his stock options so as to minimize the incidence of
income tax is a benefit or advantage that cannot be enjoyed by anyone else; such practices cannot be approved if the integrity of the market place is to be preserved. In Professor Getz's opinion, the basis of objection is that the objective of ensuring equality of access to all investors is disserved in any case in which the insider derives a benefit or advantage from his use of special knowledge in connection with a trade in securities of his corporation, regardless of the nature of the advantage, or of the capacity in which he receives it. The fact that an insider-optionee may be able to minimize the incidence of income tax by using his special knowledge to time the exercise of his option to maximum advantage for him as taxpayer, may tempt him to manipulate the timing of the public disclosure process. Surely, Professor Getz observes, "the timing of the disclosure process is of crucial importance to the proper operation of the market, and may cause damage to the integrity of the market place, to public confidence in it, can arise even in a case in which the insider obtains no advantage as an investor, and no other investor is hurt." 

The common law is unfortunately neither capable of adapting itself to the role of safeguarding the direct interest of individual investor-shareholder nor preserving the integrity of the market place. Traditional fiduciary principles refuse to recognize any fiduciary duty owed by a director to shareholders and are entitled to buy shares without disclosing the existence of negotiations for a takeover. A fortiori in the converse case of a sale by a director, the director does not owe a fiduciary duty to a prospective purchaser who is not yet a member of the company. It is undeniable that Anglo-Canadian law lags far behind the American law which, as a result largely of a judicial gloss on rule 10b-5 made under
the Securities Exchange Act 1934, has virtually placed directors in a fiduciary relationship to all those with whom they have dealings in their company securities.\textsuperscript{210}

Given that directors do not usually owe direct fiduciary duty to shareholders, it is, however, still an open question whether a director can be made accountable to the company for any profit he makes in dealing in the company's securities in reliance on confidential information. It is, of course, true that the company cannot itself have been directly injured by such dealings, since it could not have dealt in its own securities; but, it was held in Phipps v. Boardman\textsuperscript{211} that a person who has acquired confidential information in the course of his fiduciary duties must account for any benefit he has made from the use of that information even if the persons to whom the duty was owed, could not themselves have made use of it.\textsuperscript{212} Similarly, and as a result of a last ditch effort to impose some kind of control over insider trading, Fuld C.J. in the American case of Diamond v. Oreamuno\textsuperscript{213} held that there was a breach of fiduciary duty by the director owed to the company as a result of the director's self-dealing in the company's shares even though the company had suffered no loss. However, Fuld C.J. insisted that the company did suffer a loss of reputation of integrity.\textsuperscript{214} In practice, for various reasons, such as the cost of legal actions to an already victimised shareholder, the reluctance of co-directors to commence proceedings, the fact that recovery will go only to the company, and the procedural thicket surrounding the rule in Foss v. Harbottle, recourse to common law would not likely be a practical remedy to investor shareholders.

Furthermore, the common law is totally unable to furnish any form of remedy to aggrieved investor-shareholders when the inside information is
used by persons other than directors. Some comments by Posner seem highly relevant to this problem. He says:

"The costs of enforcing the rule against insider trading are probably high. Not only are concepts like 'insider' and inside information slippery, but devices for evasion of the rule abound. For example, it is said that insiders in different companies simply trade inside information about each other's companies. This loophole would be difficult to close - except by forbidding insiders and their families to trade in any corporate stock." 215

It is my main aim in our discussion here to emphasize the inadequacy of common law in adapting itself to market needs, to safeguard the interests of individual investor-shareholders and preserving the integrity of the market place. However, it is interesting to note that following the Kimber report in 1965, it has now been accepted that extensive legislation is needed to regulate the problem of insider trading. A basic twofold approach of the Kimber Report to deal with the problem has been widely accepted by provincial legislatures. 217 Firstly, the legislation requires an insider to report his beneficial holdings in the corporation and any changes in those holdings to the relevant Securities Commission and imposes criminal penalties for failure to do so. 218 Secondly, the legislation provides that every insider of a corporation and every associate or affiliate of an insider who, in connection with a transaction relating to the capital securities of the corporation, makes use of any specific confidential information for his own benefit or advantage that, if generally known, might reasonably be expected to affect materially the value of such securities. He is liable to any person or company for any direct loss suffered by such person or company as a result of such transaction, and of significance is that he is also liable to account to the corporation for any direct benefit or advantage received. 219
In addition, the stock exchanges of Canada in conjunction with the provincial securities regulators also seek to enforce a timely disclosure policy that requires listed corporations to make public disclosure of material changes in their affairs on a timely basis. In British Columbia, the timely disclosure policy is incorporated as a term in the Vancouver Stock Exchange listing agreement and does not have a statutory basis. In contrast, a timely disclosure requirement can be found under S. 74 of the 1978 Ontario Securities Act. It is also important to note that both the policy and the legislation generally define a change as material when it "would reasonably be expected to have a significant effect on the market price or value of any of the securities of the issuer." The effectiveness of enforcing the timely disclosure policy either by the exchange authorities or the securities regulators will, however, be discussed later when their role as protectors of the interest of absentee owners is touched upon.

Our discussion of the problem of insider trading also marks the end of our survey of the specific problems that may arise between the relationship of corporate controllers and absentee owners. However, this is by no means an exhaustive survey, there are countless variations of other unethical and unfair behaviour on the part of corporate controllers that may not be substantive enough to merit a topical treatment. For example, controlling shareholders who although in fact control a company, may seek to minimise their legal responsibility by avoiding becoming directors themselves but who attain a similar result by the appointment of dummy directors. Such dummy directors usually carry out instructions without question and in all too many cases, with a complete ignorance of the office of directors should carry with it. A classic illustration of this
form of abuse was aptly illustrated by the Windfall Affairs. In the Kelly report, investigating into the affairs, Mr. Justice Kelly notes that:

"Time and again during the course of the enquiry, Windfall company was referred to by Viola MacMillan as our company. The whole undertaking of the company was treated as a personal venture, which was carried out with a disregard for the interests of others who had become shareholders. This is further illustrated by the fact that, although Viola MacMillan exercised complete control of the corporate and market aspects of the companies by her husband and herself, she held no office or administrative authority in the Windfall company. Two other directors, Cole and Humphrey, were kept in the dark and denied access to information. The conduct of George and Viola MacMillan in keeping from the directors of the company knowledge of such essential matters offends every element of company law". 221

We have completed a reasonably extensive survey of the specific problems; we have analysed the issues that they have raised, issues which would help us to understand why a gap in the control of corporate controllers actually existed, and, more importantly, what should be done to close this gap. In Part III, we will examine, on a comparative basis, some current methods and assumptions as to how the interest of absentee owners can be safeguarded.
PART III

The Protection Of Absentee Owners, Current Methods
And Assumptions, And A Comparative Analysis

A. Introduction

By the end of the 1960s, it was apparent to many commentators that Canadian company law was increasingly anachronistic. The inadequacies of the existing law became intolerably apparent. The federal government in 1967 appointed a federal task force under R.W. Dickerson, to examine ways of reforming the Canada Corporations Act. The task force produced its report in 1971 in the form of a draft Act with extensive commentary which found expression in the Canada Business Corporations Act in December 1975. This Act has been described as radical in its approach by commentators, and amounts to a fundamental redefinition of the relationship between shareholders, management, and investors within the corporate form of ownership. The new Saskatchewan company legislation follows the Canada Business Corporations Act almost clause for clause; therefore, to understand the significance of the Canada Business Corporations Act, it might be convenient to examine briefly the basic philosophy of the new Saskatchewan legislation.

Firstly, it is said that the new legislation attempts to define the obligations of directors and protect minority shareholders' interests. The new Act imposes a duty on directors to act "in good faith and with a view to the best interests of the corporation" in undertaking a wide variety of corporate acts. However, in our earlier survey of the problem of self-interested directors defending against a takeover bidder,
such a formulation in effect permits offeree directors to fortify their position by issuing shares to themselves or to an ally so long as they can indicate some reasonable basis for the belief that harm would result to the corporation should a takeover bid succeed. Furthermore, such a formulation is far from befitting the description of "radical". The corporate entity is still used to represent the interest of minority shareholders. The new Act is also said to have clarified the law relating to a director's obligation to disclose his interest in a contract which the corporation has entered into. A director interested in a contract must now disclose his interest in writing and refrain from voting at a director's meeting with respect to the contract. We have earlier noted that the board of directors is hardly a sufficiently disinterested body to supervise such transactions impartially.

It was thought that the most important contribution of the new legislation is the enhanced opportunity which shareholders have under the new legislation to enforce directors' duties. The notorious rule in *Foss v. Harbottle* is largely abrogated by the new legislation, permitting shareholders to bring actions for acts "oppressive to the minority" with leave of the court, and without surmounting the legal hurdles imposed by the old rule (see *Sask. Business Corporations Act*, ss. 232-235). What is more significant is that s. 235 abrogates the rule that approval of a majority of the shareholders prevents a successful action. Unfortunately, the use of the oppression remedy is still flawed with difficulties, and in a derivative suit the shareholder is still suing in the name of the company.

What is more significant in the new Saskatchewan legislation is the attempted extension and implementation of the philosophy of shareholder
democracy. Mr. Finley comments that the provisions enhancing shareholders' rights when taken together amount to something of a bill of rights for shareholders. Shareholders entitled to vote at an annual meeting may submit a "shareholder proposal" to the corporation which must be circulated by management and considered at the next shareholder meeting (s. 131). Shareholders holding not less than 5% of the voting shares of the corporation may requisition shareholder meetings (s. 137). The holders of specific classes of shares are entitled to vote on corporate changes affecting those classes of shares, whether the shares normally carry voting rights or not, and have a power of veto as a class over those changes (s. 170). Finally, the Articles may provide for certain other corporate rules designed to protect minority interests.

For instance, cumulative voting for directors, a scheme which ensures representation of significant minorities on the board may be adopted (s. 102). The extension of shareholders' rights appear impressive. The concept of shareholder democracy seems to be assuming a new conceptual direction for the development of corporate law, an important means of closing the gap between ownership and control. Given its importance, its effectiveness or shortcomings deserve a topical treatment in our subsequent discussion.
B. Shareholders' Democracy - A Viable Solution?

Professor Manning observes that for the last generation, the prevailing school of thoughts among corporate reformers, writers and legislators has been that the key to ensuring managerial responsibility lies in the shareholders' power to vote. Since the common shareholder elects the director, all he needs is information adequate to form an intelligent judgment and he may be relied upon to vote as his personal estimate of his economic interests indicates. A fortiori, it follows that his interests will thus be protected and management will be checked.  

The prescriptions therefore as noted by Professor Manning are:

"More disclosure; greater mass attendance at shareholders' meetings; more policy issues on the ballot for shareholder vote; cumulative voting; more pre, during and post meeting reports, preferably in colour; machinery for submitting shareholder proposals to vote; and more representation for women."  

The assumption is that shareholders are part-owners of the corporation and armed with the relevant information they may exert more effective control of their company. Therefore, they should and can be assimilated into the decision-making process of the public corporations. This conception came to be built into corporate law, and corporation reform legislation in the post-war period in Canada has consistently followed a pattern designed to strengthen the voting rights of shareholders. (As evinced by the Sask. Business Corporations Act). How far this assumption conforms with realities is a question we now examine.

Professor Livingston, in his book, "The American Stockholder" noted that in 1958, out of 5,126,000 taxpayers in America who reported dividend income, 90% had salaries, wages and other income in excess of dividends. The great majority counted on salaries or wages to keep the installment collector away from the door. Few shareholders,
regardless of their occupation have sufficient at stake to devote much time to the companies in which their money is invested. Professor Livingston suggests that the significance of shareholders' democracy is therefore unlikely to mean much to them. However, can the remaining 10% of the population who might derive a major proportion of income from dividends be relied upon to play the role of a corporate watchdog?

Livingston divided this group into 2 subgroups. The majority are often the retired persons. Their income does not have to be exceptionally large to be the same as or exceed receipts from pensions, interest, and part-time work. This category of shareholders would probably like to be professional stockholders, since they have sufficient financial incentive to be corporate watchdogs. But a searching question as to their competency and capability do not regard them as guardians of their rights. Ex-corporate officials would have the competence to ask intelligent questions at annual meetings. They would possess financial skill to analyse stock options and pension plans for executives, and complicated financial statements. However, in Livingston's assessment, they would probably be amply provided for on retirement and have other interests and preoccupations. They are likely to identify with the management group, and might even be receiving consulting salaries from the corporations. This leaves the lower-income pensioners who may be comfortably provided for but not luxuriously. Unfortunately, they are handicapped as corporate watchdogs, retired farmers, mechanics or technicians cannot suddenly become conversant with finance. Their activities have been in different channels. And, by the time they have reached the age of retirement, they are hardly stocked with the energy demanded by a new career - notwithstanding their money. As Alison G. Anderson described the task:
"The kind of active supervision contemplated by shareholder democracy advocates, however, involves very substantial costs. Effective supervision of corporate managers requires the acquisition of a great deal of information, the exercise of experienced judgment, and the spending of substantial amounts of time. In other words, effective supervision requires each shareholder to act very much like a diligent outside director. It is doubtful whether many shareholders are competent to perform such a role or would find it worthwhile to incur the time and information costs involved in such supervision." 22

Furthermore, Alison suggests, even if a shareholder is competent to supervise management, he may not find such effort worthwhile, since he cannot capture more of the benefit of his own supervisory efforts. If a shareholder owns 1% of the stock of the corporation, 99% of the increase in value from better managerial performance will accrue to other "free riding" shareholders. It will therefore rarely be worthwhile for a single shareholder to incur substantial supervision costs, since what he gains from such efforts will rarely exceed the costs.23 Alison concludes that as long as other "free riding" shareholders cannot be forced to share in the costs of supervision, even a shareholder who is capable of supervising management will lack the financial incentive to do so.24

The next group, the minority, they are the really well-to-do. They are often owners or managers of corporations. Even if they are not closely connected with the management, to many of them their success in whatever capacities is more rewarding than guarding their legal rights as stockholders.25 As to institutional investors, it has been well documented that they refuse to champion the rights of other shareholders, whatever powers and influence they might have over the management, it is only exercised to safeguard their own investment interests.

