

# Addressing the Tension between Directors' Duties and Shareholder Rights - A Tale of Two Regimes

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# Addressing the Tension between Directors' Duties and Shareholder Rights - A Tale of Two Regimes

## **Abstract**

There is a basic tension inherent in the regulation of corporations between the role to be played by boards and that to be played by shareholders. Boards have the statutory responsibility to manage the business and affairs of the corporation, and owe an express duty to act in the best interests of the corporation. Shareholders, however, are the ultimate 'owners' of the corporation, and have the ability to elect and remove directors. Canadian courts and securities regulators have long struggled with this tension in determining the roles to be played by each in transactions that pose the potential for conflicts between and among boards and shareholders, such as transactions involving controlling shareholders or contested change of control transactions. For a number of reasons the Canadian regulatory regime has developed a shareholder-centric model, which tends to foster an emphasis on process and shareholder rights, and stands in sharp contrast to the American regime and its nuanced approach to director duties. We suggest that the way in which the Canadian regulatory regime has developed has displaced important corporate law concepts, negatively impacting the role to be played by boards and leading to shortcomings that have manifested themselves in a number of recent high-profile cases. Our suggestion is a fundamental reconsideration of policy orientation.

## **Keywords**

Corporation law; Corporations--Investor relations; Directors of corporations--Legal status; laws; etc.; Canada

## Addressing the Tension between Directors' Duties and Shareholder Rights—A Tale of Two Regimes

SEAN VANDERPOL \* & EDWARD J. WAITZER \*\*

There is a basic tension inherent in the regulation of corporations between the role to be played by boards and that to be played by shareholders. Boards have the statutory responsibility to manage the business and affairs of the corporation, and owe an express duty to act in the best interests of the corporation. Shareholders, however, are the ultimate 'owners' of the corporation, and have the ability to elect and remove directors. Canadian courts and securities regulators have long struggled with this tension in determining the roles to be played by each in transactions that pose the potential for conflicts between and among boards and shareholders, such as transactions involving controlling shareholders or contested change of control transactions. For a number of reasons the Canadian regulatory regime has developed a shareholder-centric model, which tends to foster an emphasis on process and shareholder rights, and stands in sharp contrast to the American regime and its nuanced approach to director duties. We suggest that the way in which the Canadian regulatory regime has developed has displaced important corporate law concepts, negatively impacting the role to be played by boards and leading to shortcomings that have manifested themselves in a number of recent high-profile cases. Our suggestion is a fundamental reconsideration of policy orientation.

Il existe une tension fondamentale inhérente à la réglementation des sociétés entre le rôle du conseil d'administration et celui des actionnaires. Le conseil a la responsabilité légale de gérer l'entreprise et ses affaires, ainsi que l'obligation expresse d'agir dans le meilleur intérêt de cette dernière. Cependant, les actionnaires sont en fin de compte propriétaires de l'entreprise et ils ont le pouvoir d'élire et de révoquer les administrateurs. Les tribunaux canadiens et les organismes de réglementation des valeurs mobilières doivent depuis longtemps composer avec cette tension pour déterminer le rôle que chacun doit jouer dans les transactions qui présentent une possibilité de conflits entre le conseil et les

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actionnaires, notamment les transactions touchant les actionnaires dominants ou les transactions touchant un changement contesté de contrôle. Pour un certain nombre de raisons, le régime de réglementation canadien a élaboré un modèle axé sur l'actionnaire, qui tend à mettre l'accent sur la procédure établie et les droits des actionnaires, et se démarque fortement du système américain et de son approche nuancée envers les devoirs de l'administrateur. Nous suggérons que la manière dont le régime de réglementation canadien s'est développé a mis de côté d'importants concepts du droit des sociétés, ce qui a une incidence négative sur le rôle que doit jouer le conseil et mène à des lacunes qui se sont manifestées dans un certain nombre de cas récents très médiatisés. Nous suggérons un réexamen fondamental de l'orientation des politiques.

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**THERE IS A BASIC TENSION** inherent in the regulation of corporations between the role to be played by boards and that to be played by shareholders. In North America, this tension has been substantially influenced by the relative prevalence of securities regulation or corporate law. In this regard, the United States and Canada, while sharing a basic legal framework, have gone down very different paths.

Shareholders are the ultimate 'owners' of the corporation, entitled to receive the residual profits and assets. They elect the board of directors and, under Canadian corporate law, also have the ability to remove them. However, shareholders have little direct involvement in or responsibility for the day-to-day management of the corporation and generally owe no duties in connection with their actions as shareholders. Boards, on the other hand, have the express statutory authority to manage the business and affairs of the corporation, and they have the duty to do so with a view to the corporation's best interests.

The different roles allocated to boards and shareholders lead to potential conflicts that manifest themselves in a number of areas. Contested change-of-control transactions and non-arm's length transactions are two obvious examples, but the basic tension is systemic, and it is also evident in areas such as proxy access, executive compensation policies, and dilutive acquisition transactions. For a number of reasons, the Canadian regulatory regime for public companies—

which is a mix of corporate law and securities regulation—has tended to favour shareholder choice and primacy by enacting specific rules and policies designed to emphasize and protect the rights of shareholders (versus emphasizing the responsibility of boards). The Canadian regulatory regime can be contrasted with that in the United States where—despite efforts of the US Securities and Exchange Commission (SEC) and, through it, the stock exchanges—these issues have primarily been the purview of corporate law. Corporate law has been used to impose corporate governance standards, which generally tends to emphasize the prerogatives of the board of directors and the board's concomitant responsibility to the corporation and its shareholders.

As Canadian corporate law and securities regulation have evolved, the distinction between the roles to be played by shareholders and by boards has been sharpened. This change has brought into focus a growing tension between corporate law and securities regulators. Corporate law imposes statutory duties on directors and officers; securities regulators, in addition to prescribing procedural standards to protect and empower shareholders, have invoked their broad “public interest”<sup>1</sup> jurisdiction to interpret duties owed by directors and controlling shareholders.

In the United States, the shareholder-centric versus director-centric debate has been both explicit and dynamic. In contrast, there has been relatively little debate in Canada until recently. Rather, the shift from a director-centric to a more shareholder-centric model has been a function of securities regulators occupying the field. We suggest that by providing complainants with a flexible and relatively quick process for adjudicating broadly framed “public interest” issues, Canadian securities regulators have displaced corporate law and its focus on the statutory duties of directors. This process has led to the creation of a self-reinforcing cycle. The securities regulators, which have the explicit goals of protecting investors and fostering fair and efficient capital markets, focus on the interests of shareholders and act to redress shareholder complaints by empowering them. The consequence has been the limitation of board authority and responsibility, with boards being either limited in their ability to manage the business and affairs of the corporation (as is often the case in contested change-of-control transactions) or functionally sidelined (as is arguably the case in related-party transactions). This has in turn limited the development of Canadian corporate law and of the judicial competence required to effectively oversee the statutory duties of directors. The marginalization of corporate law in this area has led complainants to

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1. *Securities Act*, RSO 1960, c 363, s 127 [Act].

continue to engage and appear in proceedings before the regulators, as opposed to the courts, and to frame complaints in terms of the “public interest” and shareholder rights as opposed to the statutory duties of directors. We suggest that this displacement of corporate law and consequential shift to a shareholder-centric model has left important questions or concepts of responsibility and authority unanswered or unexplored.

The regulation of public companies is complex and requires balancing the interests of multiple groups, each of whom have a different stake in the corporation. Securities regulation has empowered individual shareholders, but it has not solved (among other issues) the problem of effective collective action by those shareholders. It has also failed to address concerns relating to formal responsibility and accountability for shareholder decision making with regard to either the minority shareholders or other stakeholders in the corporation. Corporate law, in turn, has not developed meaningful mechanisms for overseeing the conduct of boards and the discharge of their responsibility to manage the business and affairs of the corporation. The Canadian regulatory framework has illustrated some of these shortcomings in a number of recent high-profile cases.

To begin, we compare how the Canadian and American regimes operate in the context of similar transactions involving controlling shareholders. We discuss the recent decisions of the Delaware Chancery Court in *In re Southern Peru Copper Corporation Shareholder Derivative Litigation*<sup>2</sup> and of the Ontario Securities Commission (the “Commission”) and Ontario courts in *Re Magna International Inc.*<sup>3</sup> We then contrast the general development of the American and Canadian regulatory regimes for public companies, particularly in the context of transactions involving related parties or controlling shareholders. We conclude with a recommendation that it is time for a fundamental re-examination of the policy orientation in Canada.

## I. A STUDY IN CONTRASTS: SOUTHERN PERU VERSUS MAGNA

The differences between the United States and Canadian regulatory regimes are well illustrated by comparing and contrasting the recent decision of the Delaware

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2. 30 A (3d) 60, 2011 Del Ch LEXIS 162 [*Southern Peru*]. This judgment was affirmed by the Delaware Supreme Court in *Americas Mining Corporation v Michael Theriault*, 2012 Del LEXIS 459.

3. (2010), 33 OSC Bull 6013, 72 BLR (4th) 235. For the additional reasons, see (2010) 34 OSC Bull 1290, 78 BLR (4th) 94 [*Magna*, Commission Reasons], affd 2010 ONSC 4123, 101 OR (3d) 736 [*Magna*, Sup Ct], affd 2010 ONSC 4685, 101 OR (3d) 721 [*Magna*, Div Ct].

