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Edward J. Waitzer
Osgoode Hall Law School of York University, ewaitzer@osgoode.yorku.ca

Douglas Sarro
Sullivan & Cromwell LLP, dougsarro@gmail.com

Source Publication:
Canadian Business Law Journal

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Repository Citation
Waitzer, Edward J. and Sarro, Douglas, "Protecting Reasonable Expectations: Mapping the Trajectory of the Law" (2016). *Articles & Book Chapters*. 2416.
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THE CANADIAN BUSINESS LAW JOURNAL

REVUE CANADIENNE DU DROIT DE COMMERCE

Volume 57, No. 3 March/mars 2016

ARTICLES

PROTECTING REASONABLE EXPECTATIONS: MAPPING THE TRAJECTORY OF THE LAW

Edward J. Waitzer[*] and *Douglas Sarro*[**]

The doctrine of reasonable expectations has evolved into a powerful tool for judicial and regulatory activism and, as a result, a bellwether for the trajectory of the law. The concept has broadened — both in scope and in the range of potential claimants. Yet it has been used to achieve goals that are remarkably consistent across different areas of law: first, to require powerful actors to treat stakeholders fairly, which entails treating them with honesty and avoiding actions that would impose unnecessary or disproportionate costs on them; second, to uphold the integrity of legal or regulatory regimes by remedying actions that frustrate their purpose by allowing an actor to avoid the obligations associated with these regimes. The doctrine is particularly relevant to contemporary society, where legislative processes have become constrained by, among other things, the short-term incentives that inform and motivate political processes. As the tension between public expectations and legislative responsiveness becomes more severe, a growing role has emerged for our courts and independent regulatory bodies to use reasonable expectations to forge new legal pathways. This article outlines what appears to be an accelerating trend — first by reflecting on the nature of "reasonable expectations" and then exploring how the doctrine has been and is likely to be applied.

* Professor and Jarislowsky Dimma Mooney Chair in Corporate Governance, Osgoode Hall Law School and Schulich School of Business; Senior Partner, Stikeman Elliott LLP, Toronto.

** Associate, Sullivan & Cromwell LLP, New York. The authors thank Stephen Aylward for his helpful comments.

Electronic copy available at: http://ssrn.com/abstract=2770452

I. INTRODUCTION

The doctrine of reasonable expectations has evolved into a powerful tool for judicial and regulatory activism and, as a result, a bellwether for the trajectory of the law. The concept has broadened – both in scope and in the range of potential claimants. It is particularly relevant to contemporary society, where legislative processes have become constrained by various factors, including the difficulties faced by governments in tackling long-term, systemic policy issues because of the short-term incentives that inform and motivate political processes.[1] This challenge is reinforced by the growing degree of interdependence and inter-connectedness that have come to define the world we live in — a world where domestic regulation no longer provides adequate instruments to deal with public stewardship challenges.[2]

As the tension between "public expectations" and legislative responsiveness becomes more severe, a growing role has emerged for our courts and independent regulatory bodies to attach the term "reasonable" to nouns such as "expectations" (or "doubt", "person" and the like) to forge new, often radical, legal pathways. This article outlines what appears to be an accelerating trend — first by reflecting on the nature of "reasonable expectations" and then exploring how the doctrine has been and is likely to be applied.

II. NATURE OF REASONABLE EXPECTATIONS

While not without its conceptual challenges (some of which are discussed below), it can be argued that the norm of protecting reasonable expectations is a central organizing principle for most legal rules.[3] The concept is explicitly invoked in a number of areas of law — including contract law, search and seizure law, administrative law, fiduciary law, and corporate law. Even in

1. See, *e.g.*, Oxford Martin Commission for Future Generations, *Now for the Long Term* (Oxford, Oxford Martin School, 2013), at pp. 45-46, online: <http://www.oxfordmartin.ox.ac.uk/>.
2. See, *e.g.*, *ibid.*, at p. 41.
3. Roscoe Pound suggests that "we [can] explain more phenomena and explain them better by saying that the law enforces the reasonable expectations arising out of conduct, relations and situations" than by, for instance, adopting the theory that the law enforces obligations only if the defendant explicitly consented to these obligations. Roscoe Pound, *An Introduction to the Philosophy of Law* (New Haven, Connecticut, Yale University Press, 1922), at p. 189.