A general criticism that can be levied against the concept of
corporate democracy is that it assumes that shareholders are part owners of corporations. The fact is that shareholders do not think of themselves as owners of corporations. The shareholders' self-conception as investors brings in train two consequences that are inconsistent with the concept and practice of shareholders' democracy. Firstly, he refuses to take part in the corporate decision-making process. As Professor Manning would say:

"It is beyond question that shareholders as a lot have little or no real concern with...the corporate transactions...It is commonplace to observe that the modern shareholder is a kind of investor and does not think of himself as or act like an "owner". He hires his capital out to the managers and they run it for him, how they do it is their business, not his, and he always votes "yes" on the proxy". 26

Another commentator in stronger tones says:

"...the stockholders resolutely refuse to participate in corporate affairs, they obey the management, they are interested in their stock only as investments; and their participation in the corporate electoral process, so far as it goes, is an empty ritual". 27

Secondly, an investor expresses his displeasure with management by selling his shares, he generally abandons his right to improve management. Management recommendations on mergers, options plan or other corporate matters are virtually never rejected. The elaborate proxy machinery set up is plagued with problems and costly. The central point is that shareholder proxy fight cannot be relied upon as effective check on management stewardship. Selling his shares at the market place is the easiest, cheapest, and from many points of view, the most practical way to express stockholder dissatisfaction with management. 28 As Hetherington puts it succinctly:

"Investor buys an investment package, not a lawsuit or proxy fight". 29

The fact that shareholders consider the market as likely to be the
only remedy for managerial default has implications beyond the observation that shareholders are unlikely to participate in the machinery for corporate governance through shareholder democracy. The legal structure that grounds our economic order is based on the assumption that shareholders in corporations will be individuals seeking to maximize their own gains and assert their legal rights. The fact that shareholders are likely to assume investor identity means that recent legislature and judicial efforts to resolve the difficulties of shareholder derivative action is unlikely to matter in a significant way. Also, Professor Livingston noted, the small shareholders will seldom, from his own investigation of corporate affairs - reading reports, studying the financial pages of newspapers - discover wrong-doing. Nor are the small shareholders' benefits in winning a suit likely to be sufficient to warrant his being a principal litigant. It is trouble, even if the lawyer does all the work. 30

Thus, to talk of rejoining ownership and control is unrealistic. Flexible centralized management is necessary and efficient large corporations will typically have many shareholders, each one with a relatively small investment in the corporation. Even if all the shareholders agreed on the most desirable business and financial policy for the corporation, the information and transaction costs of having them all participate in every managerial decision would be prohibitive. 31. To view the shareholder as the owner of a share of stock - as bondholder - conforms more closely to the shareholder's own expectations.
C. Corporate Acquisitor - The Best Ethical Catalyst?

Economists have made forceful arguments that corporate controllers should be subjected only to the control of market forces in order to achieve greater efficiency and economic benefits. It is argued that market forces not only provide automatic incentives for wealth-maximizing managerial behaviour, they also penalize poor managerial performance. If management is disregarding the interests of the shareholders the market price of the firm's common stock will fall. When this happens, alert investors will realize that the stock is underpriced—that is, its price would be higher if the firm was being managed with the object of maximizing the shareholder's return. Outsiders may thus attempt to gain control or take over the company in order to manage it more efficiently and thus profit through increased earnings and resulting high price. Thus, economists argued that the corporate acquisitor is the best ethical catalyst. Mr. Mandelman, a business executive, comments that:

"Caesar would have his entourage fat and happy. Shareholders would rather have their management lean and nervous: a takeover threat, so the saying goes, keeps management honest and alert, and forever on its toes. Management is much less likely to engage in dubious dealings and in nest feathering if there is a troupe of hungry wolves prowling out there who, pockets bulging with ready scratch, are constantly evaluating the company as a takeover candidate". 

Posner also accuses the law of paying too much attention in enforcing egalitarian principles such as "corporate democracy" and equality of shareholders and has neglected the role of market forces in assuring that corporations are controlled by those who can use that control most productively. In our earlier discussion of the problem of sale of control Posner has opined that:
"There would be another obstacle if proposals were adopted which forbid a controlling shareholder, in selling his shares, to charge a premium for the control of the corporation that the sale bestows on the purchaser....The theory has merit in cases where there is a conflict of interest between majority and minority shareholders, but in the usual takeover situation the latter will be more injured than benefited by a rule that, by reducing the controlling shareholder's incentive to sell his control, retards the reallocation of the assets of the corporation to people who can use them more productively, to the benefit of all of the shareholders". 37

In theory the economists argue that market efficiency requires us to leave the practice of insider trading alone and that the corporate acquisitor is the best ethical catalyst, therefore, take-over attempts must not be impeded. The interest of public investors are actually impeded as a result of our concern with ethical ideas. 38

However, it is my belief that fundamentally our capitalist system is still based upon the standards of fiduciary responsibilities and trust. If it is the desire of governments to draw the savings of the public into productive economic activities, management must, in every act, inspire the confidence of investors whose funds are their lifeblood. For, if the public has a large stake in the country's corporate business, so corporations have their stake in public confidence. The bottom line must be that public confidence must not be allowed to dissipate at any time, the arguments of economic efficiency must be subordinated to this overriding requirement. This is extremely important when we stop to consider the aggregate amount of savings channelled each year through the securities market to extend the productive capacity of Canadian enterprises. 39 The encouragement of Canadian ownership, assure Canadian government, that it can control more effectively the domestic economy. Public confidence is essential to achieve all these goals. The corporate controllers as market actors must have an unquestionable integrity. 40
As a concluding remark, I would like to note Professor T.W. Arnold's cynical observations of the role of economists and economic theories in his famous book, "The Symbols Of Government". He observes that the law is generally unable to explain the competitive struggle of commercial interests, its ideals were too high. Business is not considered a necessary evil, but a source of the highest good. Hence, he suggests that a philosophy was needed to justify the disorderly struggle of a commercial class, a selfish struggle for power and money by a class which refused to submit to regulation in terms of ethical ideas and yet wanted respectability and prestige. For indeed, the profit motive itself, noted by Professor Weinrib, may be regarded as the element that purifies the transaction and clothes it with a legal justification. Bowen L.J. in a classic judgment in *Mogul Steamship Company Ltd. v. McGregor* says:

"...This seems to assume that, apart from fraud, intimidation, molestation, or obstruction of some other personal right in rem or in personam, there is some natural standard of "fairness" or "reasonableness" (to be determined by the internal consciousness of judges and juries) beyond which competition ought not to go. There seems to be no authority, and I think, with submission, that there is no sufficient reason for such a proposition. It would impose a novel fetter upon trade".

Thus, the fundamental laws of economics were invented to prove that the greatest good to the world comes from the unimpeded competitive activities of enlightened greed. Economics convince us that what appears to be a disorderly struggle of commercial interests is really the most efficient way of obtaining order in the long run. As a result, Professor Arnold observes, people who produce ethically irrefutable arguments that the law should do more than it does in controlling humans can thus be told that their ideas, while in accord with the general aims of the law to promote social justice, are nevertheless economically unsound.
D. A Code Of Conduct For Corporate Management?

More and more, people are beginning to think that the law cannot effectively deal with ethical problems and the conscious adoption of more specific codes of behaviour will tend to improve the ethics of corporate insiders. Businessmen are advised that it is conventional wisdom to be sensitive to ethical standards that are not yet law because such standards may suddenly crystallise into legal restraints as a result of adverse public reaction.

A good illustration as to how a code of conduct might be used is that after the occurrence of the executive-supplier linkage affairs in Chrysler, policy statement akin to a code of ethics was promulgated and put into effect. The new policy statement specifies that:

"No officer or employee shall have any interest, direct or indirect, in any outside concern or in any competing concern, unless the management committee set up for the purpose of passing up such matters shall determine in writing after full disclosure of all the facts that such interest does not conflict with the interests of the corporation and that there is no reasonable likelihood that such interest will influence the judgment or actions in performing his duties. For the purpose of the policy, the wife and minor children of the officer and employee are treated as one with him". 46

Professor Kaplan has described this attempt as promising. In an empirical research, an American commentator was able to show especially that 71% of 1,700 business executives believe that a code would raise the ethical level of their industry. 47 The basis of their belief is that a code will make it easier for good men to conform their external behaviour to their internal ideals. At the same time, a code can discourage wrong-doers by making it easier to detect and punish unethical behaviour. On the other hand, 87% of the business executives believe that a code would not be easy to enforce. Out of this, 87% 4 out of every 7 agree that "people would violate the code whenever they thought they could avoid
detection. The major problem with a code of ethics, it seems, is its enforcement.

Generally, there are four possible methods of enforcement. Firstly, the management of each company is to enforce the code, that is self-enforcement. Secondly, a group of executives, perhaps forming a panel, can be selected from various companies. Thirdly, a group composed of executives from the industry plus other members of the community. The fourth possibility is enforcement by a government agency. The survey reveals that while 40% of the business executives favour self-enforcement and 60% favour some form of outside regulation, only 4% would use a government agency. Unfortunately, self-enforcement is not likely to work unless those at the top management have taken a strong ethical standard. Regulation by some form of outside regulation, it is feared, will not enforce the code as rigorously as the public would like. It has no teeth to put the code into action. More importantly, a code of conduct for management does not prevent corporate abuse by insiders in their capacities as controlling shareholders. Society can hardly depend on top management of corporations to instill ethical standards. For instance in our earlier discussion of the problem of transaction affected with director's intereste, the rest of the directors are hardly a sufficiently disinterested body to supervise such transactions, there is nothing to prevent mutual back scratching.
(i) Introduction

The rights of minority shareholders and the need to protect investors in their dealings, whether directly or indirectly, with corporate insiders and controllers in shares at the securities market have somehow never been neglected in the United States. Even before the great crash in 1929 and as early as 1913, Mr. Justice Brandeis in a book entitled "Other People's Money" warns that "money oligarchy" as brought about through consolidation and interlocking directorates is the root source of many evils, and induces inefficiency and disloyalty in management. As a result, small investors suffered great losses and the money oligarchy's self-dealing in the system of public financing practically amounts to extortion from the public. 51

The late Dean James M. Landis, in reflecting upon the legislative background of the Securities Act and the role played by the Senate Banking and Currency Committee recalled that:

"That Committee spread on the record more than the pecadillos of groups of men involved in the issuance and marketing of securities. It indicted a system as a whole that had failed miserably in imposing those essential fiduciary standards that should govern persons whose function it was to handle other people's money". 52

Professor Dodd of the Harvard Law School, writing at the time when the American federal securities legislation had just been drafted, asked the question of whether effective enforcement of the fiduciary duties of corporate managers was practicable, and only to conclude pessimistically that legal rules of conduct could be enforced, at best, with only moderate success. 53 When the Federal Securities Act was passed in 1933, Mr. Justice Frankfurter, noting the extensive disclosure requirements impose upon management, said:
"He who is unwilling to assume the responsibility of a fiduciary has no business to be a fiduciary. Integrity, courage and ability are not so lacking in this country that new and perhaps better leaders will not be found to take the place of those who shrink from responsibilities incident to the business of managing other people's money". 54

However, the extensive disclosure requirements did not satisfy all the critics. Nine months after the Securities Act became effective in May 1933, Professor William O'Douglas (as he then was) attacked the act for its reliance on disclosure as the main instrument of control. 55 Douglas has essentially two main objections. Firstly, he felt that the "glaring light of publicity" on which the act is based, is not enough because:

"...those needing investment guidance will receive small comfort from the balance sheets, contracts, or compilation of other data revealed in the registration statement. They either lack the training, or intelligence to assimilate them and find them useful, or are so concerned with a speculative profit as to consider them irrelevant." 56

In fact, this point is substantiated by two major Canadian investigations of the collapse of financial companies, the findings are that investors simply do not read prospectuses before buying securities. Secondly, Douglas objected to the implied assumption of the Act that:

"...our large units of production should be pulverized; that business relations in organisations should be made more personal; that the investor should be made more personal; that the investor should be more closely assimilated into the enterprise; that the centrifugal force which has been separating ownership from management should be transformed into a centripetal force which will drive back closer to the business not only the investor, but also those in the management who direct policy not detail. In other words, it is Main Street business which the Act envisages and which it desires to see returned." 57

Douglas criticizes this whole business as essentially a "19th century piece of legislation" which unrealistically envisages a return to "main street
business" of the simpler days. This, Douglas explains, is why all directors are held to be of the same standard of reasonable investigation. It explains why stockholders in many instances are bereft of all defences. More importantly, there is nothing in the Act which controls the power of the self-perpetuating management group which has risen to a position of dominance, there is nothing in the Act which purports to deal with the protection of minority rights, and nothing which concerns the capital structure, its soundness or unsoundness. Thus, when Douglas was subsequently appointed chairman of the Securities Exchange Commission in 1937 the way was paved for SEC to play an active role in the safeguarding of the interests of minority shareholders and investors. Douglas was determined through the efforts of the SEC to buttress corporate standards of trusteeship. In his opinion, once capitalism foreakes the standards of trusteeship, it bids fair to destroy itself.