Chancery Court in *Southern Peru* with the decisions of the Commission and the Ontario Superior Court in *Re Magna International Inc.*

#### A. SOUTHERN PERU COPPER CORPORATION

Southern Peru Copper Corporation (“Southern Peru”) is a NYSE-listed mining company. In February 2004, its controlling stockholder, Grupo Mexico, S.A.B. de C.V. (Grupo Mexico), proposed a transaction under which Southern Peru would buy from Grupo Mexico its 99.15% stake in Minera Mexico, S.A. de C.V. (Minera), which was not a publicly listed company.<sup>4</sup> Grupo Mexico initially proposed that Southern Peru purchase Grupo Mexico’s equity interest in Minera in exchange for 72.3 million shares of Southern Peru, which at the time had a market value of approximately 3.05 billion US dollars (“USD”). Southern Peru formed a special committee of disinterested directors to evaluate the transaction.<sup>5</sup> The special committee retained preeminent financial and legal advisors. After eight months of discussions, the special committee approved the acquisition of Minera from Grupo Mexico in exchange for 67.2 million newly-issued shares of Southern Peru. At the time the transaction was approved by Southern Peru, these shares had a market value of approximately 3.1 billion USD, essentially the price initially proposed by Grupo Mexico for its interest in Minera. Southern Peru received a fairness opinion from its financial advisor to the effect that the transaction was fair from a financial perspective to the stockholders of Southern Peru and submitted the transaction for approval by its shareholders. Conditioned on a super-majority (as opposed to majority of the minority) vote, the transaction was ultimately approved, with more than 90% of the stockholders voting in favour of the transaction.<sup>6</sup>

When the transaction with Grupo Mexico closed on 1 April 2005, the market value of the shares to be issued by Southern Peru in exchange for Minera had

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4. At the time, Southern Peru had two classes of stock: publicly traded common shares and “Founders Shares” that were owned by Grupo Mexico, as well as by Cerro Trading Company, Inc. and Phelps Dodge Corporation. Each Founders Share had five votes per share, as compared to the one vote per share for the common stock. Grupo Mexico owned 43.3 million Founders Shares, which translated into 54.17% of Southern Peru’s outstanding capital stock and 63.08% of the voting power. Grupo Mexico also had the right to nominate a majority of the Southern Peru board.
  5. The mandate of the special committee formed by Southern Peru was to evaluate the transaction proposed by Grupo Mexico. Chancellor Strine noted that the special committee was not expressly empowered to negotiate the transaction and that it was not authorized to explore other strategic alternatives. *Southern Peru*, *supra* note 2 at 2.
  6. *Ibid* at 69.

increased to approximately 3.75 billion USD. Following the closing of the transaction, a representative plaintiff for the Theriault Trust sued the Grupo Mexico subsidiary that owned Minera, the Grupo Mexico-affiliated directors of Southern Peru, and the members of the special committee of Southern Peru. The plaintiff alleged that the transaction was unfair to Southern Peru and its minority stockholders. In other words, the plaintiff alleged that Minera was not worth what Southern Peru had agreed to pay for it.<sup>7</sup>

Under well-developed Delaware law, this transaction was evaluated on the “entire fairness” standard.<sup>8</sup> This standard has two basic aspects: fair dealing and fair price. The first requires an examination of the process by which the transaction was initiated, negotiated, and approved, while the second requires an analysis of whether the consideration was substantively fair.<sup>9</sup> Although the test has two aspects, the analysis is not bifurcated. As noted by Chancellor Strine, “[T]he court ‘determines entire fairness based on all aspects of the entire transaction.’”<sup>10</sup> In non-fraudulent transactions, however, price can be a preponderant consideration: Fair dealing may help to demonstrate a fair price, but what ultimately matters the most is that there is a fair price. The obvious corollary is that transactions that are not substantively fair will not be saved by virtue of the process followed.

After detailed and careful scrutiny of both the process by which the transaction was negotiated and approved and the price that was paid, Chancellor Strine determined that the transaction was not fair. He concluded that the special committee went fundamentally awry by allowing Grupo Mexico to dictate the terms and structure of the transaction, which foreclosed a meaningful consideration of alternatives that would have either generated a real market check or allowed it leverage to negotiate better terms.<sup>11</sup> By allowing themselves to be constrained by the controlling stockholder’s demands, the special committee ultimately focused on trying to justify the terms of the transaction as proposed by Grupo Mexico instead of undertaking a meaningful analysis of whether Southern Peru ought to pursue the transaction at all. This focus hindered Southern Peru’s negotiating strength and posture. Chancellor Strine concluded that the special committee

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7. *Ibid* at 6.

8. *Ibid* at 93, 104-05.

9. *William B Weinberger v UOP, Inc*, 457 A 2d 701, 1983 Del Ch LEXIS 371 [*Weinberger*].

10. *Southern Peru*, *supra* note 2 at 88, citing *In re John Q Hammons Hotels Inc Shareholder Litigation*, 2009 Del Ch LEXIS 174 at para 44, WL 3165613 [*Hammons*].

11. Chancellor Strine noted, for example, that the special committee never seemed to consider the possibility of suggesting that Grupo Mexico purchase Southern Peru, which could have altered the deal dynamics in a way that gave the special committee leverage. *Southern Peru*, *supra* note 2 at 73.

was trapped in a “controlled mindset”<sup>12</sup> where the only options to be considered were those proposed by the controlling shareholder, observing that, “[e]ven if the practical reality is that the controlling [share]holder has the power to reject any alternate proposal it does not support, the special committee still benefits from a full exploration of its options.”<sup>13</sup>

Chancellor Strine found that this fundamentally misguided orientation of the special committee manifested itself when the financial advisor to Southern Peru was initially unable to value Minera at a level that approximated Grupo Mexico’s asking price. Rather than causing the special committee to make a strong response to the initial offer, the special committee and its financial advisor undertook a strenuous attempt to “equalize” the value of Minera and Southern Peru, ultimately devaluing Southern Peru and writing up the value of Minera in order to justify the asking price put forward by the controlling stockholder.<sup>14</sup>

In a lengthy and detailed review of the valuation exercises undertaken by the special committee and its financial advisor, Chancellor Strine concluded that the special committee’s actions were not consistent with its fiduciary duties or with how an arm’s length third party would act.<sup>15</sup> Rather than seeking to maximize credit for the value of the Southern Peru stock to be issued as part of the transaction, the special committee ended up trying to rationalize a relatively greater value for Minera while discounting the otherwise market-tested value of Southern Peru’s stock. In the result, Chancellor Strine found that the special committee agreed to “give away” stock with an actual value of over 3 billion USD in exchange for something worth demonstrably less; moreover, it did so on terms (*i.e.*, an agreement to issue a fixed number of shares of Southern Peru stock, as opposed to a floating number based on the market price of Southern Peru stock) that made the value gap substantially worse by the time it closed.<sup>16</sup> As a consequence, Chancellor Strine awarded damages of 1.26 billion USD against the controlling shareholder and its nominee directors on the Southern Peru board. Chancellor Strine determined that this compensation would approximate value in a “fair” transaction.<sup>17</sup>

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12. *Ibid* at 111.

13. *Ibid* at 100.

14. *Ibid* at 101.

15. *Ibid* at 160.

16. *Ibid* at 113.

17. Members of the special committee were insulated from liability because of an exculpatory provision in the company’s charter, as is permitted under Delaware corporate law.

## B. THE MAGNA PROCEEDINGS

In 2010, the board of Magna International Inc. (Magna) submitted to shareholders a plan of arrangement under the Ontario *Business Corporations Act*, the effect of which was to collapse the dual class share structure through which Frank Stronach (Magna's founder and then-Chair) had exercised control over the company since 1978. In return for incurring an unprecedented 11.4% dilution of their equity, the subordinate voting Class A Shares—which carried one vote each, did not have “coat-tail” protection (*i.e.*, a mechanism designed to allow the subordinate voting shares to participate in a premium offer for the high voting shares), and were not subject to a “sunset” provision—were converted into a single class of Common Shares. Mr. Stronach's Class B Shares, carrying 300 votes each, were eliminated. Based on the market price of the Class A Shares immediately before the proposed transaction was announced, Mr. Stronach obtained a premium of approximately 1,800% in exchange for giving up control of Magna. The terms of the transaction were substantially negotiated between management and Mr. Stronach prior to the involvement of the board or the special committee. The transaction was structured to be conditional on minority shareholder approval, which was obtained by a decisive 75% majority (80.4% of the issued Class A Shares were represented and voting at the meeting). Mr. Stronach made it clear to the special committee that if shareholders chose to reject the proposed transaction, he would be happy to preserve the status quo.<sup>18</sup>

A number of major Canadian pension funds opposed the transaction,<sup>19</sup> initially by supporting a Commission Staff application to the Commission to cease-trade it on the basis that it was contrary to the public interest. They later intervened in proceedings before the Ontario Superior Court to dispute the fairness and reasonableness of the plan of arrangement.<sup>20</sup> In contrast, a majority

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18. *Magna*, Div Ct, *supra* note 3 at para 28-30.

19. The Ontario Teachers' Pension Plan acquired a single share so that it could have standing at the Commission hearing and be a complainant/appellant in the judicial proceedings, presumably reflecting a concern as to the precedential impact of the transaction.

20. It is interesting to note that the opposing shareholders did not seek relief under the statutory oppression remedy, presumably because, among other things, it imposes the initial burden on the complaining party (rather than the controlling shareholder or the board) to challenge the fairness of the transaction. In contrast, under an “entire fairness” review in Delaware, it is the board that bears the burden of establishing that the impugned transaction is entirely fair, although it can shift this burden if certain procedural protections have been put in place. Moreover, in a previous oppression application that had been brought against Mr. Stronach in connection with a related company, the Ontario Superior Court had shown deference to the decisions of the board: “[T]he court only requires that the directors make a decision

of the minority shareholders were involved in proposing the transaction to Mr. Stronach and committed (with him) to vote in its favour. Between the announcement of the proposed transaction on 6 May 2010 and the end of that month, Magna's Class A Share price increased by 7.9%.<sup>21</sup> Two months after the announcement the price was still up 6.9%, despite declines of 4% in the S&P/TSX Index, 9.1% in the S&P 500 Index, and 13.5% in the stock prices of Magna's US comparables.<sup>22</sup>

The Commission held a two-day hearing, the bulk of which was taken up with argument by the parties, including Commission Staff. Shortly afterward it determined that, while the disclosure in the proxy circular that Magna had submitted to its shareholders was inadequate, "once the issue of adequate disclosure was addressed, there were no valid grounds for us to conclude in the circumstances that the Proposed Transaction was abusive of Class A Shareholders or should be restrained on other grounds."<sup>23</sup> The Commission noted, however, that had shareholder approval not been a pre-condition for the transaction, "we have little doubt that we would have restrained it as an abusive related-party transaction."<sup>24</sup> While the Commission noted that "[i]t is clear from Commission decisions that any view or perception that we may have as to the possible unfairness of a transaction is not a sufficient ground upon which we can or should intervene in the public

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which is within a range of reasonableness and the courts will not interfere with the selection by the directors of one of several reasonable alternatives." *Greenlight Capital Inc v Stronach* (2006), 22 BLR (4th) 11 at para 30, 152 ACWS (3d) 616 (Ont Sup Ct), aff'd (2008), 91 OR (3d) 241, 47 BLR (4th) 215 (Div Ct).

21. Magna International Inc. Management Information Circular/Proxy Statement (May 31, 2010) at 35. The increase occurred despite significant declines in equity markets and, in particular, comparable U.S. companies. It was argued that a portion of the increase in share price was attributable to the contemporaneous announcement of favourable results and a dividend. See Edward Iacobucci, "Making Sense of Magna" (2011) 49:2 Osgoode Hall LJ 237. Iacobucci, while finding faults in the process, endorsed the outcome on the basis that informed minority shareholder approval was not likely affected by the procedural defects he identified (*ibid* at 271-72).
22. *Magna*, Sup Ct, *supra* note 3 at para 84.
23. *Ibid*; *Magna*, Commission Reasons, *supra* note 3 at para 193. It should be noted that the Commission released its written reasons approximately six months after its decision and well after the court fairness hearing and judicial review thereof.
24. *Magna*, Sup Ct, *supra* note 3 at para 190. It also concluded, however, that the proposed transaction did not contravene Multilateral Instrument 61-101, the securities rule that otherwise governs related-party transactions. The Commission thus concluded that the proposed transaction was not contrary to any established securities laws or regulations. The Commission's substantive review was based solely on its "public interest" jurisdiction.

interest,”<sup>25</sup> it also observed that, if a transaction is abusive of shareholders or the capital markets, “then shareholder approval will not be sufficient.”<sup>26</sup>

The Commission rejected arguments that the Magna board had failed to comply with its fiduciary duties, noting, “We have no reason to believe that by submitting the Proposed Transaction to shareholders for their consideration in these circumstances, the Magna board or special committee improperly delegated that decision to shareholders or thereby breached their fiduciary duties.”<sup>27</sup> Finally, while the Commission was highly critical of the process followed by the Magna board and special committee—declaring that “... the Special Committee process appears to have been tainted by the involvement of executive management at the start of and during the process, and the Special Committee’s mandate and terms of reference were too narrow and fundamentally flawed”<sup>28</sup>—it concluded that it did not have sufficient grounds to justify intervening in the transaction on that basis.<sup>29</sup> In the result, an amended proxy circular containing an unprecedented level of disclosure was submitted to shareholders prior to the vote, and a subsequent “fairness hearing” was held before Justice Wilton-Siegel of the Ontario Superior Court.<sup>30</sup> In the court’s decision on the fairness and reasonableness of the proposed plan of arrangement, Justice Wilton-Siegel applied the principles established by the Supreme Court of Canada in *BCE*,<sup>31</sup> noting that:

[T]he court must focus on the terms and impact of the arrangement itself, rather than on the process by which it was reached. ... [T]he corporation [seeking approval] bears the onus of satisfying the court that: (1) the statutory procedures have been met; (2) the application has been put forward in good faith; and (3) the arrangement is fair and reasonable ...<sup>32</sup>

The court rejected the notion that the directors owed a duty to the Class A shareholders, as distinct from Magna:

There is no such duty under corporate law in a related party transaction, however desirable such a requirement might be. In allowing the transaction to be put before

25. *Ibid* at para 193.

26. *Ibid* at para 195.

27. *Ibid* at para 201.

28. *Ibid* at para 226.

29. *Ibid* at para 228.

30. *Magna*, Sup Ct, *supra* note 3.

31. *BCE v 1976 Debentureholders*, 2008 SCC 69, [2008] 3 SCR 560 [*BCE*]. It should be noted that commercial courts (including the Supreme Court of Canada in *BCE*) have often evidenced their responsiveness to the exigencies of markets by expediting the hearing and resolution of corporate disputes.

32. *Magna*, Sup Ct, *supra* note 3 at para 101, citing *BCE*, *ibid* at paras 136-37.

the Class A shareholders, the OSC Panel also determined that no such obligation existed under securities law.<sup>33</sup>

Ultimately, the court determined that the Class A shareholder vote could reasonably be regarded as a proxy for the substantive (as opposed to procedural) fairness and reasonableness of the arrangement. It noted that, in concluding that the business judgment rule is not useful in the context of statutory arrangements, the Court in *BCE* “actually reinforced the need to rely on the outcome of a shareholder vote in appropriate circumstances.”<sup>34</sup> Hence, while unable to make its own factual determination, the court ruled that Magna had satisfied the requirements of the “fair and reasonable” test under the criteria set out in *BCE* and approved the proposed transaction. An appeal to the Divisional Court was dismissed unanimously.<sup>35</sup>

### C. DIFFERING APPROACHES AND RELATIVE INSTITUTIONAL COMPETENCIES

While the facts in *Southern Peru* and *Magna* differ,<sup>36</sup> the contrasting results exemplify the divergent regulatory regimes in Canada and the United States and the different approaches taken to broadly similar questions. In the United States the issue of related-party transactions is ultimately within the purview of corporate law and proceeds from a principled examination of whether the board has discharged its fiduciary duties. The analysis requires an examination of not only whether the process followed was fair but, more critically, whether the ultimate result was fair. As illustrated by *Southern Peru*, this is a substantive analysis, which allows a nuanced review of board and shareholder conduct and can offer minority shareholders substantial protection.

By contrast, in *Magna* the focus was less on the substantive merits of the transaction and more on the nature of its approval by shareholders. The approach of the Commission, which was framed on the one hand by the specific rules of Multilateral Instrument 61-101<sup>37</sup> and on the other by a broad but not clearly defined

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33. *Magna*, Sup Ct, *supra* note 3 at para 149.

34. *Ibid* at para 162.

35. *Magna*, Div Ct, *supra* note 3 at para 79.

36. For example, in *Magna* the transaction was conditioned on approval by a majority of the minority shareholders. Also, *Southern Peru* featured a more classic “zero sum” transaction, whereas it is arguable that in *Magna* both the Class A shareholders and the Stronach family interests were able to benefit from the transaction, even if the relative shares of the benefit were disputable.

37. *Protection of Minority Security Holders in Special Transactions*, OSC MI 61-101, 31 OSCB 1321 (1 February 2008) [Multilateral Instrument 61-101].

“public interest” jurisdiction, seems to have admitted a “principle” gap—the lack of a clear basis on which to review the substantive merits of the transaction.<sup>38</sup> Hence, its analysis was largely confined to one of disclosure and procedure, with the emphasis being on the nature and quality of shareholder approval. Similarly, at the court, the question of substantive fairness was ultimately collapsed into the question of whether a sufficient majority of shareholders had approved the transaction on a fully informed basis.

The approach taken in *Magna* is, we suggest, a function of how the Canadian regulatory regime in respect of related-party transactions has developed and the way in which the “public interest” jurisdiction of the Canadian securities regulators has displaced the development of corporate law concepts. The emphasis by the Commission on the protection of shareholder rights, and the concomitant bias toward the empowerment of shareholders as compared to boards, has diminished the role of boards of directors in related-party transactions.<sup>39</sup> As a consequence, Canadian courts have simply not developed nuanced judicial doctrines for reviewing transactions involving related parties in public companies. The “public interest” jurisdiction of securities regulators has not adequately filled this gap.

Elsewhere, we have described similar displacement effects with respect to the regulation of takeover defensive tactics.<sup>40</sup> Until the Commission’s decision in *Re Canadian Tire Corp.*,<sup>41</sup> the respective roles of the Commission and the courts were relatively clearly defined—the Commission was essentially restricted to granting exemptive relief and to acting as a complainant before the courts. Since 1987,

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38. As Iacobucci notes, this gap may well be the state of the law following the Court’s decision in *BCE*, which effectively gives boards wide and unguided discretion. Iacobucci, *supra* note 21 at 267.

39. Of course, it can be argued that shareholders ultimately bear the consequences of their choices, and so should have the ability to decide their fate. This fails to distinguish, however, between individual shareholders and the shareholders as a body. More fundamentally, it also glosses over the distinction between the best interests of the corporation and the best interests of (individual) shareholders. The board of directors owes a duty to act in the best interests of the corporation itself. Shareholders, on the other hand, act in their own interests. If it is the shareholders that ultimately manage the business and affairs of the corporation, then the issues of collective action (and collective responsibility) will need to be addressed.

40. Sean Vanderpol & Ed Waitzer, “Mediating Rights and Responsibilities in Control Transactions” (2010) 48 Osgoode Hall LJ 639.

41. (1987), 10 OSC Bull 857, 35 BLR 56 [*Re Canadian Tire*], aff’d sub nom *CTC Dealer Holdings Ltd v Ontario Securities Commission*, (1987), 37 DLR (4th) 94, 59 OR (2d) 79. In this case, the OSC used its cease-trade power without finding a breach of the *Act*, regulations or policy statements “to deal with situations that are inconsistent with the best interests of investors or where a transaction constitutes a flagrant abuse of the marketplace” (*Re Canadian Tire, ibid* at 929).

however, the Commission and the courts have exercised substantial and often overlapping powers. Not surprisingly, the Commission has been viewed as having particular expertise. Similarly, it enjoys procedural flexibility that may offer advantages when quick decisions must be made based on limited evidence and argument. Conversely, the Commission's expertise and procedural flexibility leave it more susceptible to the risks inherent in quick decisions rendered as events are unfolding. In contrast, courts tend to deal with issues slowly and after the fact. Their decisions are informed by a disciplined evidentiary process and assume prospective significance.

The Commission's ability to determine whether and when it will entertain applications for relief and the Commission Staff's ability to initiate applications and intervene of their own accord have proven potent instruments to give effect to the policy biases of Canadian securities regulation. One example is *National Policy 62-202 – Take-Over Bids – Defensive Tactics*, which states that “[t]he primary objective of the take-over bid provisions of Canadian securities legislation is the protection of the bona fide interests of the shareholders of the target company.”<sup>42</sup> In the case of contested control transactions, the result has been a long line of decisions by Canadian securities regulators establishing that it is the shareholders, rather than the board of directors, who decide whether a corporation is for sale. Even if the board decides to implement defensive tactics, Canadian securities regulators will typically override the business judgment of the board in short order (70 to 90 days) in order to allow shareholders to decide on the proposed transaction.<sup>43</sup> While there are grounds to argue that this approach is inconsistent with the duties and authority granted to boards under Canadian corporate law,<sup>44</sup> the displacement effect described above has generally deterred resort to the courts, either in the first instance or for judicial review of a regulatory decision.<sup>45</sup>

The primacy of the securities regulators, as compared to the courts, in the regulation of public companies is not inherent in the role played by each. It is, rather, a function of the development of corporate law and securities regulation

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42. OSC NP 62-202 (4 August 1997), s 1.1(2). This contrasts sharply with US corporate law, where the regulation of substantive decision-making by directors in the context of a change of control transaction is left to the courts.

43. See Vanderpol & Waitzer, *supra* note 40.

44. As stated by the Supreme Court of Canada in *BCE*, *supra* note 31 at para 38, “The fiduciary duty of the directors to the corporation is a broad, contextual concept. It is not confined to short-term profit or share value. Where the corporation is an ongoing concern, it looks to the long-term interests of the corporation.”