Despite the efforts of the SEC, Professor A. Berle was able to write in 1954 that:

"Herein lies, perhaps, the greatest current weakness of the corporate system. In practice, institutional corporations are guided by tiny self-perpetuating oligarchies. These in turn are drawn from and judged by the group opinion of a small fragment of America-its business and financial community. Change of management by contesting for stockholders votes is extremely rare, and increasingly difficult and expensive to the point of impossibility. The legal presumption in favour of management, and the natural unwillingness of courts to control or reverse management action save in cases of the more elementary types of dishonesty or fraud, leaves management with absolute power. Thus, the only real control which guides or limits their economic and social action is the real, though undefined and tacit, philosophy of the men who compose them."
(ii) The SEC And The Receptive American Judiciary

(a) The Development of US Corporate Common Law

The end results of the thoughts and action of the men mentioned above have paved the way for the better protection of absentee owners of corporations. The implementation and enforcement by the SEC in the intervening years has wrought major changes in corporate law and practice. The growth of securities regulation, now so extensive, has been characterized as federal corporate law. This has been paralleled by the growth of corporate common law, mainly through minority shareholders' suits, facilitated by the federal rules of practice governing class actions and derivative suits, and by the spur of the contingent fees. And most important of all, as noted by Professor Beck, the American judiciary has been alive to the realities of the corporate world and willing to play its essential part in corporate regulations.61

Anglo-Canadian law in general do not recognise any fiduciary duties owed by directors to individual shareholders and, as we have noted, this has caused much unsatisfactory results. In the United States and in the context of insider trading, it was felt that where the director of a private company seeks out his shareholders, and makes offer for their shares, should there be any special facts making it highly inequitable for the director to profit through a personal stock transaction with the shareholder, the courts ought to give the special facts due weight in holding the director accountable without invoking fiduciary concept.62 It was in accordance to this line of thought and later to circumvent the Percival rule that give rise to the"special facts rule" first established in Strong v. Repide.63 The decision was based on the premise that while in general no fiduciary relationship exists between the director
and the individual shareholder, special facts may place the director in a position of confidence that will give rise to the fiduciary rule. The "special facts" rule has been so widely applied that, a British commentator, Professor Tom Hadden notes that it closely approaches the "fiduciary concept", and became more or less interchangeable. Before long, this head of liability under the special circumstances doctrine was to be extended to cover market transactions. In the case of Diamond v. Oreamuno it was held that corporate officers and directors who traded on undisclosed inside information violated their fiduciary duty to the corporation and might be held accountable to the corporation for their gain. Although the primary liability is still to the company and not to the individual shareholder, this development may mark the beginning of a new conceptual direction for fiduciary relations. This clearly shows that the American judiciary is sensitive to the needs of shareholder-investors.

In our earlier discussion of the problem of the sale of control at a premium, we observe that in the Canadian case of Farnham v. Fingold the court concerned refuses to hold that majority shareholders in their sale of control owe fiduciary duties to the minority shareholders. In the United States, two landmark decisions of the Federal courts have established that controlling or dominant shareholders owed fiduciary duties to the minority shareholders. In the case of Southern Pacific Co. v. Bogert, the Supreme Court in the year 1919 held that:

"The majority has the right to control; but when it does so, it occupies a fiduciary relation toward the minority, as much so as the corporation itself or its officers or directors. If through that control a sale of the corporate property is made and the property acquired by the majority, the minority may not be excluded from a fair participation in the fruits of the sale."
Similarly, in the case of Pepper v. Lutton, decided in 1935, the Supreme Court held that:

"As director is a fiduciary, so is a dominant or controlling shareholder or group of stockholders. Their powers are powers in trust." 72

This naturally gives rise to the Perlman v. Feldmann decision which has been cited as authority for the proposition that minority shareholders of a corporation were entitled to share in the premium paid to a control block owner in a private sale. 74 The majority decision delivered by Clark, C.J. rested its case on the view that, as majority shareholder and director, Feldmann "stood in a fiduciary relationship to the corporation and to the minority shareholders as beneficiaries thereof". 75 Unfortunately, the judgment of Clark C.J. does not clearly explain what fiduciary duty Feldmann had. However in his judgment he concludes that:

"...So in a time of market shortage, where a call on a corporation's product commands a usually large premium, in one form or another, we think it sound law that a fiduciary may not appropriate to himself the value of this premium. Such personal gain at the expense of his co-venturers seems particularly reprehensible when made by the trusted president and director of his company. In this case, the violation of duty seems to be all the clearer because of this triple role in which Feldmann appears, though we are unwilling to say, and are not to be understood as saying, that we should accept a lesser obligation for any one of his roles alone." 76

More significantly, Clark C.J. went on to hold that:

"Hence, to the extent that the price received by Feldmann and his co-defendants included such a bonus, he is accountable to the minority shareholders who sue here. As plaintiffs, as they contend, are entitled to a recovery in their own right, instead of in the right of the corporation (as in the usual derivative actions), since their successors in interest should not share in any judgment which may be rendered." 77
Once again, we witness that the American judiciary is realistic and alive to the way a corporation is managed and controlled and to the needs of the minority shareholders. It is indeed regrettable if we compared this decision to the Canadian decision in *Farnham v. Fingold* where the Ontario Court of Appeal refused to permit a class action so that the plaintiffs could claim directly against the controlling shareholders and held that the matters were properly the subject of a derivative action.78

It is beyond the scope of this paper to elaborate in a comprehensive manner on the various legal precepts, when American courts will be willing to intervene at the behest of stockholders in the decisions of the board of directors and impose liability on directors, officers, and controlling shareholders for their business decisions; the earlier discussions are nothing more than some illustrations.

(b) The SEC And Insider-Trading

In the context of insider-trading, we will see how a supportive judiciary permits the SEC to play an active role in regulating this dubious business practice.

S. 16(b) of the 1934 Securities Exchange Act created a new cause of action by which a corporation, or a security holder suing in the corporate name, might recover any profit realized by a director or substantial shareholder on short-term dealings in his corporation's securities, regardless of any question of the misuse of confidential information. This statutory action, in conjunction with the general duty imposed on directors at the same time to disclose their dealings in the corporation's shares (s. 16(a)), has proved generally successful in curtailing speculation of this kind. But, liability under this provision extends only to officers
and major shareholders, and to purchases or sales undertaken within six months of each other.\textsuperscript{79}

Liability for the misuse of confidential information in itself is based on the breach of regulations issued by the SEC under S. 10(b) of the same statute. The section in broad terms prohibits the use of any fraudulent device or course of business which would operate as a fraud or deceit on any person, or the issue of any false statement, or the concealment of any material fact in connection with the sale or purchase of any security.\textsuperscript{80} In order to grasp the ambit of the 10b-5 rule and the role played by SEC to safeguard the interest of investor-shareholders, the notable case of SEC v. Texas Gulf Sulphur Co.\textsuperscript{81} needs to be dealt with.

The facts of the case are as follows. On November 8, 1963, as part of exploratory operations started in 1957 in eastern Canada, the Texas Gulf Sulphur Company (TGS) drilled test hole K.55-1. On November 12th a visual inspection of the core so extracted disclosed an unusually high content of copper and zinc. Between March 31st 1964 and April 10th 1964, four additional holes were drilled and inspection of the cores revealed a substantial mineral content in each. Meanwhile, rumours of a major strike became rife. On April 12th, the company then issued a press release discounting the rumours and stating that to issue details of the prospects would be premature and possibly misleading. Between April 12th and 16th, three more drill holes were completed and an examination of their cores disclosed substantial mineral content. On April 16th, TGS issued a release which announced a major ore discovery.\textsuperscript{82}

During the period from November 12th 1963 to April 12th 1964, three officers and five employees of TGS purchased or recommended that others purchase TGS stock or calls thereon. Between the first press release on
April 12th and the dissemination of the TGS official announcement on the morning of April 16th, the secretary of TGS and an employee purchased TGS stock. Moreover, during the press conference on April 16th, one director left the room and made a telephone call to his broker which resulted in purchases of TGS securities by third parties. Furthermore, on February 20th, some of the defendants accepted stock options from a company committed which had not been informed of the drilling results.

The SEC took proceedings against the company and its officers and employees seeking an injunction against further violations of Rule 10b-5, recission of all share contracts entered into by insiders, and compensation for those who had sold the shares affected. It was held that the company had been in breach of the Rule in issuing the press release, as had those who had purchased shares or given tips to others. The issue of compensation was deferred, but it was implied that those responsible for making public statements to investors might be liable to market buyers "if such assertions are false or misleading or are so incomplete as to mislead irrespective of whether the issuance of the release was motivated by corporate officials for ulterior purposes." 83

The results of this case have two important significances. Firstly, liability under 10b-5 is being broadened and definitively defined. Liabilities now extend not only to insiders, but include their associates who have engaged in improper dealings or tipping. Rule 10b-5 prohibits "any person" from making affirmative misstatements in connection with the purchase or sale of a security. 84 However, an affirmative duty to disclose material facts has only been imposed on those termed "insiders". Previously, the term "insider" had not been clearly defined, and the only people definitely included within the term were corporate officers, directors and controlling stockholders. 85
However, in the case of Cady Roberts & Co. (40 S.E.C. 907 (1961)), the SEC, held that the duty of disclosure is not limited to "insiders" but is imposed on any person having "access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of anyone." Since Cady, Roberts, the violator, was a broker and the business partner of an insider, it was unclear whether the SEC was imposing a special obligation on brokers, or whether the obligation would be imposed on all having access to such information. The significance of the present case is that it has left no doubt that the SEC intended the ruling to apply to all having access to material inside information. The decision imposed a duty of disclosure on lower employees such as an engineer and a geologist. The court also held that the defendants who gave tips to outsiders had violated the rule.

Also of important significance is that liabilities now extend not only to insiders and their associates, but also to those responsible for misleading corporate publicity without themselves buying or selling any shares. The decision actually requires that corporate press release not to be misleading to reasonable investors. The rationale for such a requirement is that, if one of the more significant purposes of the federal securities legislation was the prevention of the circulation of improper information by the issuer itself, the company could not be held to a less rigorous standard of care in the issuance of the press release on April 12, 1964. Rejecting the trial court's reasoning that no cause of action against TGS had been established since the press release had not been given out "in connection with the purchase or sale of any security", Judge Waterman pointed out that, unlike other sections of the securities acts, no language within S 10(b) specifically required the defendant's participation as a condition to
liability. The Congress's broad goals in passing the Act, particularly the need to protect investors, dictate a broad reading of the requirement of section 10(b) and rule 10b-5 that the activity complained of be "in connection with the purchase or sale of any security". Under such a reading, a corporate statement made without intention to mislead and not in connection with securities transactions by the corporation or its insiders is nevertheless within the rule if made in a manner reasonably calculated to influence the investing public. Judge Waterman believes that the section was intended as a catchall clause to enable the SEC to deal with new forms of manipulative devices. Secondly, apart from the extension of liabilities, the other significance of the case is that the SEC is the party itself that actually initiated the proceedings. It must be pointed out that no statutory right of civil recovery is granted for Rule 10b-5, enforcement is essentially effected through administrative arm-twisting inducing the guilty party to make voluntary restitution. The earlier weapons of Rule 10b-5 were the sometimes empty remedy of an injunction and threat of securities penal sanctions. However, in 1947 it was held that the rule authorized a private action by the defrauded seller based on concealment of material facts by an insider. The implied right of civil recovery did much to strengthen SEC enforcement. The Texas Gulf Sulphur case for the first time permitted SEC to bring a civil action on behalf of an injured class of investors. The ability of the SEC to bring at its own motion an action on behalf of investor-shareholders is a clear recognition that the integrity of corporate management is a matter affected with so much public interest that individual shareholders cannot be relied upon to assert their own legal rights. It is beyond doubt that after this decision, the possibility of personal liability, whether to compensate external investors who suffer direct loss or to reimburse any improper profit is a real deterrent both to insider trading and to any attempt to influence the market by misleading public statements.
(c) Rule 10b-5 And Corporate Mismanagement

In our earlier discussion we saw that Rule 10b-5 was found to encompass the areas of insider trading and misleading corporate publicity, the latter having been outlined for the first time in the Texas Gulf Sulphur case. Another important but still vaguely defined area encompassed by the rule is the area of internal corporate mismanagement. Within the corporate context, 10b-5 governs a broad range of mismanagement claims, involving the relationship between shareholders of a corporation, on one hand, and its officers, directors and controlling shareholders on the other.