45. See Vanderpol & Waitzer, *supra* note 40.

in Canada. With the benefit of hindsight, some have commented on what might have transpired in *Magna* had the complaining shareholders not sought relief at the Commission.<sup>46</sup> The Commission allotted only two days for the “public interest” hearing and ultimately acknowledged that it was not equipped to consider substantive fairness or the effectiveness of the process undertaken by the board and special committee. Moreover, it is clear that the enhanced level of disclosure provided as a result of the Commission’s decision gave additional weight to the shareholder vote at the statutory fairness hearing. Further, the Commission’s highly critical reasons were not available to the court, which, in turn, did not consider procedural fairness. In contrast to *Southern Peru*, shareholder approval was determinative. The transaction proceeded on substantially the same terms initially agreed to by the controlling shareholder, notwithstanding the Commission’s view that the special committee of *Magna* had succumbed to the “controlled mindset”<sup>47</sup> described by Chancellor Strine.

## II. DEVELOPMENTS IN THE UNITED STATES: THE CONSTITUTIONAL CONSTRAINT

Unlike Canada, US constitutional law reserves corporate law for the states, while securities regulation is primarily federal. As the US Supreme Court has stated:

Corporations are creatures of state law, and investors commit their funds to corporate directors on the understanding that, except where federal law *expressly* requires certain responsibilities of directors with respect to stockholders, state law will govern the internal affairs of the corporation.<sup>48</sup>

Given this demarcation of powers, the US Court of Appeals for the District of Columbia vacated SEC Rule 19c-4,<sup>49</sup> adopted in 1988, which purported to bar national securities exchanges and the National Association of Securities Dealers from listing companies that took any action “with the effect of nullifying, restricting or disparately reducing the per share voting rights of [existing common stockholders].”<sup>50</sup> The Rule was designed to promote one vote per share for listed

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46. Kent E Thomson, James D Bunting & J Alexander Moore, “The Magna Proceedings: Devising a Litigation Strategy and Elaboration on the BCE Test” in *Expert/American Lawyer Guide to the Leading 500 Lawyers in Canada* (Thomson Reuters Canada, 2011).

47. *Southern Peru*, *supra* note 2 at 111.

48. *Santa Fe Industries, Inc, et al v Green et al*, 430 US 462 at 479, 97 S Ct 1292 (USSC, 1977), citing *Cort et al v Ash*, 422 US 66 at 84, 95 S Ct 2080 (USSC, 1975) [emphasis added].

49. 17 CFR § 240.19c-4 (1990).

50. See *Business Roundtable v SEC*, 905 F 2d 406 at 407, 284 US App DC 301 (DC Cir 1990).

companies. The Court did not question the wisdom of the requirement or the propriety of its imposition at the federal level. It nonetheless struck down the Rule, holding that there was no specific authorization in the SEC's governing legislation. Likewise, it rejected the SEC's argument that authorization could be found in the provisions allowing the SEC, in registering an exchange (or association of brokers and dealers), to consider whether its rules "in general, . . . protect investors and the public interest."<sup>51</sup> The Court held that a vague "public interest" standard could not be interpreted without some confining principle and that the SEC's assertion of authority invaded the "firmly established" jurisdiction of the states over corporate governance and shareholder voting rights.<sup>52</sup>

As a result of this constitutional constraint, securities regulation in the United States has tended to be more narrowly focused than in Canada. As a consequence, we argue, corporate law jurisprudence has been more robust in the United States than in Canada. American courts have taken a flexible approach to the scope of directors' duties under corporate law.<sup>53</sup> The basic foundations of this jurisprudence are the duties of care and loyalty and the duty of directors to manage the business and affairs of the corporation—the same basic duties of boards of Canadian corporations. From these foundations, US corporate law, and especially Delaware corporate law, has developed a number of key judicial doctrines that govern the conduct of boards and controlling shareholders, including the business judgment rule, "enhanced scrutiny," and the entire fairness standard.<sup>54</sup>

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51. *Ibid* at 413.

52. *Ibid*, citing *CTS Corp v Dynamics Corporation of America*, 481 US 69 at 89, 107 S Ct 1637 (USSC 1987). More recently, the US Court of Appeals for the District of Columbia Circuit struck down the SEC's Rule 14 a-11 in *Business Roundtable v SEC*, 647 F 3d 1144, 396 US App DC 259 (DC Cir). This was the SEC's attempt (pursuant to the *Dodd-Frank Wall Street Reform and Consumer Protection Act*, Pub L No 111-203, 124 Stat 1376 (2010)) to give shareholders the right under federal proxy rules to have their director nominees included in management proxy materials. In this instance, the rule was struck down on the basis that the SEC had failed to adequately justify it on a cost-benefit basis. It was not clear whether the court had set a high threshold for such justification because of the fact that the SEC was addressing issues traditionally left to the states (notwithstanding clear legislative authority for the SEC in this instance).

53. For example, the California Supreme Court noted that traditional fiduciary law "failed to afford adequate protection to minority shareholders" and, in the context of the facts of the case before it, decided to impose upon a controlling shareholder a "comprehensive rule of good faith and inherent fairness to the minority in any transaction where control of the corporation is material[.]" *June K Jones v HF Ahmanson & Company et al*, 1 Cal 3d 93 at 111-12, 460 P 2d 464 (1969).

54. See *e.g.* Julian Velasco, "Structural Bias and the Need for Substantive Review" (2004) 82

The business judgment rule is a familiar concept. It is the basic standard by which the actions of directors of a Delaware corporation are reviewed. In recognition of the fact that it is the directors, not the shareholders, who manage the business and affairs of a corporation, the business judgment rule operates to protect the business decisions of boards from judicial “second-guessing” so long as those decisions were made in good faith by disinterested and informed directors.<sup>55</sup> Delaware law has recognized, however, that this standard of review is not appropriate in all circumstances. It has therefore developed the concept of “enhanced scrutiny,” an intermediate standard of review that applies when the business judgment rule is not appropriate. Under this standard, the court reviews the process and information relied upon by the board as well as the reasonableness of its decision.<sup>56</sup> The two most important circumstances in which enhanced scrutiny applies are takeover defenses and board review of shareholder derivative litigation. The logic in each case is that the inherent conflict arising from management’s and the board’s interest in retaining control or in avoiding shareholder claims requires enhanced scrutiny.

“Entire fairness” is the most exacting standard of review. In a transaction that is reviewed on this standard, courts will look to both the process (“fair dealing”) and the price (“fair price”) in determining whether the transaction is “entirely fair.”<sup>57</sup> The Delaware courts have taken a broad view of the circumstances in which to apply the “entire fairness” standard. For example, in *In re Lorol Space and Communications Inc Consolidated Litigation*, the court applied the standard to a board’s approval of financing from a controlling (though not majority) shareholder.<sup>58</sup> The court found a lack of fair dealing based on the “flawed” composition of the special committee, which consisted of two directors—one independent and

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Washington U L Quart 821.

55. *Senior Aronson, et al v Harry Lewis*, 473 A 2d 805 at 811, 1984 Del LEXIS 305 (Ch). The court noted that

[a] cardinal precept of the General Corporation Law of the State of Delaware is that directors, rather than shareholders, manage the business and affairs of the corporation.” As a consequence, there is a “presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company... . Absent an abuse of discretion, that judgment will be respected by the courts. (*Ibid* at 812).

56. Martin Lipton & Theodore N Mirvis, “Enhanced Scrutiny and Corporate Performance: The New Frontier for Corporate Directors” (1995) 20 Del J Corp L 123.

57. See *Weinberger, supra* note 9; *Cinerama, Inc v Technicolor, Inc*, 663 A 2d 1134, 1994 Del Ch LEXIS 178, aff’d 663 A 2d 1156, 1995 Del LEXIS 251 (Ch). See also Julian Velasco, “How Many Fiduciary Duties are there in Corporate Law?” (2010) 83:6 S Cal L Rev 1231 at 1244.

58. 2008 Del Ch LEXIS 136.

one affiliated with the controlling shareholder. The court further stated that the special committee had a “cramped view of its mandate” and had used a financial advisor that, in the court’s view, was “not qualified to swim in the deep end.”<sup>59</sup> Holding that there was no fair price, the court fashioned a remedy by rewriting the financing arrangements to rectify the harm.<sup>60</sup>

In *Khan v Lynch Communication Systems, Inc*, the court suggested that the entire fairness standard was appropriate for any merger involving a controlling shareholder, irrespective of whether the transaction was negotiated by an independent special committee, approved by an independent board majority, or subject to a majority-of-the-minority vote condition.<sup>61</sup> The court based its conclusion on a determination that such protective provisions are insufficient in light of the coercion that inheres whenever a controlling shareholder indicates its intention to buy the minority’s shares.<sup>62</sup> Recognizing the utility of such protective measures, the court suggested that their use could shift the burden of proof on the issue of fairness from the controlling shareholder (and target board) to the shareholder plaintiffs.<sup>63</sup>

Unlike the regulatory framework imposed by Canadian securities laws, US corporate law imposes few constraints on the controlling shareholder’s ability to sell control at a premium that is not shared with non-controlling shareholders,<sup>64</sup> perhaps because it imposes constraints on the private benefits of control that flow from ongoing operations.<sup>65</sup> However, US courts have developed some limitations on the ability to sell control at a premium.<sup>66</sup> In *In re Tele-Communications, Inc Shareholders Litigation*, the court denied a motion for summary judgment in

59. *Ibid* at paras 77, 81, 84.

60. *Ibid* at paras 114-20.

61. 638 A 2d 1110, 1994 Del LEXIS 112 (Ch) [*Lynch*].

62. *Ibid* at 1116.

63. *Ibid* at 1117.

64. Although in *Pertman v Feldmann* the court held that control premiums must be shared with non-controlling shareholders, the US law has since changed radically. 219 F 2d 173, 50 ALR 2d 1134 (2d Cir 1955).