The American 10b-5 case, Birnbaum v. Newport Steel Corporation, is generally looked upon as having established a set of rules that provide a conceptual framework for analysing the development of the 10b-5 rule in the mismanagement area. The "rules" it articulated as noted by Professor Sherrard are as follows:

1. A plaintiff, to have standing to sue for a violation of rule 10b-5, must be purchaser or seller of securities;
2. The fraud alleged must be of the type "usually associated with the sale or purchase of securities".
3. 10b-5 were not intended to afford relief in cases in which the fraud alleged is the kind of internal corporate mismanagement traditionally characterized as a breach of fiduciary duty.

In reality what 10b-5 has achieved is that it provided a realistic conceptual basis to determine whether 'corporate controllers' investment judgments were impaired as a result of improper influence and conflict of interest. Its application calls for the need to inquire into the good faith of the decision-maker of a corporation, irrespective of whether the decision-maker is acting in the capacity of shareholder voting in a GM, or as corporate executives and directors. A task which fiduciary ideology
has tried hard to avoid. Unfortunately, the ambit of 10b-5 is limited only to management fraud connected with sale or purchase of securities and its growth and development has been restricted because it must not replace state laws and traditional fiduciary principles. I would also further make the observation that the ability of 10b-5 to penetrate the realm of motives is because it takes a realistic look as to who and how corporate decisions are made. Once this is achieved, the only limit for the 10b-5 rule to regulate corporate mismanagement is only dependent upon the willingness of the judiciary in permitting it. Perhaps, I need to substantiate these opinions by analysing the application of the 10b-5 rule in the important cases. Before the important decision in Santa Fe by the Supreme Court that sets the new limits on 10b-5 rule, the two main standards of liability in 10b-5 mismanagement cases are "deception" and "new fraud".

10b-5 and Deception

Deception under 10b-5 rule is taken to mean a misrepresentation or non-disclosure, an unfair securities transaction between the corporation and a member of the decision-making body, who stood to gain a direct benefit. Let us first discuss the head of liability under misrepresentation or non-disclosure. The basic rationale of this head of liability under rule 10b-5 is that information necessary for an impartial business judgment has not been disclosed or misrepresented. In Ruckle v. Roto American Corporation, a majority of the board of directors withheld a financial statement from the others at a meeting to authorize the issuance of treasury stock. The stock was then sold to the president at an unreasonably low price with the ulterior motive of perpetrating the control of the majority. The court enjoined the consummation of the
transaction, finding that the corporation was a seller of securities and had itself been the victim of deception because of the concealment of information from one of its neutral director. What is more significant for our purpose in this paper is that in dictum the opinion suggested that a corporation could be defrauded even though the entire board was informed fully. If all directors have an interest adverse to that of the corporate entity, clearly there is an implicit recognition that if the purpose of 10b-5 is to ensure disclosure of information that would affect decisions, its application is called for in any case in which the defrauding management is not acting alone. The corporation would suffer the same harm even if the decision had been approved by the shareholder's meeting or the board. More subtly, Rule 10b-5 seems to insist that the interest of the corporation is not what the management defines it to be or what controlling shareholders honestly believe it to be, the interest of the corporation must be the interest of all constituent parties of a corporation.

The second head of liability is that all unfair transactions by directors in the corporation's securities can be successfully attacked as deception, even in the absence of a misrepresentation or an omission. However, approval of the transaction by stockholders who receive full disclosure cures this type of deception. Of more relevance to our discussion is that 10b-5 was held to apply if market manipulation and mismanagement merges, when a purpose of a corporation action is to affect prices of the issuer's securities. (In our earlier discussion, we have noted how powerless Anglo-Canadian courts are when dealing with such a situation). Thus, cases condemn manipulations such as the reduction or elimination of dividends designed to depress the stock's price. An example of such cases is Mutual Shares Corporation v. Genesco In.
In order to understand this head of liability, we need to trace the development of 10b-5 after the Ruckle case. The rationale in Ruckle that a corporation can be defrauded by all its directors was put into doubt by the O'Neill decision. O'Neill concludes that a corporate entity cannot be deceived if none of its directors were deceived in the actual sense. This conflict between a pure deception standard under rule 10b-5 and the need to provide relief when the decision-making body acts in concert to abuse their power led to the creation of a new theory of liability in Schoenbaum v. Fistbrook. In this case, the controlling shareholder caused the issuance to it of a large block of treasury stock at an unfair price. Despite the fact that no proof that the corporation was deceived because full disclosure had been made and the transaction had been approved by a majority of the "disinterested" directors, the court held that a triable claim existed, if the plaintiff established that defendant exercised a "controlling influence" over the entire board of directors.

Professor Sheward noted that the standard's significance lies in its recognition of the artificiality and inadequacy of a deception requirement when the controlling shareholder exercises its control to impair the independent, disinterested judgment of the board of directors. The reality of a director-shareholder control group within the corporate structure is more than recognized. Thus, "new fraud" can be used to condemn any securities transaction between the corporation and a defendant who could exercise a controlling influence over the corporation. The Third, Fifth, Seventh, and Eight Circuits are noted to have adopted "new fraud" concepts that are even broader than those of the Second Circuit. Thus, "new fraud" expanded the class of actionable wrongs.
beyond deception to include transactions where the persons who received some sort of direct or indirect benefit improperly influenced the decision-making directors.\textsuperscript{114}

However, the ambit of the "new fraud" theory of liability is limited somewhat by the Popkin decision\textsuperscript{115} In this case, the minority shareholders sued derivatively to enjoin a proposed merger on the ground that the exchange ratios were unfair to the shareholders of the corporations to be acquired in the merger. The merger had been required by a stipulation of settlement in a previous action against the controlling shareholder. Unfortunately, the court of the Second Circuit here declared that Schoenbaum's emphasis on self-dealing did not eliminate non-disclosure as a key issue in rule 10b-5 cases. As a result, although the court found that exchange ratios indeed were unfair, it nevertheless held that without deception and given full disclosure, the court would not entertain allegation of unfairness alone.\textsuperscript{116} It seems that this decision was reached in order to defer to state law which has approved such a transaction upon approval by a majority of shareholders. The influence of the Popkin rationale upon subsequent decisions has not been easy to measure. However, outside the Second Circuit, courts have continued to take an expansive view of the kinds of misconduct reached by rule 10b-5.\textsuperscript{117}

\textbf{10b-5, Deception And Going Private Transactions}

It is interesting to note that there was an unsuccessful attempt to expand 10b-5 to include breaches of fiduciary duties without any deception, misrepresentation or non-disclosure. What's more interesting is that such a development took place within the context of going private transactions, a problem that we have earlier concerned ourselves with.

The case of Santa Fe Industries Inc. v. Greene\textsuperscript{118} concerns the
propriety of an amalgamation squeeze-out. Santa Fe Industries Inc. acquired 60% of the stock of Kirby Lumber Corporation in 1936 and increased its stock position to 95% during the succeeding years. In 1974, Santa Fe acquired the remaining 5% of the Kirby Stock pursuant to a merger between parent and a subsidiary under the Delaware Statute. The minority shareholders of the subsidiary was forced to take $150 in cash for each share they owned or to seek appraisal rights pursuant to Delaware law. The shares were worth $640 per share. Mr. Greene, the minority shareholder, brought the instant 10b-5 suit seeking to set aside the merger or to obtain damages.  

The Second Circuit found violation of 10b-5 in the absence of a misrepresentation or an omission holding that there was a breach of fiduciary duty. In so doing, the court actually expanded the common law fraud to include the equity definition of fraud to include the taking of an "unconscientious advantage". (Perhaps, it might be helpful to point out that "deception" is merely a specie of "fraud", the terms are used interchangeably). It must be reminded that Chancery frequently has equated the concept of fraud with oppression, overreaching, unconscionability, breaches of fiduciary duty, and unfairness. Perhaps, "new fraud" requiring the showing of "controlling influence" is also based upon the equity definition of fraud. The court in the present case went on to find breaches of fiduciary duty because the price was unfair, the merger did not have a valid corporate purpose, and minority shareholders received no prior notice (not required by Delaware law).

The U.S. Supreme Court reversed this decision and refused to extend the ambit of 10b-5 to cover breaches of fiduciary duties without any deception, misrepresentation or non-disclosure. A policy reason
for so doing was that the Supreme Court does not wish to override the Delaware Statutes which sanction such a transaction. The Supreme court held that 10b-5 cases do not support the proposition that a breach of fiduciary duty by majority shareholders, without any "deception", "misrepresentation", or "nondisclosure", violates the Rule. It is not important for the purpose of this essay to explore the precise scope of Rule 10b-5 after this decision. However, it is interesting to note that 10b-5 continues to provide a quick means for squeeze-out victims to attack going private transactions whenever there is a misrepresentation or an omission. For example, a misleading assertion in a proxy statement in connection with a merger of two corporations may be adequate to furnish a cause of action. Furthermore, although the scope of deception is unclear, a going-private transaction that does not involve a misrepresentation or omission can still be attacked, since deception can continue to be interpreted to include conduct of mismanagement short of a breach of fiduciary duty (At least, this is possible in courts other than the Second Circuit). What is more significant is that an amalgamation squeeze-out involving a parent and subsidiary can be attacked if the parent violated 10b-5 in prior transactions. A good example would be a tender offer to be followed by short-form merger, the misrepresentation in the tender was held in one case to be connected with a subsequent merger. Multistep transactions where motives play an important part can now be regulated to ensure fairness to the minority shareholders.

The growth and development of 10b-5 has been restricted. However, it is beyond doubt that the rule furnishes a realistic conceptual tool to deal with mismanagement by corporate controllers. It is also one rule that clearly recognizes that a shareholder does not cease to be an investor when he has completed the transaction that gives him status as a shareholder.
The SEC as Corporate Watchdog

We have emphasized the fact that ever since its inception the SEC has been playing an active role to buttress the fiduciary standards of corporate management. In 1962, William L. Cary, the then Chairman of the SEC says that:

"...I firmly believe that a proper function of the securities and Exchange Commission is to raise ethical standards in the industry.... I hope to be able to convey the wisdom in being sensitive to, and anticipating, public reactions that may crystallize into legal restraints." 127

Once the Commission is committed to this task, how the job can be done is perhaps only limited by the ingenuity of the men who composed this federal regulatory agency. However, this role played by the Commission has not escaped criticism. Commentators have accused the Commission of extending its authority not because of the felt or experienced needs of investors, but because of its own views about what investors should have and because of its own institutional interest in extending the reach of its jurisdiction.128 I shall not attempt to discuss this controversy, but instead would examine how the Commission may extend and exert its authority over corporate controllers.

Professor Hetherington noted that the usual means by which the Commission's jurisdiction is extended is not by the acquisition of new authority, but by the reinterpretation of the old.129 A good example of such a development is the growing ambit of Rule 10b-5 in regulating insider-trading, misleading corporate publicity and mismanagement which we have already discussed. However, the Commission may at times urge legislation to be adopted by the congress that may give it new authority. The foreign payments affairs illustrates this process. The result of the whole exercise is that the SEC has been given authority to police management
behaviour in areas no more directly related to securities regulation than any other type of management activity. 130

Generally, the SEC has powers to conduct any investigation, and to call for any witnesses and documents which appear necessary to the discharge of its functions, either in respect of an individual company or transaction where there is suspicion of impropriety or illegality, or in respect of any wider issue which may arise over the operation of the market, as for instance, insider trading or corporate bribery mentioned above. 131 More importantly, we have also witnessed how the Commission's wide injunctive power to check any violation of the federal statutes, later give rise to the development of an implied right of action, and finally permitted SEC to bring class action at its own motion. The inevitable comment is that the Commission has gradually extended and developed its activities far beyond the scope of the simple disclosure philosophy upon which it was originally founded in 1933.

All in all, the growth of fiduciary concepts in the States have not been limited to the enforcement activities of corporate law, as Professor Kaplan noted, the growth of fiduciary concepts have taken place as a result of: 132

(i) SEC's enforcement of the acts administered by it,
(ii) partly through court decisions, and
(iii) partly through the adoption of SEC and trust fiduciary standards by courts, lawyers, and businessmen, through analogy and example, even where such SEC or trust fiduciary standards are not mandatorily applicable, and
(iv) the activities of state blue-sky commissioners by limiting offerings within their own states by imposing "corrective requirements."
F. United Kingdom and the Control of Corporate Controllers

(i) The System of Non-Statutory Control

The term "City" is a term of art used to denote the various constituents which make up the capital market of London. The City is geographically small in size, occupying not more than one square mile of space within London. The City is, therefore, very closely knit and geographically centred in nature. Unlike the North American securities markets, where there are various different other forms of securities market, the London Stock Exchange situated in the City controls access to a near-monopoly of securities market. Perhaps, this explains why the Council of the London Stock Exchanges and other City authorities are effective in their efforts to buttress the standard of fiduciary responsibilities in the United Kingdom.

It is misleading to think that the success and effectiveness of the City authorities in exercising self-regulation were entirely results of their own merits. The informal, non-statutory system of regulation is dependant upon official backing, especially when such a system lacks power to impose civil or criminal liabilities. For example; the Stock Exchange authority is dependent upon the Department of Trade and Industry to conduct investigation into allegations of breaches of the Stock Exchange listing agreements. Similarly, the Panel on Takeovers and Mergers is dependent upon the Department to investigate an alleged breach of City Code. It is also commonly acknowledged that the virtual monopoly of the London Stock Exchange on the securities market bringing in train the possibility of effective self-regulation, was directly due to the use of the licensing power held by the department to exclude all other competitive forms of securities market.

Unlike Britain, the stock exchanges in Canada do not enjoy a virtual monopoly of the capital markets. As in the United States, Canada has encouraged a build-up of an extensive structure of brokers/dealers. These
brokers/dealers trade in a securities market popularly described as the "over-the-counter market". Far from enjoying a monopoly of the capital markets, the Canadian stock exchange must compete with these "over-the-counter" markets for listing. They must also compete with each other for listing of securities. The results have been a generally much lower standard of listing requirements, and the inability to impose tough sanctions on controllers of corporations. These are serious obstacles for the various provincial stock exchange authorities to play any effective role to control the conduct of corporate controllers. Furthermore, unlike United States or Britain there is no umbrella body at the federal level to supervise the various provincial stock exchanges. An umbrella body that might, generally, supervise and maintain standards of the securities market with the broader national interest in view. Provincial stock exchanges are generally left to be supervised by the securities commission set up within each respective province. However, the extent of supervision is minimal. Before the occurrence of the ugly Windfall affairs, the Ontario Securities Commission had mainly concerned itself with the examination of the financial affairs of members of the stock exchange. With the absence of a strong tradition of self-discipline and due to its diversified capital markets, the Canadian attempt to introduce a voluntary code on takeovers in 1963 was a total failure. The code without legal force was simply disregarded and had to be replaced by legislation.

After the great crash in 1929 in the United States, the crisis of confidence in the old free market system resulted in the creation of the Securities Exchange Commission in 1934. All public issues and dealings on an interstate basis were henceforth to be subjected to stringent administrative controls. In Britain, it was the City rather than government which decided to take matters under control. The Council of the Stock Exchange in London set up a system of discretionary and informal controls, all applications for
admission to quotation were henceforth subjected to searching scrutiny, and the antecedents of promoters, directors and all those involved were carefully checked. Any suspicion of unsoundness or impropriety would result in a simple but firm rejection, with no right of appeal. The Quotations Department of the London Stock Exchange is a large and expanding department which carries out many of the functions which in the United States are left to the SEC. It would not be unduly arrogant for the London Stock Exchange to claim that since the 1930's, no patently unsound floatations have slipped through the net. The need to maintain a fair and orderly market naturally requires the Stock Exchange to assume responsibility for the regulation of the behaviour of corporate management. The conduct of corporate management is governed by a written listing agreement, the most important obligations accepted in the listing agreement relate to the full and prompt disclosure of information and to a company's conduct towards its shareholders. The significance of these listing requirements is that they go beyond those imposed by Companies Acts. For example, the notes to the agreement make clear that listed companies are expected to comply with the Takeover Code, to give reasons for any departure from standard accounting practices, to give existing equity holders pre-emptive rights in the event of the issue of further equity securities for cash, and the agreement requires disclosure of any contract in which a director has a material interest to a much greater degree than the Statutes. More significantly, the Exchange is able to monitor the market activities of corporate controllers and to monitor the flow of information from a company to shareholders by requiring that all circulars be submitted to the Quotations Department first for approval. The ultimate sanction for breaches of the listing agreement is the suspension of dealing in a company's shares. In practice, the threat of suspension
and the consequent notoriety, are said to have proven sufficient in the past to ensure compliance in all important respects.

With a system similar to United States, all public issues in Canada were subjected to stringent administrative control. The respective provincial securities commissions generally possess wide discretion to refuse prospectus application for a public distribution of shares. The obvious differences with the British system is that, while the British market authority is responsible for admission to quotation and continues to supervise the conduct of corporate controllers after the admission, the Canadian market authorities come into play only after the market entry stage. The public corporations intending to list their shares permitted for public distribution at the various provincial stock exchanges, must then enter into listing agreements with the respective stock exchange authorities. The listing requirements of the Vancouver Curb Exchange, for example, require the company to submit to the Exchange for approval every proposed new release of shares and/or letter to shareholders. The company must obtain the consent of the Exchange before mortgaging, hypothecating or charging in any way of its properties or equipment or assets. Also, the company must promptly notify the Exchange of each material change in the general character or nature or organisation of its business, property or affairs. The wide ambit of this last requirement with some detailed specifications of what corporate transactions constitutes material change, meaning that many important corporate transactions cannot proceed without the approval of the Exchange.

However, events have proved that there is a lot to be desired in the ability of the Canadian market authorities to control the conduct of corporate controllers. The infamous Windfall affairs, exposed the inadequacy of the Ontario Securities Commission's supervision of the Toronto Stock Exchange. It also demonstrated the inability of the TSE to force disclosure
by listed companies.

In theory, the Exchange has accepted the role of a regulatory body, but in practice, self-regulation in the TSE displays weaknesses in two respects. Firstly, rule-making has not kept pace with the ingenuity of those who wish to take advantage of the deficiencies in the rules. Secondly, there is a woeful lack of any effective surveillance to ensure adherence to the rules. An explanation frequently offered in justification for departure from the rules is that it is customarily done that way. The Kelly Report, reporting on the affairs, insisted that the root cause of the problems is that members viewed the exchange as a private club. It recommended that the Exchange must achieve the proper status of a public institution. There must be a professional administrative staff distinct from the Board of Governors. It is of interest to note that the London Stock Exchange remains very much a private club until today, although it has a large full-time staff for its Quotation Department.

Following the Kelly Report, the 1966 Ontario Securities Act gave the OSC statutory power to regulate virtually every aspect of the operations of the TSE. Despite other improvements and general tightening up of the provincial exchange authorities, their attempts to regulate corporate controllers remain ineffective. It is the provincial securities commissions that are assuming more responsibilities to regulate corporate controllers.
The Council of the Stock Exchange in London is far from being perfect as a self-regulatory organisation; the ensuing takeover booms in the 1960s and the accompanying malpractices and abuses revealed its weaknesses. Investors were treated unequally. There were allegations of excessive payments to the retiring directors of bid-for companies, either for their shares or by way of compensation for loss of office. There were unethical manoeuvres adopted by corporate management in take-over battles, whether by way of attack or defence. The stock exchange fails to remove quotations from certain "shell" companies and so to prevent exploitation of minority holdings in "agreed mergers" and market "raids", to check "insider dealings" and "stripping operations". Following such widespread criticism the Panel on Takeovers and Mergers was set up in 1968 as a result of an initiative by the Governor of the Bank of England, to interpret and administer the City Code on takeovers and mergers. The resulting structure is firmly based on the concept of self-regulation. The four principal objections of the Code as listed by the Wilson Committee clearly show that the Code is directly concerned with the problems in the relationship between corporate controllers and minority shareholders. The four main objectives as summarized by the Wilson Committee are:
(i) There should be equity between all shareholders of a company involved in a takeover bid.

(ii) In particular, where control of a company has a value in itself, the control premium should be shared by all shareholders. Control should therefore be acquired by discriminatory purchases. This means that all shareholders in a company subject to a takeover should have the opportunity of receiving the same price of their shares.

(iii) Shareholders should be given adequate information and sufficient time to make a judgment on the merits of an offer and should not be stampeded or blackmailed into acceptance.

(iv) Directors of a company for which an offer has been made should not do anything to frustrate the offer by the exercise of their powers of management before shareholders had had an adequate opportunity to consider it, and should secure independent advice on it.

Judging from these objectives, what the Panel hopes to achieve is the maintenance of fair market practice and ethical behaviour on the part of corporate management. Day-to-day supervision of the Code is the responsibility of the Panel executive, who works closely with the Quotations Department of the Stock Exchange on whom they rely for detailed monitoring of the documentation issued and the market activities of corporate insiders. In the ten years since its inception the Panel had dealt with ten cases with allegations of insider trading.143 (Here again, we witness the fact that an external agency at its own motion attempts to check insider trading, rather than leave it to individual shareholders to assert their legal rights.) Also of significance is that the Panel may intervene in any takeover situation where it appears that the parties have not been acting in accordance with the spirit or letter of the Code, and make what order or ruling may seem necessary.144 It must be pointed out that the chief virtue of self-regulation in the United Kingdom is its ability to enforce the spirit of the rule. The question to ask is not whether it is legal but whether it is equitable.145
The Wilson Committee has described the success of the Takeover Panel in its sphere of operation as "transforming what was described as a jungle ten or so years ago into an orderly and regulated procedure." Perhaps, it has also succeeded in buttressing the standards of fiduciary responsibilities. Directors who have broken the Code have resigned from their boards, insider dealers have been made to pay improper profits to charity and purchasers have been restrained from voting their shares or required to reduce their holdings.

Apart from the self-regulatory organisations already mentioned, another self-regulatory body that merits mentioning is the Council Of Securities Industries set up by the Governor of the Bank of England as an umbrella body responsible for non-statutory regulation of the securities market as a whole. It is expected to act as the "shotgun behind the door" ensuring that the rest of the self-regulating bodies acted firmly and swiftly in the public interest. One of the principal objectives of the Council of Securities Industries is to maintain the highest ethical standards in the conduct of business within the securities industry. The message is clear, despite the absence of an American styled SEC in Britain, the concern to enhance market integrity, fairness and fiduciary responsibilities is in no way less intense. However, the Council of Securities Industries like the Takeover Panel, or the Council of Stock Exchange, or indeed any other self-regulatory bodies suffers from a lack of authority.

When the Takeover Code was drawn, the sanction of censure was thought to be more than adequate to enforce the Panel's authority and ruling. However, the Panel soon proved to be powerless against people who are not afraid of public censure and whose livelihood does not depend on the City. Even to those whose livelihood is dependent on the favour of the City institutions, the sanctions may still be ineffective. The original Bank
of England thinking on sanctions was that offenders against the Code would be able to be fined or suspended from their respective associations such as the Stock Exchange or the Issuing House Association. Unfortunately, the Stock Exchange's only weapon is the suspension of quotation and it has been slow to use this weapon because it hits innocent investors. An outstanding problem of the Panel and the Stock Exchange is their inability to provide civil or criminal remedies. Furthermore, both suffer from the inability to gain access into corporate information. Both have to rely on the statutory investigatory power of the Department of Trade, the Panel for investigation into the breaches of Code and the Stock Exchange for investigation into the breaches of listing agreement. This brings us to our next concern, the role played by the Department of Trade in safeguarding the interest of public investor shareholders.

(ii) Corporate Controllers And The Department Of Trade

In the United Kingdom, the Department of Trade now has extensive powers to investigate companies, and the existence of these powers is in the opinion of Gower of outstanding importance, both as a remedy against unfair treatment and as a preliminary action to civil or criminal proceedings against corporate controllers.151

The Department of Trade has a number of overlapping powers to appoint an inspector to investigate and report on "the affairs of a company". It is significant to note that when the court is given the opportunity to interpret the meaning of the word "affairs" in one case it has given it a wide meaning.152 "Affairs" has been held to mean its business affairs - its goodwill, profits or losses, contracts and assets, including its control over subsidiaries. Under section 165(a) of the 1948 Companies Act,
the Department shall appoint one or more competent inspectors of the com-
pany by special resolution or the court by order declares that its affairs
ought to be investigated by an inspector appointed by the Department. It
is very uncommon for an application to be made to the court for an order
since it is cheaper, quicker and normally easier to apply direct to the
Department to exercise their power under section 168(b), and since compa-
nies are frequently controlled by a director-shareholder group, the right
to obtain an appointment by passing a special resolution is not frequently
made use of.\textsuperscript{153}

For practical reasons, the more important procedures are those which
the Department may make a discretionary appointment, either of its own
motion or on the application of a shareholder.\textsuperscript{154} There are two broad
grounds upon which the Department may act. Firstly, that the affairs of
the company appear to have been conducted fraudulently or in a manner
oppressive of any part of its members or that persons connected with mana-
gement of its affairs have been guilty of fraud, misfeasance or other mis-
conduct towards it or towards its members. The second ground is that the
shareholders have not been given all the information which they might
reasonably expect. (The detailed provisions can be found in S. 165(b) of
the U.K. 1948 Companies Act). It is of significance to note that the
1978 Company bill will replace the existing stringent requirement that
the affairs of the company are being or have been conducted in a manner
oppressive with a lesser standard that emphasizes fairness. The Depart-
ment of Trade may now intervene if the company's business is being or has
been conducted unfairly in a manner prejudicial to some part of its
members or that any actual or proposed act or omission of the Company (in-
cluding an act or omission on its behalf) is or would be so prejudicial.\textsuperscript{155}

Section 164 provides for another procedure for the appointment at the
discretion of the Department, on the application of 200 shareholders or the holders of 1/10 of the shares. Although no specific grounds for intervention are specified, the Department appears to regard this as governed by the same general principles of s. 165(b).