65. See Ronald J Gilson & Jeffrey N Gordon, “Controlling Controlling Shareholders” (2003) 152:2 U Pa L Rev 785 at 794.

66. The American Law Institute’s Principles of Corporate Governance restrict a controlling shareholder’s right to sell control at a premium if:  
the controlling shareholder does not make disclosure concerning the transaction to other shareholders with whom the controlling shareholder deals in connection with the transaction; or  
it is apparent from the circumstances that the purchaser is likely to violate the duty of fair dealing ... in such a way as to obtain a significant financial benefit for the purchaser or an associate.  
*Principles of Corporate Governance: Analysis and Recommendations*, loose-leaf (consulted on 25 January 2012) (American Law Institute, 2005), ch 5 at s 5.16.

respect of a transaction whereby AT&T acquired TCI by paying a 10% premium for the high-vote Class B shares (mostly held by the controlling shareholder).<sup>67</sup> The court reviewed the transaction under the “entire fairness” standard not merely because the controlling shareholder received a premium but because a majority of the company’s directors were beneficiaries of the premium and therefore interested in the transaction.<sup>68</sup> The court found that the special committee process was flawed: No fairness opinion was received, the special committee’s mandate was unclear, and, for various reasons, several of its members were conflicted.<sup>69</sup>

Likewise, in *In re John Q Hammons Hotels Inc Shareholder Litigation*, the Delaware Chancery Court applied the entire fairness standard to a third-party merger in which the majority shareholder received a premium for its shares.<sup>70</sup> Distinguishing *Lynch*, the Court held that entire fairness should be the standard unless the transaction was both recommended by an independent committee and approved by shareholders in a non-waivable “majority of all of the minority” vote.<sup>71</sup> The court was concerned that “Hammons and the minority stockholders were, in a sense ‘competing’ for portions of the consideration Elian [the disinterested acquirer] was willing to pay to acquire JQH and that Hammons, as a result of his controlling position, could effectively veto any transaction.”<sup>72</sup> The court downplayed the fact that minority shareholders were entitled to vote “because the vote could have been waived by the special committee and because the vote only required approval of a majority of the minority stockholders voting on the matter, rather than a majority of all the minority stockholders.”<sup>73</sup>

In *In re Delphi Financial Group Shareholder Litigation*,<sup>74</sup> Vice-Chancellor Glasscock of the Delaware Court of Chancery found that the plaintiffs had a reasonable likelihood of success in showing a breach of duty by Delphi’s CEO and controlling shareholder, who negotiated a friendly transaction in which he would receive 53.88 USD for each of his (10 vote) Class B shares while the public shareholders of Delphi would receive 44.88 USD for each of their (single vote) Class A shares. The court reached the decision to allow the transaction to proceed despite its determination as to likelihood of success (based on a provision in Delphi’s certificate of incorporation that provided for automatic conversion

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67. CA No 16470 (Del Ct Ch 2005), 2005 Del Ch LEXIS 206 [*In re Tele-Communications*].

68. *Ibid* at paras 25-26.

69. *Ibid* at 54-57.

70. *Hammons*, *supra* note 10.

71. *Ibid* at para 38.

72. *Ibid* at para 41.

73. *Ibid*.

74. *In re Delphi Financial Group Shareholder Litigation*, 2012 WL 729232 (Del Ch).

of Class B shares to Class A shares upon a sale and the special committee's attempt to persuade Delphi's CEO to accept the same consideration as the Class A shareholders). The court allowed the transaction to proceed because it was at a substantial premium and any harms could be remedied by damages. Delphi later announced that it had agreed to settle the shareholder litigation by paying the Class A shareholders consideration equivalent to that to be received by the Class B shareholders.<sup>75</sup>

As noted above, the use of a special committee (duly constituted, with independent financial and legal advice, and demonstrating an ability and willingness to diligently and actively "negotiate the highest or best available transaction for the shareholders whom they undertook to represent")<sup>76</sup> will often shift the burden of proof in an entire fairness review to the plaintiff. Another way to shift the burden is to obtain the fully informed approval of a majority of the minority stockholders.<sup>77</sup> In either circumstance, however, the issue before the courts is whether the impugned transaction is entirely fair from both a substantive and a procedural perspective.

### III. CANADIAN COMMON LAW CONSTRAINTS ON THE CONDUCT OF SHAREHOLDERS

Building on the key concepts of care, loyalty, and the duty of directors to manage the business and affairs of the corporation, the Delaware courts have developed a flexible set of judicial doctrines designed to review board conduct and the actions of controlling shareholders in a variety of situations. Entire fairness and enhanced scrutiny are the two primary standards of review.<sup>78</sup> There are others, however. For example, in the event of an inevitable sale or break up of a company, the duty of directors is to secure the highest price for the shareholders.<sup>79</sup>

Canadian courts have effectively (if somewhat obliquely) affirmed the business judgment rule<sup>80</sup> and required that directors exercise their powers with

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75. Delphi Financial Group, Inc, News Release, "Delphi Financial Announces Settlement with Class Action Plaintiffs Regarding Acquisition by Tokio Marine," (9 April 2012), online: <[http://www.delphifin.com/news/DFG\\_Announces\\_Settlement\\_with\\_Class\\_Action\\_Plaintiffs.pdf](http://www.delphifin.com/news/DFG_Announces_Settlement_with_Class_Action_Plaintiffs.pdf)>.

76. *In re Trans World Airlines, Inc Shareholders Litigation*, 1988 Del Ch LEXIS 139 at para 12.

77. See *e.g. Emerald Partners v Berlin*, 726 A 2d 1215 at 1223, 1999 Del LEXIS 97 (Ch).

78. See Velasco, *supra* note 54 at 1246-47.

79. See *Revlon, Inc v MacAndrews & Forbes Holdings, Inc*, 506 A 2d 173 at 182, 1986 Del LEXIS 1053 (Ch).

80. See *BCE*, *supra* note 31.

a “proper purpose.”<sup>81</sup> These concepts are, however, less developed in Canadian jurisprudence than in the United States, notwithstanding the fact that Canadian corporate law shares many of the same basic foundations as Delaware corporate law. Also, Canadian corporate law has not developed a doctrine for imposing duties on controlling shareholders of public companies or for reviewing the substantive fairness of transactions with controlling shareholders.<sup>82</sup> This is not to say that there are no concepts in Canadian corporate law that could address these situations. For example, the oppression remedy found in the *Canada Business Corporations Act* (and other Canadian corporate law statutes) gives the courts a wide range of powers to remedy conduct that is oppressive, that is unfairly prejudicial, or that unfairly disregards the interests of a shareholder (among others).<sup>83</sup> The foundation of the oppression remedy is, however, the “reasonable expectations” of the complainant.<sup>84</sup> This concept has proven difficult to apply in managing rights and responsibilities as between the security holders and directors of a public company. In the Court’s decision in *BCE*, the question of reasonable expectations ultimately shaded into a question of whether the board of directors was acting in accordance with its fiduciary duties—an issue that was analyzed by reference to the business judgment rule.<sup>85</sup>

Although the Court has yet to impose formal duties or constraints on the shareholders of public companies, there is ample historical precedent for doing so in the common law. The House of Lords decision in *Ebrahim v Westbourne Galleries Ltd et al* is frequently credited as the antecedent to the modern Canadian oppression remedy.<sup>86</sup> The case involved a private corporation with three shareholders who were also directors. Two shareholders (a father and son) removed the other as a director in compliance with the corporate articles and governing legislation. The House of Lords granted a winding-up order on “just and equitable”

81. *Hogg v Cramphorn, Ltd*, [1966] 3 All ER 420, [1967] Ch 254; *Teck Corp v Millar* (1972), 33 DLR (3d) 288 at para 3, [1973] 2 WWR 385 (BCSC).

82. See e.g. *Maple Leaf Foods Inc et al v Schneider Corp et al*, 42 OR (3d) 177, 44 BLR (2d) 115 (CA). In this case, the Court of Appeal affirmed the trial judge’s determination that the directors, in allowing the controlling shareholder to enter into a “lock-up” agreement, acted in good faith and were entitled to deference. The court found that the directors had no obligation to keep the bidding process alive (notwithstanding an extant higher bid) given the controlling shareholders’ indication that they would not tender to the higher bid.

83. RSC 1985, c C-44, s 241(2) [CBCA].

84. *BCE*, *supra* note 31 at para 56. See also Ed Waitzer & Johnny Jaswal, “Peoples, BCE, and the Good Corporate ‘Citizen’” (2009) 47:3 Osgoode Hall LJ 439.

85. *Ibid* at para 40.

86. [1972] 2 All ER 492, [1973] AC 360 (HL).

principles after considering the reasonable expectations of the minority shareholder in the context.<sup>87</sup>

Earlier cases imposed a duty of good faith on controlling shareholders. In *Allen v Gold Reefs of West Africa, Limited*, shareholders wished to make a claim against an insolvent estate. They passed a special resolution that amended the corporate articles to give the company a lien on fully paid shares, all of which were held by the estate.<sup>88</sup> While he acknowledged that the governing statute allowed such an amendment, Lord Lindley held that:

Wide, however, as the language of ... [the statute] is, the power conferred by it must, like all other powers, be exercised subject to those general principles of law and equity which are applicable to all powers conferred on majorities and enabling them to bind minorities. It must be exercised, not only in a manner required by law, but also bonâ fide for the benefit of the company as a whole, and it must not be exceeded.<sup>89</sup>

Although the Privy Council specifically rejected the application of a “majority of the minority” test in *North-West Transportation Company v Beatty*,<sup>90</sup> several cases have applied some variation of the principle to constrain conduct that unfairly favours controlling shareholders. In *British America Nickel Corporation v MJ O'Brien*, the company promised to pay the holder of 70% of a class of bonds 2 million Canadian dollars (“CAD”) worth of common stock in order to secure his vote for a proposed reorganization.<sup>91</sup> The Privy Council accepted an application by the minority bondholders to reject the vote, noting that the 70% holder “was bound to exercise it [his vote] with the interests of the class itself kept in view as dominant.”<sup>92</sup> While the court distinguished *North-West* because that case concerned itself with the rights of shareholders rather than bondholders, the court did not indicate clearly why one should be deserving of any higher rights than the other.

The majority of the minority principle was also applied in *Rights & Issues Investment Trust Ltd v Stylo Shoes Ltd*.<sup>93</sup> In this case, in order to issue shares to preserve control while effecting an acquisition, the defendant company proposed to divide the existing shares into ordinary shares and management shares (the latter would gain substantial additional voting rights). The fact that the holders

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87. *Ibid* at 493.

88. [1900] 1 Ch 656, 16 TLR 213 (CA) [*Allen*].

89. *Ibid* at 671.

90. [1887] 12 App Cas 589, 3 TLR 789 (PC) [*North-West*].

91. [1927] AC 369, 43 TLR 195 (PC).

92. *Ibid* at 378.

93. [1965] 1 Ch 250, [1964] 3 WLR 1077.

of the management shares refrained from voting their shares on the proposed recapitalization and that approximately 90% of the disinterested shareholders voted in favour of the transaction were key to the court's determination that the transaction was not oppressive of the minority. Applying the *Allen* principle, Justice Pennycuik held that, since only disinterested shareholders had voted, the test of voting in good faith and in the interests of the company as a whole had been satisfied.<sup>94</sup>

For reasons discussed below (describing what we call the “displacement effect”), neither this UK decision nor the US case law was considered relevant in the Magna fairness hearing. Even more telling is the fact that many of the academic critiques of the Magna transaction have focused on why the Commission should have invoked its “public interest” jurisdiction to enjoin the transaction (by issuing a cease-trade order or mandating a coat-tail provision), notwithstanding the overwhelming degree of minority shareholder support for the transaction.<sup>95</sup> One author goes so far as to argue that the exercise of the Commission's “public interest” jurisdiction in this manner should have been based on the “likely reasonable expectations” of the Class A shareholders—conflating the corporate law oppression remedy test with the Commission's “public interest” jurisdiction.<sup>96</sup>

#### IV. THE FLEETING INTERSECTION OF CANADIAN CORPORATE AND SECURITIES LAW

Although the common law certainly had the potential to develop doctrines similar to those found in US corporate law, the Canadian regulatory regime evolved in a different direction. A key factor influencing this trajectory was the concomitant development of securities regulation.

Historically, Canadian securities legislation was designed to protect investors in their dealings with brokers and promoters.<sup>97</sup> However, by 1965 the Attorney General's Committee on Securities Legislation in Ontario recommended that

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94. *Ibid* at 256.

95. See e.g. Jeff MacIntosh, “Some Reflections on Magna and Dual Class Share Structures,” (2011) [unpublished], online: <<http://www.rotman.utoronto.ca/userfiles/cmi/file/Some%20Reflections%20on%20Magna%20and%20Dual%20Class%20Share%20Structures%20June%2017%202011.pdf>>; Anita Anand, “Was *Magna* in the Public Interest?” (2011) 49:2 Osgoode Hall LJ 311.

96. *Ibid* at 331.

97. See Philip Anisman, “The Commission as Protector of Minority Shareholders” in *Special Lectures of the Law Society of Upper Canada: Securities Law in the Modern Financial Marketplace* (Toronto: De Boo, 1989) 451 at 452.

the Ontario *Securities Act*<sup>98</sup> be amended to reflect the recognition that public confidence in the integrity of capital markets also depends on investors' ability to make informed decisions and exercise their franchise.<sup>99</sup> The following year Ontario enacted a new *Securities Act*, the first Canadian legislation to require continuous disclosure by issuers and to regulate the proxy process, takeovers, and insider trading.<sup>100</sup> The province made an effort to integrate these provisions with Ontario corporate law by enacting parallel provisions in the corporate statute.<sup>101</sup> As late as 1971, the Ontario Court of Appeal differentiated between identical provisions in corporate and securities legislation by noting that the purpose of the former was evaluating the conduct of management while the *Securities Act* provision was limited to the exemptions relating to trading in securities.<sup>102</sup>

While the distinction between corporate and securities law in the United States reflects the division of legislative jurisdiction between the federal government and the states, no such constitutional limitation arises in Canada, where the provinces have jurisdiction over both corporate and securities law.<sup>103</sup> Shortly after the new *Securities Act* was enacted, the Chair of the Ontario Securities Commission argued that:

The distinction between corporate and securities law is a largely artificial one that was developed in the United States to meet distinctive constitutional problems in that country. Investors would, I believe, be better served in Canada if the two regulatory activities were combined.<sup>104</sup>

This was not to be the case. Over time, Canadian securities regulators became increasingly active in their interventions in corporate transactions. As they gradually expanded the exercise of their powers to constrain the conduct of controlling shareholders, the role of corporate law and company law administrators simultaneously decreased.<sup>105</sup> Likewise, there was less demand for corporate law

98. *Supra* note 1.

99. *Report of the Attorney General's Committee on Securities Legislation in Ontario* (Toronto: Queen's Printer, 1965) [Kimber Report].

100. *The Securities Act, 1966*, SO 1966, c 142.

101. See *An Act to amend the Corporations Act, 1966*, SO 1966, c 28.

102. *Re Niagara Wire Weaving Co Ltd*, [1971] 3 OR 633, 21 DLR (3d) 305 (CA).

103. *Reference re Securities Act (Canada)*, 2011 SCC 66, 339 DLR (4th) 577 [*Reference re Securities Act*]; Ramandeep K Grewal & Edward J Waitzer, "National Securities Regulation: Centralization and its Discontents" (2012) 27:3 BFLR 529.

104. James C Baillie, "Shareholders Remedies" in *Special Lectures of the Law Society of Upper Canada: New Developments in the Law of Remedies* (Toronto: De Boo, 1981) 21.

105. In 2001 the takeover bid and most of the insider trading and going-private provisions in the *CBCA* were repealed. The last Policy Statement issued by the Director under the *CBCA* was issued on 4 January 2010 and clarified a Policy Statement issued by a previous

expertise and activism by Canadian courts. This stands in sharp contrast to the United States.

## V. CANADIAN SECURITIES REGULATION TO THE FORE— THE DISPLACEMENT EFFECT

Canadian corporate statutes have embraced, to a limited extent, the notion of imposing constraints on shareholders through various forms of majority-of-the-minority approval. The primary manifestation is through the requirement for class voting with respect to fundamental changes where a class of shareholders is affected in a manner different than other classes, irrespective of whether the class ordinarily votes.<sup>106</sup> However, with limited exceptions, Canadian corporate law does not impose majority-of-minority requirements within a class of shareholders.<sup>107</sup>

Perhaps more importantly, Canadian corporate statutes provide that shareholder ratification does not relieve directors and officers from their duty to act in accordance with the applicable statute.<sup>108</sup> This reverses the common law embodied in *Foss v Harbottle*.<sup>109</sup> It is clear that the drafters of the Dickerson Report, which served as the foundation of the federal corporate statute, felt that this reversal would serve as a restraint on the conduct of controlling shareholders: “Rather than set out a specific rule declaring how an act of the directors may be ratified, we think it better to characterize shareholder ratification or waiver as an evidentiary issue, which in effect compels the court to go behind the constitutional structure of the corporation and examine the real issues.”<sup>110</sup>

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Director, which had suggested that the arrangement provisions of the Act might be construed narrowly. The immediately preceding Policy Statement (regarding oppression remedy guidelines) was issued 8 June 2005. Canada, Industry Canada, *Notice from the Director, Amendments to the CBCA Policy Concerning Arrangements*, (Ottawa: Corporations Canada, 2010); Canada, Industry Canada, *Oppression Remedy Guidelines, Policy Statement 11.30*, (Ottawa: Corporations Canada, 2005).

106. See *e.g.* *CBCA*, *supra* note 83, ss 176, 183(4), 189(7); *Business Corporations Act*, RSO 1990, c B.16, ss 170, 176(3), 185(2) [*OBCA*].

107. One exception is a majority of minority requirement in connection with going-private transactions under section 189 of the *OBCA*, *ibid*. Another variation on minority approval is the requirement for an acquiror to achieve a 90% tender into a takeover bid of the target shares “other than shares held at the date of the take-over bid by or on behalf of the offeror” in order to be able to squeeze-out the remaining shareholders (without resorting to a second step amalgamation transaction): *CBCA*, *supra* note 83, s 206(2); *OBCA*, *ibid*, s 188(1).

108. See *CBCA*, *supra* note 83, s 122(3); *OBCA*, *ibid*, s 134(3).

109. (1843), 67 ER 189, 2 Hare 461 (Ch).

110. *Proposals for a New Business Corporations Law for Canada*, vol 1 (Ottawa: Information Canada, 1971) at para 487 [Dickerson Report].

In spite of such admonition, one is hard-pressed to find cases involving public companies in which Canadian courts have been prepared to develop the common law regarding the conduct of shareholders or to look beyond shareholder ratification and review the substantive fairness of a transaction. In *Maple Leaf Foods*, the Ontario Court of Appeal upheld the trial judge's decision not to apply the "enhanced scrutiny standard" or "proper purpose test" (which shifts the burden of proof to the directors to show that their acts were consistent only with the best interests of the corporation).<sup>111</sup> The enhanced scrutiny standard was also rejected by Justice Blair in *CW Shareholdings Inc v WIC Western International Communications Ltd.*<sup>112</sup> Instead, the majority-of-the-minority principle and other constraints on controlling shareholders, including a willingness to review the fairness of a transaction, were taken up by securities regulators and stock exchanges, initially on an *ad hoc* and reactive basis.<sup>113</sup>

In *Re Cablecasting Ltd.*,<sup>114</sup> the Commission declined to issue a cease-trade order to block a freeze-out transaction. However, it noted that it might do so even where a transaction did not violate the *Securities Act* if the transaction, "while consistent with the language of prior policy rulings and statements of the Commission, would contravene the intent of these rulings and statements and detract from the credibility of the capital markets or be otherwise inconsistent with the best interests of investors."<sup>115</sup> The Commission noted the procedural advantages of court adjudication, which carries with it a "level of refinement of fact-finding that is attained by the exchange of pleadings, the examinations for discovery, the formal trials and the adversary relationship that characterize judicial proceedings."<sup>116</sup> Accordingly, the Commission stated that it would only exercise its "public interest" power in cases involving fraud or a "flagrant abuse in some other respect" and "only if no lesser remedy suffices."<sup>117</sup>

111. *Pente Investment Management Ltd v Schneider Corp* (1998), 40 BLR 244, 62 OTC 1 (Gen Div). As was noted by the Court of Appeal in *Maple Leaf Foods*, earlier judicial decisions had adopted a proper purpose test as a way of addressing the potential conflict of interest between directors and certain groups of shareholders. *Supra* note 82 at para 35.

112. *CW Shareholdings v WIC Western International Communications Ltd* (1998), 30 OR (3d) 755, 160 DLR (4th) 131.

113. As early as 1966, the Ontario Securities Commission made the proposed sale of an escrowed control block of securities conditional upon the approval of disinterested shareholders. *In the Matter of the Securities Act and In the Matter of Consolidated Manitoba Mines Limited and Great Basin Metal Mines Limited*, [1966] OSC Bull 5.

114. *Re Cablecasting Ltd.*, [1978] OSC Bull 37 [*Cablecasting*].

115. *Ibid* at 41.

116. *Ibid* at 42.