Once the Department exercised its power of investigation, the primary duty of instituting any further proceedings which may seem desirable on the basis of an inspection report is now cast on the Department. If a criminal offence has been committed, the Department may refer the matter to the Director of Public Prosecutions, or institute proceedings on its own account. The Department may petition for the winding up of the company, for which purpose the inspector's report may be used as prima facie evidence that sufficient grounds for the petition exist, subject only to any objections on behalf of the Company concerned. It is important to note that the Department may institute civil proceedings in the name of any company against directors or others to recover any property of the company or damages in respect of any fraud or misfeasance. (It is interesting to note that the SEC is able to initiate class action in the name of the shareholders and not a derivative suit in the context of insider trading.)

The advantages of Department of Trade investigations into the needs and interest of public investor-shareholders are obvious. The Department's inquisitional power is the only means to determine the good faith of a corporate controller. The power may also serve as a preventive action if exercised speedily enough. Its other advantages are aptly summed up by Professor Gower. Firstly, the Department of Trade's power enables a shareholder to obtain important information necessary to establish that the member's rights have been infringed. This is of immense importance since one of the great weaknesses of a shareholder to safeguard his own interest is
his lack of access to the company's books and records. Also of consequential importance is that the Department of Trade will follow up their investigation with the necessary course of remedial action. This means that those shareholders who could not afford the time and expenses of initiating legal proceedings are now relieved of this burden. Perhaps, the effectiveness and potential of the Department of Trade to come to the aid of minority shareholders can be gaged from the nature of the matters that have been investigated upon. In investigating into the affairs of Ferguson and General and associated companies, it was found that the company lost £5 million by irresponsible investment in company for benefit of controlling shareholders. In investigating the First Reinvestment Trust and associated companies, it was found that there was a secret sale and resale of subsidiary for profit of controlling directors; and in investigating the Loncho company, it was found that the managing director failed to disclose transactions in which he and other directors were interested.

Unfortunately, the Department has in general adopted a cautious approach to the exercise of its powers. A main reason is that the publicity of an investigation may so undermine public confidence in the company that the company might be destroyed even if the allegations made against it turn out to be without foundation. This difficulty has been removed in part by the grant to the Department of new powers of preliminary enquiry, under which it may demand the production of documents and accounts from any company without necessarily proceeding to the appointment of a full inspection (1967 Companies Act S. 109). This power to seek disclosure is however further limited by the fact that the period between appointment and report in almost every case is between 2 and 3 years. This is thus a highly unsatisfactory means of getting the relevant information to share-
holders as soon as is possible. 158

It is not important to argue that a government agency akin to the Department of Trade with power of investigation be established in Canada, what is more important is the fact that it is recognised in Britain that public investor-shareholders are unable to initiate legal proceedings due to the lack of information, time or money and that a government agency with inquisitional ability and power is needed to supplement this need.
G. Canada - A Gap in Regulation?

(i) The Nature of the Problem

An important theme of this paper is to show that public minority shareholders are actually investors. Adequate protection therefore calls for laws that are able to conceptually adapt themselves to the needs and requirements of the market place, and regulatory agencies that are able to regulate substantively the conduct of corporate controllers at the market place as well as within the corporate context. The refusal of Anglo-Canadian common law to recognize fiduciary duties owed by controlling shareholders and directors to shareholders essentially means that investor-shareholders are effectively denied the appropriate common law remedies in the situations of insider trading, sale of control at a premium, the practice of "Golden Handshake", multistep squeeze-out transactions involving mismanagement and market manipulation etc. It is unable to respond to the greater demand by investor-shareholders for fairness in their dealings of shares with corporate controllers at the capital markets. Canadian securities regulators, on the other hand, have restricted their control of corporate controllers mainly through the disclosure process and have refrained from regulating the conduct of corporate controllers in any substantive way. The notion that securities regulation and company law are two distinct fields and one should not interfere or intrude into each other has somehow taken root. The result is a serious gap in regulation, the problem constantly exacerbated by the growing demand for more fairness by investor-shareholders.

However, there are signs that Canadian commentators are beginning to realize that it is conceptually unsound to treat the dual capacities of investor-shareholders as distinctive identities whose needs and
expectations can be separately met by regulatory mechanisms performing distinct functions. For example, Professor Weinrib once commented that shareholders in large corporations are now investors, and attempts to make them anything other than well-informed investors are backward looking. Similarly, Professor Slutsky comments that:

"It is wrong to assume, as company law so often appears to have done, that all shareholders have the same desires and interests, and are all searching for the same rights. The law ought to recognise the particular needs of the minority shareholders in the large public company, and work towards making him a better informed investor."  

In contrast, the dual capacities of investor-shareholders have always been clearly recognised in the United States. We have seen, how the operation of rule 10b-5 has virtually placed directors and controlling shareholders in a fiduciary relationship to all those with whom they have dealings in their company securities. An American commentator, Professor Bloomenthal, writing on the emergence of Federal Corporate Law comments that:

"There is however ample evidence of the fact that a shareholder is also an "investor" and does not cease to be one merely because he has completed the transaction that gives him status as a shareholder". 

Also, Justice Douglas (as he then was) puts it cogently that:

"The protection of the integrity of the securities markets and investors along with disregard of trust relationship by those whom the law should regard as fiduciaries is one all a seamless web". 

As a result, despite the rule in Percival v. Wright, there have been attempts to adapt common law to meet the needs of the market place. In Diamond v. Oreamuno, a case we mentioned earlier, Fuld C.J., concerned with the maintenance of integrity at the market place, held that
although the loss of the shareholders is irrelevant to the company, the company does suffer a loss of reputation for integrity.\textsuperscript{165} As a result, through the vehicle of fiduciary relations, an action on the part of the corporation itself was judicially created.\textsuperscript{166} Hence, it seems that the squabble over nomenclature as to whether an insider in this context can be labelled as a fiduciary is not important. What is more imperative is that a subordinate function of enforcing fiduciary duties of corporate insiders is to maintain the integrity of the market place.\textsuperscript{167} Fuld C.J. clearly recognises this objective.

In contrast, Anglo-Canadian courts did not attempt to adapt fiduciary principles to the needs of the market place; the need to protect the integrity of the market place was never looked upon as providing a new conceptual direction for the further development of fiduciary ideology. Canadian securities regulators have restricted themselves to the task of regulating corporate controllers through the disclosure process. However, there are signs that the Ontario Securities Commission is willing to play a more active role and is more prepared to regulate the conduct of corporate controllers in a more substantive way. This development shall be elaborated upon in our later discussion; now, it is sufficient for us to note that critics have objected to such a development and criticize it as an intrusion into corporate law. This is indeed unfortunate.

From our survey of the specific problems in the relationship of corporate controllers and absentee owners, a theme that also emerges is that we are not confronted with conduct that violates the law; what it does offend is the public investor's and society's sense of fairness. Fairness has, in most circumstances, become an ultimate criterion where all
corporate practices are to be judged. For reasons that we shall discuss, the law seems unable to cope with all kinds of unethical behaviour where motives play so important a part. Firstly, the law often allows what honour forbids; its standards are those of the reasonably prudent man—not the stickler for probity and honour. Secondly, the multiplicity of business practices cannot be reduced to simple formulae. The requirements of business prevent it. The ingenuity of man forestalls it. Frequently, a loophole will be found and exploited widely before it can be closed. Thirdly, the force and sanction of the law tend to apply at the margin so that a practice which is marginally on the other side is by definition permissible. This is in human terms unjust and tends to encourage practitioners to operate as close as possible to the boundaries of the law. Fourthly, the law's preoccupation with legal rights of parties means that it is unable to respond to the demand for fairness, provided these legal rights are not infringed, it is difficult for them to intervene effectively, however inequitable the results may be. Perhaps, it can be summed up that effective regulation seems to call for constantly progressive standards of fairness that are able to keep pace with changing business practices, that can be quickly applied and delicately adjusted to the requirements of particular cases.

In the United Kingdom, the reason why self-regulation has been retained as a means to regulate corporate controllers within the City is that self-regulation in the City relies on concepts of fair market practice. With its concentration on fairness and on the spirit as well as the letter of its rules, it is able to deal with grey areas and, where necessary, it is able to introduce new rules much more expeditiously and interpret its rules flexibly. In
the United States, the Securities Exchange Commission has generally played an active role to buttress the fiduciary standards of corporate controllers; it has also been delegated wide rule-making power to keep pace with changing business practices. In Canada, securities regulators have been able to issue policy statements that can be enforced by administrative procedures. Not only that such policy statements can be expeditiously introduced, it can also be introduced as interim policy statements that take effect immediately while the securities regulator invites comments. In effect, securities regulators are able to initiate public discussion so that a consensus can be reached which would also provide the basis for administrative action. Given such advantages over the slower and heavier method of judicial decision, it is indeed unfortunate that Canadian securities regulators do not play an active role to safeguard the interests of investor-shareholders.

The exercise of corporate discretion against the background of complex business practices render the task of supervising such exercise of corporate discretion extremely difficult. Anglo-Canadian courts are generally unwilling or unable to perform this task. If courts are asked to determine the fairness of a particular business transaction, we are essentially asking the court to do the job of inquiring into the circumstances in which the decision is made, and to substitute its judgment in place of those made by businessmen. For example, in our earlier discussion of the problems of going private transactions, in order to ensure fairness to the public minority shareholder, the courts must determine, for instance, whether a scheme to amalgamate two firms actually enhances efficiency, and whether the terms are fair. The court is clearly neither able to pass judgment on the economic merits of the
schemes or to make the necessary valuations and accounting investigations. As a result, the courts professedly refused to enquire into whether a potentially improper influence actually affected the exercise of the fiduciary's discretion or damaged the interests of investor-shareholders. Rigid rules based upon fiduciary obligation became law's blunt tool for the control of discretion, the unsatisfactory results were best evinced by our earlier discussion of the corporate opportunity cases. Perhaps, what is needed is an external agency with wide investigatory powers capable of inquiring into the affairs of a company.

Apart from the criticisms that courts are unable to deal with ethical problems and to supervise the exercise of corporate discretionary power, another reason that accounts for the courts' inability to do the job is that the law relies on the victims to initiate legal proceedings. It must be realised that the control of management abuses depends as much on the system of law enforcement as on the law itself. Legal rights and duties, however strict, are no more effective than an informal moral code if there is no way of making sure that they are enforced. And, in this sphere, the right to apply to a court for redress against a wrong is not always enough. Investor-shareholders who are exploited cannot be relied upon to see to it that the law is observed. Law enforcement is expensive, and unless there is a good chance of recovery, there is not a real reason for the victims of a fraud to throw good money after bad. Legal rules and regulations may in themselves be totally ineffective if those injured are unable or unwilling to set the law in motion. Furthermore, one must not forget the procedural thicket surrounding the Foss v. Harbottle rule that further discourages or prevents private action.

Another major factor that accounts for the inadequacy of the law is
that fiduciary concept based upon trust analogy is used to define the rights and duties of parties within the corporate structure.

The trust is a device for the separation of management and enjoyment. In a trust, the interaction between managers and those who receive the benefits of the managed property is governed by a number of duties owed by the trustees to the beneficiary and by corresponding rights in the beneficiary to control the trustees. It is significant to note that the addition of this new element attenuates and sometimes destroys the lines of responsibility and control that run between the managers and those who benefit from the management. Thus, in company law the managers owe their duties to the company and not to the shareholders. The unsatisfactory results of such a legal assumption has clearly been noted in our earlier survey of the specific problems. The company law also presumes that the power of shareholders to elect directors at general meetings would also be an effective check on management. However, when the ownership and management are merged into a group of director-shareholders, the checks designed to protect the corporation are effectively by-passed, and the majority is given a free hand to benefit itself.