117. *Ibid* at 42. Section 127 of the *Act* gives the Commission broad powers where "in its opinion it is in the public interest to make the order or orders." The Court has held that this power

In *Re Lindzon*, the Commission declined to issue a cease-trade order sought by Commission Staff in respect of a related-party transaction.<sup>118</sup> Although the Commission found that the transaction could be regarded as oppressive and improvident, it again exercised adjudicatory restraint, determining that “[e]xcept in special circumstances the Commission’s authority should not be extended to exercising a jurisdiction analogous to that of the civil courts in matters that do not arise under the Act.”<sup>119</sup> The Commission acknowledged that one reason for this “self-imposed restraint” was that a determination by it of a breach of directors’ duties “would raise difficult issues of fact and law between private litigants which the procedures of the Commission are not suited to resolve.”<sup>120</sup>

Such restraint was soon overtaken by a series of Commission responses to particular transactions. The starting point was OSC Policy 3-37 (issued in September 1977 in respect of “issuer bids” but amended the following year shortly after the *Cablecasting* decision), which required majority-of-minority approval and an independent valuation of the affected securities in going-private transactions.<sup>121</sup> Ultimately, Policy 3-37 became Policy 9.1 and then Multilateral Instrument 61-101, which sets out a detailed host of procedural requirements that apply to issuer bids, insider bids, business combinations, and related-party transactions, including valuation requirements and minority approval requirements.<sup>122</sup>

The real inflection point, however, was in *Re Canadian Tire Corp*, which dealt with a proposed transaction in which the “independent dealers” of Canadian Tire (a retail chain) sought to acquire control of the company from the Billes family members at a substantial premium. The independent dealers made a bid for only 49% of the common (voting) shares, thereby circumventing the coat-tail provision that was geared to a bid for a majority of the common shares.<sup>123</sup> The Commission, while reaffirming the principles it had expressed in *Cablecasting* and acknowledging that the proposed transaction did not violate any provisions

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should not be used merely to remedy misconduct alleged to have caused harm or damage to private parties. See *Committee for the Equal Treatment of Asbestos Minority Shareholders v Ontario (Securities Commission)*, 2001 SCC 37, [2001] 2 SCR 132 [*Asbestos*].

118. *In the Matter of the Securities Act, 1978 and in the Matter of Irving S Lindzon, and 370815 Ontario Limited* (1982), 4 OSC Bull 43C.

119. *Ibid* at 59C.

120. *Ibid* at 59C-60C.

121. “Going Private” Transactions, Including Comments as to other Issuer Bids and Insider Bids, OSC Notice, [1978] OSCB 214 (July 1978).

122. Multilateral Instrument 61-101, *supra* note 37.

123. (1987), 10 OSC Bull 857, 35 BLR 56, 1987 CarswellOnt 128 (OSC) (WL Can), aff’d (1987), 59 OR (2d) 79, 35 BLR 117 (Ct J (Gen Div)) [*Canadian Tire*]. Leave to appeal to the Ontario Court of Appeal was refused on 16 April 1987.

of the *Securities Act* or other regulatory requirements, took the view that the bid was “as grossly abusive a transaction as the Commission has had before it in recent years,” and that if “allowed to proceed, confidence in our capital markets will inevitably suffer and individuals will be less willing to place funds in the equity markets.”<sup>124</sup> Accordingly, the Commission noted that “[t]here is bound to be overlap [between the courts and the Commission] as there is no clear line between securities and corporate matters”<sup>125</sup> and was prepared to exercise its public interest power under Section 123 (now Section 127) of the *Securities Act*—notwithstanding the absence of a demonstrated breach. Moreover, while stating that “[o]ur decision to impose a cease trading order does not depend on a finding of breach of fiduciary duty,”<sup>126</sup> the Commission stated that:

[A]n allegation of breach of fiduciary duty, and evidence which clearly concerns the conduct of those who are fiduciaries, can be important in supporting facts which otherwise would support a section 123 order. That is the case here. The Billeses are in a fiduciary position in at least two categories—as directors of [Canadian] Tire and as [Canadian] Tire’s controlling shareholders. While the law in Canada is still developing with respect to the fiduciary duty that controlling shareholders owe to the minority, the Courts in Ontario have clearly signalled that a duty of fairness to the minority is imposed upon those who are in a controlling shareholder position.<sup>127</sup>

The Commission’s decision in *Canadian Tire* was controversial. Many commentators argued that the use of its “public interest” power, in the absence of a breach of some specific provision in the *Act*, conferred upon the Commission unduly broad discretion without appropriate standards.<sup>128</sup> Justice Reid summarized the concern as follows:

Appellants contend that the discretion that section [123] confers on the Commission was not intended to be exercised in the absence of a concurrent breach of the *Act*, or regulations made under the *Act*, or of policies declared by the Commission in the form of policy statements. ... To interpret the section differently would, in appellants’ submission, confer an unprecedented, unjustified, unintended and unreviewable discretion on the Commission. It would place the Commission “above the law”. Simply by labelling something as being contrary to the public interest, the

124. *Ibid* at 945.

125. *Ibid* at 953.

126. *Ibid* at 954.

127. *Ibid* [emphasis added].

128. See e.g. Hudson N Janisch, “Reregulating the Regulator: Administrative Structure of Securities Commissions and Ministerial Responsibility” in *Special Lectures of the Law Society of Upper Canada: Securities Law in the Modern Financial Marketplace* (Toronto: De Boo, 1989) 97 at 102-03.

Commission could invoke a jurisdiction beyond effective review by any court. Thus the Commission, by this bootstrapping device, could create a jurisdiction for itself it was never intended to have.<sup>129</sup>

However, in denying judicial review, Justice Reid invoked a tautological response:

Yet to suggest that the discretion conferred by s.123 is “unfettered” in that sense is unjustified. The fetter consists in the finding that something proposed or done is contrary to the public interest.<sup>130</sup>

This conclusion was contrary to that expressed by the Royal Commission Inquiry into Civil Rights several years earlier, which recommended that, where possible, the criteria for Commission action should be more clearly specified than simply stating that it may act “where in its opinion such action is in the public interest.”<sup>131</sup> More recently, the Task Force to Modernize Securities Legislation in Canada recommended that the “public interest” power be used sparingly, especially where the behaviour to be sanctioned has not been identified in advance as unacceptable.<sup>132</sup>

Having embarked down the “public interest” path, the Commission wasted little time in broadening its ambit. The following year, in *Re Selkirk Communications Limited*, the Chair and two Commissioners noted:

Apart from our decision in this case, we wish to note that the test quoted above from the reasons in *Canadian Tire* specifically referred to a case where there had not been a “demonstrated breach of the Act, the regulations or a policy statement . . .”. In such a case, in the context of a s.123 application, the standard of “clearly demonstrated to be abusive” may be appropriate. That is not the test that ought to be applied in every case in which the “public interest” standard of a particular section of the Act is invoked.

The concept of the “public interest” is used in a number of sections in the Act and, as this case demonstrates, will be used in differing contexts by applicants, including OSC Staff. No one standard will be applicable in all cases and “unfairness” may well be a sufficient reason to invoke the concept in a particular case. Each case will depend on its own circumstances, including statutory context, particular facts, the applicant and burden of proof.<sup>133</sup>

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129. *Supra* note 41 at 110.

130. *Ibid* at 112.

131. Canada, *Royal Commission Inquiry into Civil Rights, Report No. 3*, vol 5 (Toronto: Queen’s Printer, 1971) at 2096.

132. Canada, Final Report of the Task Force to Modernize Securities Legislation in Canada, *Canada Steps Up*, vol 1 (Toronto: no publisher, 2006) at 110.

133. *In the matter of the Securities Act, RSO 1980, Chapter 466, as Amended and In the Matter of Selkirk*

The public interest jurisdiction of the Commission was further developed and advanced in subsequent cases featuring contests among shareholders or between shareholders and boards of directors. In *Re HERO Industries Ltd*,<sup>134</sup> the Commission used its public interest jurisdiction to intervene in a takeover bid that, while otherwise in compliance with the *Securities Act*, thwarted another takeover bid, thereby depriving the minority shareholders of the premium offered under that bid. Another example was *Re Canadian Jorex Ltd*,<sup>135</sup> in which the Commission used its public interest jurisdiction to cease-trade a shareholder rights plan that would otherwise have prevented shareholders from choosing to accept one of two unsolicited takeover bids that had been made to the shareholders. The breadth of the Commission's public interest jurisdiction, and the deference to be shown to its exercise of this jurisdiction, were affirmed by the Court in its decision in *Asbestos*, wherein the Court stated:

In this case ... it cannot be contested that the OSC is a specialized tribunal with a wide discretion to intervene in the public interest and that the protection of the public interest is a matter falling within the core of the OSC's expertise. Therefore, although there is no privative clause shielding the decisions of the OSC from review by the courts, that body's relative expertise in the regulation of the capital markets, the purpose of the Act as a whole and s. 127(1) in particular, and the nature of the problem before the OSC, all militate in favour of a high degree of curial deference.<sup>136</sup>

In hindsight, it is clear that judicial deference to the expertise of the administrative tribunal extended beyond reluctance to interfere with the Commission's determinations in particular hearings. Rather, by its adoption of Policy 3-37 and its willingness to utilize its public interest powers, the Commission effectively "occupied the field" with respect to the imposition of constraints both on controlling shareholders, and on the role of boards in the context of transactions involving these parties.

The exclusive influence of the Commission on imposing constraints became evident in short order. For example, in 1981 the Ontario Court of Appeal rejected the application of a majority-of-the-minority standard in *Wotherspoon v*

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*Communications Limited, Southam Inc, Cablecasting Limited, the Eaton Superassuaction Plan, Viking Canadian Fund and Viking International Fund* (1988), 11 OSC Bull 286 at 305-06.

134. *In the Matter of the Securities Act, RSO 1980, Chapter 466, As Amended and In the Matter of HERO Industries Ltd, Middlefield Capital Fun, Middlefield Financial Ltd and New Frontiers Development Trust plc and in the Matter of Garth Jestley, Charles Hobbs and Murray Brasseur* (1990), 13 OSC Bull 3775, 49 BLR 182.

135. *In the Matter of the Securities Act, RSO 1980, Chapter 466, as Amended and in the Matter of Canadian Jorex Limited and Mannville Oil & Gas Ltd* (1992), 15 OSC Bull 257, 4 BLR (2d) 1.

136. *Supra* note 117 at para 49.

*Canadian Pacific Ltd.*<sup>137</sup> The Court of Appeal declined to find that the controlling shareholder owed any duty to the minority or that a related-party transaction must be approved by a majority of the disinterested shareholders, noting that:

Majority rule still applies to shareholders' meetings, and controlling shareholders can still sell assets of the company to their own subsidiaries, provided that full and fair disclosure is made to all shareholders of what is being done, and all shareholders are treated alike.<sup>138</sup>

Likewise, both the Alberta Court of Queen's Bench and the High Court of Ontario have rejected the majority-of-the-minority approach and held that minority shareholders do not constitute a separate "class" for the purposes of securing requisite shareholder approvals at corporate law.<sup>139</sup>

Courts continue to extend extraordinary deference to the Commission. In *Re Sears Canada Inc*, the Commission found inadequate disclosure, collateral benefits, and coercive and abusive conduct on the part of a controlling shareholder seeking to effect a privatization.<sup>140</sup> The Divisional Court dismissed the application for judicial review of the Commission's decision, noting that "[t]he standard of review of reasonableness encompasses 'the right to be wrong.'"<sup>141</sup> It is ironic that, whereas a court hearing the case in the first instance would have applied different evidentiary standards and likely deferred to the business judgment of the board absent evidence of bad faith, it may permit the Commission to do the opposite.<sup>142</sup>

The recent decision of the Quebec Court of Appeal in *AbitibiBowater Inc v Fibrek Inc* is an extreme and apparently anomalous result of this sort.<sup>143</sup> In contrast to the UK and US cases that impose duties on controlling shareholders, here the Quebec securities regulator effectively protected the controlling shareholder's rights to the detriment of the minority. If the Ontario Commission paved the

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137. (1982), 35 OR (2d) 449, 129 DLR (3d) 1 (CA), rev'd [1987] 1 SCR 952.

138. *Ibid* at para 117.

139. See *Stevens v Home Oil Co* (1980), 123 DLR (3d) 297, 28 AR 331 (QB); *General Accident Assurance Co of Canada v Lornex Mining Corp* (1988), 66 OR (2d) 783, 40 BLR 299 (H Ct J).

140. (2006), 22 BLR (4th) 267, 2006 CarswellOnt 6994 (WL Can) (OSC).

141. *Re Sears Canada Inc* (2006), 84 OR (3d) 61 at para 13, 21 BLR (4th) 311 (Div Ct), aff'g (2006), 22 BLR (4th) 267, 2006 CarswellOnt 6994 (OSC) (WL Can).

142. See The Honourable James M Farley, QC & Andrew Matheson, "The Right to Be Wrong: Deference to Securities Commissions in M&A Disputes," (Paper delivered at the Continuing Legal Education Society of British Columbia, February 2008), online: <[www.cle.bc.ca/PracticePoints/BUS/03%2004%20Securities.pdf](http://www.cle.bc.ca/PracticePoints/BUS/03%2004%20Securities.pdf)>.

143. *Fibrek Inc c AbitibiBowater Inc*, 2012 QCCA 569, 2012 CarswellQue 2952 (WL Can) [*Fibrek*]. Leave to appeal to the Supreme Court was denied on April 19, 2012.

way for the court's fairness determination in *Magna*,<sup>144</sup> here the Quebec regulator pre-empted fair treatment of the Fibrek minority.

The board of Fibrek, relying on legal and financial advice and the recommendation of a committee of independent directors, decided to issue redeemable warrants to induce a competing bid at a 40% premium to the initial unsolicited bid.<sup>145</sup> The initial bidder had entered into irrevocable lock-up agreements with three of Fibrek's shareholders who collectively held about 46% of Fibrek's shares. One of those supporting the initial bid was also a large shareholder in the parent company of the bidder. Another large shareholder in the bidder's parent company (which acquired most of its Fibrek shares after the bid was announced) agreed to support the initial bid, bringing the total support for the initial bid to almost 51%.<sup>146</sup> The warrants would have converted to 19.9% of Fibrek's outstanding shares, thereby effectively reducing the percentage of shares locked up to the initial bid from 46% to about 37%. The warrants were clearly crafted to enable an auction process in the face of the lock-up agreements. They could not be exercised for 21 days and the holder was required to tender all of its shares to a superior proposal accepted by 50.1% of the Fibrek shareholders. In such circumstances, the holder would have to surrender to Fibrek either the break fee or its profit on tendering to the superior proposal.<sup>147</sup>

The initial bidder, having previously succeeded in an application to cease-trade Fibrek's rights plan, successfully applied to the Quebec securities regulator to cease-trade the issuance of the warrants.<sup>148</sup> The panel, after citing various decisions of other Canadian securities regulators which, it suggested, affirmed its right to intervene "in the public interest," determined that the issuance of warrants in connection with a control contest should only be allowed where there is an immediate need for capital, not to neutralize the effect of lock-up agreements. It also effectively determined that the lock-up agreements were rights to be protected, notwithstanding that this result would deprive minority shareholders of a superior bid.<sup>149</sup>

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144. Anand argues that, in *Magna*, the court deferred to the Commission's determination of whether the transaction was fair to the minority shareholders. See Anand, *supra* note 95 at 325.

145. The redemption provision was intended to allow for a further competing bid. The board also agreed to a break fee of about 5%.

146. *Fibrek*, *supra* note 143 at para 9.

147. *Ibid* at para 14.

148. *AbitibiBowater inc et RFP Acquisition inc (demandereses) c Fibrek inc et Mercer Internal inc. (intimées) et Autorité des marchés financiers (mise-en-cause)*, (16 April 2012), Montreal 2012-024-001 (QC).

149. *Fibrek*, *supra* note 143 at para 24.

While the trial judge overturned this decision,<sup>150</sup> the Quebec Court of Appeal restored it unanimously (the Supreme Court later denied leave to appeal). It is difficult to reconcile the decision with National Policy 62-202,<sup>151</sup> which focuses on shareholder primacy in change-of-control transactions, when allowing the warrants would have afforded all shareholders a 40% premium to the initial and ultimately successful bid. Yet, as in *Re Sears Canada*, the Court of Appeal was deferential to the determination of the regulatory tribunal and concluded that the regulator's broad and unfettered power to act in the public interest may not be interfered with unless the decision was not justifiable, transparent, or intelligible.<sup>152</sup>

## VI. CONCLUSION—STRIKING THE RIGHT BALANCE

As we have illustrated, the Canadian and American regulatory regimes have evolved along quite different tracks, leading to substantively different approaches to similar transactions. In the United States the shareholder-centric versus director-centric debate has been explicit and dynamic. For the last three decades shareholder wealth maximization has prevailed as the goal of corporate governance, while securities regulation remained largely director-centric. Responses to market crises have led to corporate law reform focused on giving shareholders greater power.

In contrast, there has been relatively little debate in Canada. Rather, the shift from a director-centric model to one that is more shareholder-centric has been a function of securities regulators occupying the field. Through their willingness to use their ill-defined public interest jurisdiction to intervene in corporate transactions, securities commissions have displaced corporate law and its focus on the statutory duties of directors. Over time, this displacement has created a self-reinforcing cycle in which the courts largely defer to the regulators, who, by the nature of their intervention, tend to approach the question of appropriate corporate conduct from the perspective of particular complainant's shareholder interests. The result

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150. *Fibrex Inc c AbitibiBowater Inc*, [2012] RJQ 878, 2012 CarswellQue 2484 (WL Can).

151. *Supra* note 40. The Instrument states that

[t]he primary objective of the take-over provisions of Canadian securities legislation is the protection of the bona fide interests of the shareholders of the target company. A secondary objective is to provide a regulatory framework within which take-over bids may proceed in an open and even-handed environment. The take-over bid provisions should favour neither the offeror nor the management of the target company, and should leave the shareholders of the target company free to make a fully informed decision. (*Ibid*, s 1.1(2).)

152. *Fibrex, supra*, note 143 at para 27.

of this shift has been to leave important questions of responsibility, authority, and accountability unanswered or unexplored.

The regulation of public companies is complex and requires balancing the diverse interests of multiple groups. Securities regulation has empowered individual shareholders, but it has not solved the problem of effective collective action by those shareholders. It has also not addressed issues relating to shareholders' formal responsibility and accountability for their decision making, either to the minority shareholders or to other stakeholders in the company. Securities regulators generally lack the evidentiary discipline in their process, as compared to courts, to allow for a detailed and meaningful inquiry into director conduct and the question of the best interests of the corporation. In addition, given the fragmented nature of securities regulation in Canada, there is an inherent tendency towards static policy and inconsistent adjudication.<sup>153</sup> Notwithstanding these limitations, the intervention of securities regulation has, in our view, prevented corporate law from developing meaningful mechanisms to oversee the conduct of boards and the discharge of their responsibility to manage the business and affairs of the corporation. Canadian corporate law has generally not moved beyond a focus on process, leaving to the side the issues of the substantive merits of directors' decisions and the accountability of boards for their decisions.

Given the increasingly dynamic nature of our capital markets, and their close integration with those of the United States, the substantively different approaches to regulating corporate conduct and the inability of Canadian courts or securities regulators to undertake a more rigorous examination of the role and responsibility of the board of directors hinder the effective regulation of public companies. It is time for a fundamental re-examination of policy orientation. As with the three major reviews undertaken in the 1970s—one of the *CBCA*<sup>154</sup> and

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153. Even if securities regulators are to adjudicate directors' duties, they should do so based on express legislative authority and by explicit reference to those duties, rather than by resorting to their "public interest" jurisdiction. This is the case in Australia, where section 1 of the *Australian Securities and Investments Commission Act 2001* (Cth) sets out the regulator's public interest objectives and section 1317 of the *Corporations Act 2001* (Cth) specifically allows the regulator to take enforcement action against directors in response to alleged breaches of their duties. See Renee M Jones & Michelle Welsh, "Toward a Public Enforcement Model for Directors' Duty of Oversight" (2012) 45:2 *Vand J of Transnat'l L* 343 (arguing as to why some form of external enforcement mechanism beyond private shareholder litigation is necessary to ensure optimal conduct from corporate directors). Note that in the Australian model, the securities regulator is authorized to sue (in the courts) to enforce directors' duties, rather than to determine them itself.

154. See Dickerson Report, *supra* note 110.

the others of securities regulation<sup>155</sup>—it would be timely to engage the “best and brightest” in a broader policy review. The Court’s decisions in *BCE* and the recent constitutional reference concerning a proposed Canadian Securities Act<sup>156</sup> lend additional impetus to such a holistic exercise.

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155. See Canada, Department of Consumer and Corporate Affairs, *Proposals for a Securities Market Law for Canada* (Ottawa: Consumer and Corporate Affairs Canada, 1979); Kimber Report, *supra* note 99.

156. In this case, the Court addressed the desirability of cooperative federalism, animated by “respect that each level of government has for each other’s own sphere of jurisdiction.” *Reference re Securities Act*, *supra* note 103 at para 133. The same logic applies in this instance.