The law has insisted that the entity of a corporation would be a convenient medium for describing corporate abuses, the fiduciary duties of directors and controlling shareholders are owed not to the minority shareholders but to the company and therefore it is the company itself which should sue, thus, giving rise to the Foss v. Harbottle rule. Recent statutory revisions have increased possibilities of minority suing in the name of the company by replacing the rule in Foss v. Harbottle with a court-supervised derivative suit. Despite the simplification of the procedural requirements for a derivative suit, the old conceptualisation has
been retained. A minority shareholder is still viewed as defending his own position by insisting on the rights of the company.\textsuperscript{179} This produces two undesirable results. In our discussion of the problem of sale of control, we observe that a derivative suit would mean that liability would rest on the premise of whether the corporation has suffered any loss and not whether minority shareholders have been unfairly treated. Secondly, recovery therefore must be for the benefit of the company rather than shareholders who have brought the suit. The recovery may bring about a result which the lawyer will no doubt cherish as a legal novelty, but which the layman will tolerate only if he has a taste for the ironic. In the \textit{Regal (Hastings)} case, for instance, the loss suffered by the former shareholders was recovered from the directors for the benefit of the new shareholders whose transactions with the directors were the occasions of the loss and who had not themselves suffered.\textsuperscript{180}

It is also obvious that the use of trust analogy and the trust language is proving awkward in many instances because it just does not fit the actual corporate practices. For instance, it is somewhat incongruous to speak of corporate controllers as trustees when it is realised that they have a major built-in conflict of interest, namely, the competing self-interest of stock ownership, option holdings or other interests.\textsuperscript{181} The trust analogy is further strained by the fact that majority shareholders are to be restricted by the same fiduciary ideology developed for trustees and agents. Majority shareholders, unlike officers or directors, do not acquire power as designated representatives. There is no express reliance by other shareholders.\textsuperscript{182}

Professor Kaplan made an incisive comment when he said that much confusing language and fuzzy thinking in dealing with the problems in the
relationship between corporate controllers and absentee owners could be eliminated if attention were focused directly upon the position of an insider in our corporate structure, rather than discussing his position as a fiduciary in relation to that of an express trustee or trying to determine the precise difference in intensity of duty between the two types of fiduciaries.\textsuperscript{183} The real purpose of trying to impose restrictions upon corporate insiders is to control their behaviour in order to advance the interests of the corporation and, equally important, to prevent them from exploiting the positions to the detriment of other interested persons such as absentee owners. These objectives and the nature of the relationships here involved, are sufficiently differentiated and specialised, so that they should be discussed in their own premises and in their own terms.\textsuperscript{184}

After all the above discussion, we have arrived at the final question. The question is, what should Canada do to close her regulatory gap? It is beyond doubt that Canada does not have the conditions necessary for the establishment of an effective scheme of self-regulation. It is also of interest to note that, Britain has long considered whether to replace its scheme of self-regulation with a formal system of statutory control. The establishment of an American-style Securities Exchange Commission has been proposed in Britain. Perhaps, what is needed in Canada to protect the interest of absentee owners is as suggested by Professor Slutsky, the establishment of a governmental agency or body to handle inquiries and complaints pertaining to companies - a corporate ombudsman in effect.\textsuperscript{185} An agency that possesses the power of economic analysis and investigation, and therefore could initiate action at its own motion, as well as being able to put it into motion upon receipt of complaints from private persons. An agency that is sensitive to the needs of public minority shareholders and the little investors at the public markets, and clearly understood its role to buttress the standards of fiduciary responsibilities. An agency that has power to
prosecute or commence civil proceedings at the end of its inquisitional attempt, or even correct wrongdoings by administrative arm-twisting, without troubling the public minority shareholder or costing them great sums of money. Hopefully, such activities will generate a new source of fiduciary standards that corporate controllers cannot afford to ignore when handling other people's money.

Rather than suggesting that Canada establishes an American-style SEC or a British Department of Trade, I believe that the job can be done if respective securities regulators are made to be aware that they have to assume more responsibilities and they must address themselves specifically to the problems inherent in the corporate controller and absentee owners relationship. They have been given wide administrative powers, the ways and means which the job can be done is only limited by their imagination. I will illustrate why this is so in our concluding discussion.

(ii) The Status Quo

Canada does not lack rules that will regulate the behaviour of corporate controllers; to some extent, the voluminous Ontario Securities Act and Regulations is a convincing example. Canada even has securities regulators who are administrative agencies set up by respective provincial legislatures to administer and enforce the extensive rules and regulations. The securities regulations essentially perform functions similar to that of the American SEC. The crucial distinction lies in the philosophy of regulation. Canadian securities regulators are essentially committed to the goal of maintaining market efficiency, and as Professor Johnston noted, it comes to be accepted in Canada that the general goal of maintaining public confidence in the persons and institutions operating in the capital markets is less directly linked to and in fact may be inconsistent with the goal of market efficiency. It is thus considered more important
that an investor with financial resources at his disposal should be able to convert them from one form to another with minimum obstruction and expense. This perhaps explains why the majority of the committee of Merger Report (1973) insists that shares of a corporation are a form of personal property and that the owner should be entitled to dispose of them on whatever terms he may deem fit. This is clearly a far cry from the prevailing regulatory spirit in the U.S.A. or United Kingdom. For example, in the context of the sale of control at a premium, a point we have already noted much earlier, both the U.K. legislation and the City Code impose much more extensive obligations on the seller of control as well as the buyer. In the Province of British Columbia, there has yet to be regulations or legislation to deal with the matter.

What is seriously lacking in Canada is the willingness of securities regulators to supervise the exercise of corporate power to ensure fairness and impartial business judgment, and to complement this task, the willingness to investigate into the affairs of companies. The results are that firstly, regulation of corporate management is achieved only through the disclosure process and through enforcement actions requiring compliance with rules, and secondly, blue-sky jurisdiction is only exercised at the prospectus-issuing stage, that is, entry to the market stage. The inadequacy of disclosure to prevent substantive violations when wrongdoers have the power to carry through the scheme of mismanagement has already been noted throughout this paper. Unless the securities regulators are willing to exercise discretionary powers, the process of ensuring compliance with fixed rules is nothing more than a static process unable to respond to new tactics and evasions. The exercise of blue-sky jurisdiction is a promising way to control corporate controllers. To understand "blue sky" jurisdiction, perhaps, one needs to contrast it to the full, true and plain disclosure regime of the SEC type. Under the disclosure regime, a person
or company may sell whatever securities he likes, the only condition is that he must make all relevant disclosure about them. Under the "blue sky" regime the securities administrator has the responsibility to decide whether it is fair for the public to be allowed to buy dubious securities, disclosure is not enough.\textsuperscript{188} Canadian securities regulators generally possess wide discretion to refuse prospectus application. As a result they are able to apply the "blue sky" approach, imposing terms and conditions whenever it is felt that disclosure does offer adequate protection. Let us now look at the Ontario Securities Commission's decision in the New Hiawatha's prospectus application to illustrate the operation of blue sky jurisdiction.\textsuperscript{189} In this case the deputy director of filings refused to issue a receipt for New Hiawatha's prospectus intended to permit the distribution of additional shares of New Hiawatha to the public for a mining venture. The basis of the Commission's decision is that, although the commission cannot eliminate risk, it can certainly identify high risk ventures as in the present case, and it can insist that promoters assume reasonable portions of the risk with the investors. This is done in order that there will be incentive for the promoter to explore realistically and spend the money wisely. The commission opined that the largest shareholder in the company should undertake the required new financing. Clearly, there is no limitation in the way terms and conditions can be imposed on the corporate controllers to ensure that their business judgment would be impartial and not affected with self-interest. Unfortunately, blue sky jurisdiction is only applied at the market entry stage, the inevitable conclusion is that in Canada after the prospectus qualifying stage, the controllers of a public corporation is essentially free from any other substantive control by the securities regulators.
What is needed in Canada is for the securities regulators to play a more active role in supervising the exercise of corporate power. Supervision essentially connotes a constant process of monitoring and imposition of corrective requirements whenever necessary. As Brandeis has warned, market efficiency is not the ultimate end, what is more important is that corporate controllers be reminded of their duties to investor-shareholders, and to society in general. To complement this task, the securities regulators must also be willing to exercise investigatory powers similar to that of the SEC or the British Department of Trade. Most Canadian securities regulators have already been granted investigatory powers to investigate into a company's affairs. However, the circumstances in which they can be exercised is limited and do not cover mismanagement not amounting to a violation of the Securities Acts or Regulations or the Criminal Code. It is interesting to note that s. 11(2) of the 1978 Ontario Securities Act provides that the Commission may exercise investigatory power in the circumstances deemed expedient for the due administration of the Act or into any matter relating to trading in securities. The wide ambit of s. 11(2) seems to suggest that the Commission have ample room to expand its investigatory powers if it so desired.

It is important to note that the Ontario Securities Commission has shown signs that it is willing to assume a supervisory role as to the exercise of corporate power. This is indeed encouraging.

(ijj) The Signs Of Change - The Ontario Securities Commission

The first sign of change can be gleaned from the 1976 National Sea Decision of the Ontario Securities Commission taken in the context of insider-trading. Under the Old Ontario Securities Act, the Commission was not granted the power to initiate proceedings to enforce proper insider
trading. S. 113 provides civil remedies for insider trading, and s. 114 enables the OSC to assert those remedies on behalf of those entitled to them, but only after a court order in proceedings initiated by an "owner of capital securities" in the subject corporation. This state of affairs quickly put the officials of the Commission into a powerless situation when no one, including the victims that suffered losses, attempted to seek remedial action even when shares sold to them by the controllers of Canada's sixth largest fishing company took place under circumstances that strongly suggest improper insider trading. (A point we have noted in our earlier discussion, investor-shareholders cannot be relied upon to assert their own legal rights.) As a result, the OSC through the ingenuity of its staff can only begin proceedings under s. 19(5) of the Old Act, based on the OSC's broad discretionary power to deny personal trading privileges in Ontario's Securities markets owing to alleged contraventions in the standards for insider trading and timely disclosure. Although the proposed use of the s. 19(5) power under the Old Act have been characterized by commentators as being imaginative and innovative, the situation essentially reflects the inability of the Ontario Securities Commission to enforce on behalf of victims their right to be compensated. The malpractice of insider trading is a matter which is affected with so much public interest that this shortcoming is promptly corrected, for the New Securities Act in section 132(1) enables the Commission to apply for permission to bring or continue an accountability action to enforce liability on behalf of victims.

However, a more exciting development took place in the context of going private transactions designed to eliminate public minority shareholders. In this context, the enforcement activities of the commission gradually shifted its concern from disclosure to the fairness of
issuers inviting the public to subscribe to their shares and subse­
quently designing a transaction for the purpose of eliminating the public
shareholders. 194

In the Cablecasting case 195 , a resolution was being submitted to the
shareholders of the company for confirmation by a 2/3 vote of a resolution
passed by the directors who were the controlling group, to amend the
company's articles. The effect of the amendment to the articles was to
permit the control group to cause the company to use its funds to redeem
the shares held by the public minority shareholders at a specific price and
thereby allowed the control group to wholly own the company. The matter
was challenged by minority shareholders. At the hearing before the
Commission, the Director of the Commission submitted to the Commission
that the Commission should prohibit the implementation of this re­
organisation unless it was approved by 2/3 of the votes cast, excluding the
votes held by the management control group. The Commission, for the first
time, imposed an extra condition not required by the Business Corporation
Act to authorize a corporate transaction in order to protect minority
interests. 196 In its decision, the Commission expresses the opinion that
"an application before the Commission can be processed more quickly and
cheaply than would a formal court proceeding on the same facts. To
conclude that availability to the applicant of a remedy in the courts
ousts the jurisdiction of the Commission would, in our view, be inconsistent
with the principles of the Securities Act. If a clear abuse of investors
is demonstrated, the Commission should not be forced to rely on a single
minority shareholder to initiate legal proceedings on behalf of all". 197

It is clear for the first time the Commission acknowledged the artificial
distinction between corporate law and securities regulations. It also
recognised the advantages of administrative procedures over the judicial process and seems to suggest that the Commission should play a more active role to safeguard the interest of public minority shareholders. Unfortunately, after making enlightening statements about its own role, the Commission quickly withdrew and insisted that it will use its power of a cease trading order only where a significant contravention of another statute can be expeditiously demonstrated.\footnote{198} Despite this, the imposition of the majority of the minority test remains a significant indication of the new role the Commission has assumed for itself.

Following this decision, the Commission formulated a new interim OSC policy No. 3-52 that officially endorsed the majority of the minority test in late 1980. The tenor of the wordings of the policy statement is indeed significant.

"The Commission is of the view that it is important, in order to maintain confidence in the integrity of the capital market, that adequate disclosure be made of complex and multi-step transactions. ... Certain complex business combinations are structured in such a manner that security holder approval is not required by the applicable statutes although the effect of the reorganisation or combination is akin to that of an amalgamation where security holder approval would clearly be acquired. Issuers should give serious consideration to providing security holders with an opportunity to approve the corporate restructuring contemplated. Where the possibility exists that management or a dominant security holder may be entitled to or be perceived to be entitled to some benefit or advantage as a result of the restructuring which is unavailable to other security holders, the Commission believes that approval of the majority of the "minority" security holders is appropriate for each issuer involved...." \footnote{199}

It is clear that the main thrust of this policy statement is that it has incorporated the element of fairness to guard against mismanagement, and established the Commission as the champion of minority rights. Such a development has however not gone unnoted or unopposed. The main objections are that, firstly, the expansion of the activities of the OSC
in this area intrude into corporate law. Secondly, there is an inexplicable resentment that the OSC would develop into a Canadian SEC, heavily involved in asserting the rights of public minority shareholders. Thirdly, the objections obtusely argue that existing courts and corporate legislation already provides "adequate remedies". (It must be noted that such "adequate remedies" are nothing more than existing legal rights of parties and frequently does not deal with issues of fairness). As to such arguments, James C. Bailie, Q.C., the Chairman of the Commission replies cautiously:

"We are sitting there, we have certain authorities and when a new kind of Corporate transaction comes along which seems to have serious policy implications, serious policy overtones, I guess I think that the Commission perhaps ought not to take complete shelter behind a nice distinction between corporate and securities laws, perhaps ought to ready to move very carefully and only after an opportunity for public debate and comment, which I think is the thrust of the Cablecasting decision". 200

Despite such overtly cautious public statement made by the Chairman, it is clear that the development in Ontario is to be welcome. The objective is not to displace the market but only to make a constrained market work better. The institutionalization of responsibility within market actors, such as corporate controllers, are clearly consistent with the aim of maintaining a fair and efficient capital market. Perhaps, this is also the only practical way to close the gap of regulation presently existing in Canada.
CONCLUSION

Traditional corporate rights and values which underlie existing Canadian corporate law are no longer able to define satisfactorily the relationship between those in control and those who are not. In the world of complex business and financial practices, fairness is becoming the ultimate criterion in which all corporate transactions and the behaviour of corporate controllers are to be judged. There is no regulatory agency in Canada, whether statutory or non-statutory that is able to respond to this development and translate this demand for fairness into effect. The securities regulations of Canada should take on such a task. I hope the thrust of this paper has convinced them that this is the role they should now play. This development together with other important developments, such as the development of a receptive judiciary sensitive to the needs of absentee owners, the codification of directors' duties and imposing upon them greater responsibilities, will serve in a substantial way to safeguard the interests of Canadian investor-shareholders.
PART I: FOOTNOTES


3. Supra, note 1, p. 22.


5. Ibid., p. 175.

6. Ibid., p. 177.

7. Ibid., p. 177.

8. Ibid.

9. Ibid., p. 179.


11. Ibid.


15. A. Berle: "Power Without Property, p. 73.


17. supra, note 13, p. 20.


21. Ibid., p. 5.

24. Ibid
26. Ibid.
30. See Footnote 17 of Professor Dodd's article, supra, note 2.
33. Eisenberg, supra, note 19, p. 31.
42. A.A. Berle Jr., supra, note 29, p. 71-72.
44. Ibid.

48. See e.g. p. 73, A. Berle: "The 20th Century Capitalist Revolution"; p. 110 Berle: "Power Without Property".

49. A. Berle, supra, note 15, p. 112.

50. Ibid.

51. Ibid., p. 111.

52. Ibid.


54. A. Berle, supra, note 15, p. 113.


56. Ibid., p. 739.

57. Ibid., p. 744

58. Ibid.

59. Ibid., p. 746

60. Ibid.

61. Ibid., p. 747


63. Ibid

64. Ibid., p. 1647.


4. See e.g. Ry v. Blaikie (1854) 1 Macq. H.L. 461 per Lord Cranworth L.C.


11. Ibid.

12. Iacobucci, supra, note 8, p. 312.


15. Ibid.


17. Ibid.


22. Douglas, supra, note 1, p. 73.


25. Ibid., p. 466.
28. Ibid., p. 590.
29. Ibid., p. 594.
30. Tom Hadden, supra note 26, p. 286.
33. Ibid., p. 45.
34. Supra, note 31.
35. See generally, J.A. Livingston: "The American Stockholder".
37. Livingston, supra, note 31, p. 33.
38. Ibid.
40. Kaplan, supra, note 3, p. 38.
42. See text accompanying note 46, supra.
43. Iacobucci, supra, note 8, p. 285.
44. Palmer, supra, note 10, p. 382.
45. Iacobucci, supra, note 8, p. 382.
46. Gower, supra, note 9, p. 582.
48. Ibid.
49. Alboini, supra, note 27, p. 589.
50. Ibid., p. 592.
51. See Footnote 28 and accompanying text in "Ontario Securities Law" by Alboini.


57. Ibid., p. 18.

58. Ibid., p. 19.

59. Ibid.

60. Ibid., p. 1


64. See e.g. Dean McLean: "The Theoretical Basis of the Trustee's Duty of Loyalty", 7 Alta. L.R. 1969.

65. Prentice, supra, note 61, p. 452.

66. Ibid.

67. Ibid.

68. Ibid.


70. Prentice, supra, note 61, p. 457.


72. Prentice, supra, note 61, p. 454.

73. Weinrib, supra, note 56, p. 15.

74. Gower, supra, note 9, p. 594.


78. Prentice, supra, note 61, p. 454.
79. Baxt, supra, note 75, p. 49.

80. For criticism, see p. 235-236, Stanley M. Beck, supra, note 63.
82. Beck, supra, note 63, p. 221.
83. Prentice, supra, note 61, p. 453.
84. Beck, supra, note 63, p. 220.
85. Weinrib, supra, note 56, p. 16.
86. Prentice, supra, note 61, p. 452.
87. Gower, supra, note 9, p. 596.
89. Ibid.
92. Prentice, supra, note 90, p. 627.
94. Gower, supra, note 9, p. 597.
97. Iacubucci, supra, note 8, p. 199.
100. Ibid., p. 12.
102. Ibid., p. 719.
103. Ibid., p. 720.
104. Para. 1151, Chapter 22, Wilson Committee on Financial Institutions.
106. Iacobucci, supra, note 8, 455.
109. Ibid., p. 182.
110. Alboini, supra, note 27, p. 718.
113. Bryan, supra, note 99, p. 3.
114. 219 F (2d) 173.
118. Ibid.
120. Ibid.
121. Alboini, supra, note 27, p. 719.
122. Ibid.
123. Rule 34(4) City Code.
124. See Rule 34(1) City Code.
126. Alboini, supra, note 27, p. 637.
128. Ibid., p. 2.
129. Ibid., p. 9.

131. Ibid., p. 239.


133. Hetherington, supra, note 130, p. 240.

134. Salter, supra, note 127, p. 25.

135. Ibid., p. 27.


140. Salter, supra, note 127, p. 29.

141. Calton Realty Company et al. v. Maple Leaf Mills Limited et al., (1978) 4 B.L.R. 300 (Ontario High Ct.).


143. Alboini, supra, note 27, p. 641.

144. Gower, supra, note 9, p. 709.

145. (1975) 7 O.R. 2d 98 (Ont. H.Ct.)

146. Salter, supra, note 127, p. 32.

147. Gower, supra, note 9, p. 717.

148. Ibid., p. 718.

149. Ibid.

150. Alboini, supra, note 27, p. 638.

151. Ibid., p. 630.


153. Gower, supra, note 9, p. 703.


155. Eisenburg, supra, note 2, p. 31.

156. Avner Mandelman: "The Invisible Hand, or The Corporate Acquisitor

157. 1907 1 Ch. 5.

158. Gower, supra, note 9, p. 698.

159. Ibid. p. 699; S.58 of the Alberta Securities Act makes express provision for such persuasion (at the expense of the Company, by allowing the directors jointly or individually to send to the shareholders a circular with their recommendations. (see p. 454, Iacobucci: Canadian Business Corporations).


162. Ibid.

163. Ibid.

164. Pg. 594, Ibid.

165. Ibid.

166. Pg. 595, Ibid.

167. Ibid.


173. Ibid.

174. Ibid., p. 291.

175. Alboini, supra, note 27, p. 678.


177. Eisenberg, supra, note 2, p. 33.


179. See Form 31 and 32 of Ontario Securities Regulation.


181. Gower, supra, note 9, p. 704.
182. Ibid.

183. For exact wording of the provision see Ontario Securities Regulations.

184. Gower, supra, note 9, p. 705.


186. Ibid., p. 156.

187. Ibid.

188. Iacobucci, supra, note 8, p. 318.

189. See United Kingdom Companies Act, 1948, ss. 191-194.

190. Gower, supra, note 9, p. 705.

191. See supra, note 189.

192. Kaplan, supra, note 3, p. 44.


194. Iacobucci, supra, note 8, p. 343.


197. Iacobucci, supra, note 8, p. 343.


199. Ibid.

200. Ibid.


202. Ibid.

203. Leon Getz, supra, note 46, p. 57.

204. Ibid., p. 60.

205. Ibid.

206. Ibid.

207. Ibid.

208. It was so held in the case of Percival v. Wright (1902) 2 Ch. 421.


211. (1967) 2 A.C. 46.


218. Ibid.

219. Ibid., p. 343.


PART III: FOOTNOTES


3. Supra, note 310, p. 252.


6. See earlier discussion at p.61 of this paper.


8. Finley, supra, note 1, p. 256.

9. Ibid.

10. Ibid., 257.

11. Ibid.

12. Ibid.


14. Ibid.

15. L. Getz: "The Structure of Shareholder Democracy", Chapter 6 in Ziegel: Canadian Company Law, vol. II.


17. Ibid.

18. Ibid., p. 29.

19. Ibid., p. 32.

20. Ibid.

21. Ibid.


23. Ibid.


25. Ibid.


32. Ibid., p. 785.


34. Anderson, supra, note 22, p. 786.


37. Ibid., p. 182.

38. See generally, J.A.C. Hetherington, supra, note 29.


40. Ibid.


42. Ibid.


44. (1892) A.C. 25 H.L.


48. Ibid., p. 170.

49. Ibid.

50. Ibid.


56. Louis Loss: Securities Regulation, p. 79.


58. Ibid., p. 528.


63. 213 U.S. 419, 29 S. Ct. 521.

64. Supra, note 53, p. 142.


67. Supra, note 53, p. 351.

68. (1972) 29 D.L.R. (3d) 279 (Ont. H. Ct.)

69. 250 U.S. 483 (1919).


72. Supra, note 69, p. 614.

73. 219 F. 2d 173 C.A. 2d Cir. 1955.


75. Ibid.

77. Ibid.
78. Ibid.
79. Supra, note 65, p. 350.
80. Ibid.
81. 401 F. 2d 833 (2d Cir. 1968).
83. (1968) 4 Ont. F. (2d) 833.
84. Supra, note 82, p. 491.
85. Ibid.
86. Ibid.
87. Ibid.
89. See SEC v. Texas Gulf Sulphur 401 F.2d 833 (2d Cir. 1968) at p.862 per Judge Waterman.
92. Supra, note 90, p. 591.
94. Ibid.
95. Ibid, p. 320.
96. 193 Fd. 461 (2d. Cir.).
100. Ibid., p. 15.
101. 399 F 2d. 24 (2 Cir.) (1964).
103. Sheward, supra, note 97, p. 1392.
105. Sheward, supra, note 97, p. 1392.
107. 384 F 2d 540, (2d Cir.).
110. 405 F 2d 200 (2d Cir.).
111. Sheward, supra, note 97, p. 1394.
112. Ibid., p. 1395.
114. Ibid.
115. 464 F 2d 714, (2d Cir. 1972).
116. Sheward, supra, note 97, p. 1398.
117. Ibid., p. 1400.
118. 97. Supreme Court 1292 (1977).
120. Bloomenthal, supra, note 51, p. 11-63.
121. Sheward, supra, note 97, p. 1391.
123. Ibid.
124. Ibid., p. 23.
125. Ibid.
126. Ibid.
128. See Hetherington, supra, note 29, p. 211 to 222.
129. Ibid., p. 217.
130. Ibid.
131. Tom Hadden: "Company Law and Capitalism", p. 360


134. Ibid.

135. Ibid.


138. Ibid.


140. Ibid., p. 106.

141. P. 557, supra note 133.

142. Para. 1151, note 137, supra.

143. Ibid., Para. 1153.


145. Para. 52, supra, note 137.

146. Para. 1183, supra, note 136.

147. Para. 1184, ibid.

148. See The Times, Tuesday, October 7th, 1980, Hugh Stephenson: "Keeping Watch on the Watchdogs"; and The Times, Tuesday, October 14th, 1980, Hugh Stephenson: "Self-Regulation: A Return to the Fray".

149. Stamp and Marley: "Accounting Principles and the City Code", p. 32.

150. Ibid., p. 43.

151. Gower, supra, note 9, p. 671.


153. Gower, supra, note 151, p. 672.

154. Ibid., p. 673.

155. Supra, note 144, p. 354.


158. Ibid., p. 12.


160. B.v. Slutsky: "The Division of Power Between the Board of Directors and the General Meeting", Chapter 4 of Ziegel: "Canadian Company Law", Vol.II.


162. Ibid.

163. 1902, 2 ch. 421.

164. (1962) 248 N.E. 2d. 910, NYCA.

165. Supra, note 9, p. 631.

166. Weinrib, supra, note 43, p. 15.

167. Ibid.


169. Para. 52, supra, note 137.


171. Para. 33, supra, note 137.

172. Unfortunately, the exact legal status of such policy statements is still subject to controversies.


177. Ibid.

178. Ibid., p. 20.

179. Gower, supra, note 9, p. 641.

180. See for example, Sask. Business Corporations Act, ss. 232-235. S235 abrogates the rule that approval of a majority of the Shareholders prevents a successful action.

182. Ross, supra, note 70, p. 396.


185. Kaplan, supra, note 183, p. 53.

186. Ibid.


189. See earlier discussion on Sale of Control at A Premium.

190. Supra, note 157, p. 158.


197. Supra, note 196, p. 41.

198. Ibid., p. 42.


200. Supra, note 196, p. 286.


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