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areas of law which do not explicitly use "reasonable expectations", the concept's influence can nonetheless be observed.

There are obvious weaknesses. For one, the standard itself is applied unevenly — private law generally emphasizes the more subjective aspect of expectations of particular stakeholders, while public law tends to focus more on objective "reasonableness", emphasizing the expectations of society as a whole. Nor is the test susceptible to application in a principled manner when applied to cases "near the margin". Indeed, it is this essential contestability that lends the principle its greatest utility when dealing with borderline cases.

A related issue is its inherent circularity — as one case examining the concept notes, if reasonable expectations are shaped by what courts allow, they tend to become what courts say they are.[4] But by definition, "reasonable" expectations mean more than the current law. As the Supreme Court of Canada noted in *Re BCE Inc.*,[5] reasonable expectations "look ... beyond legality to what is fair, given all of the interests at play" to address conduct that is "wrongful, even if it is not actually unlawful."[6] Indeed, where the law is in a state of transition, the expectations that are aroused contribute to reform. Posner describes this dynamic as follows:[7]

> [Judicial] [d]ecisions are not the only source of expectations — far from it. Changing the law to bring it into closer harmony with lay intuitions of justice and fair dealings may protect rather than defeat the parties' expectations.

Again, a perceived weakness can also be a strength. Contextual and dynamic, reasonable expectations can be thought of as legal Polyfilla® — moulding themselves around other structures to plug the gaps. This gap-filling, inherent to the administration of the law,[8] engenders reasonable expectations in and of itself. It is this self-reinforcing feedback mechanism that posits "reasonable

4. *Lucas v. South Carolina*, 505 U.S. 1003 (U.S. Sup. Ct., 1992), at pp. 1034-1035, Kennedy J. (concurring).
5. [2008] 3 S.C.R. 560, 2008 SCC 69 (S.C.C.).
6. *BCE Inc.*, *supra*, footnote 5, at para. 71.
7. Richard A. Posner, *The Problems of Jurisprudence* (Cambridge, Massachussets, Harvard University Press, 1990), at p. 260.
8. See *R. v. Salituro*, [1991] 3 S.C.R. 654 (S.C.C.), at p. 678 ("The courts are the custodians of the common law, and it is their duty to see that the common law reflects the emerging needs and values of our society."); *Re Dylex Ltd.* (1995), 31 C.B.R. (3d) 106 (Ont. Gen. Div. [Commercial List]), at para. 8, Farley J. ("the court has the inherent jurisdiction to fill in gaps in legislation so as to give effect to the objects of the [Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36]").

expectations" as a critical heuristic,[9] helping us to understand how tension points arise and are resolved, both on and beneath the surface of the law. In this sense, it is a way of thinking about the law that both informs and accelerates reform.[10]

III. APPLICATION OF THE DOCTRINE IN DIFFERENT CONTEXTS

Despite the wide range of contexts in which courts have applied the doctrine, and the conceptual concerns outlined above, reasonable expectations have been used to achieve objectives that are remarkably consistent. We focus on two objectives that appear to be the most salient: first, to require the fair treatment of others; second, to uphold the integrity of legal or regulatory regimes by remedying actions that frustrate their purpose by allowing an actor to avoid the obligations associated with these regimes. Below, we discuss examples of how reasonable expectations have been used to further these objectives, as well as examples of legal doctrines and regulatory actions that reflect similar objectives — evidence of the power of reasonable expectations to shape the trajectory of the law.

1. Fair Treatment of Others

Fair treatment has at least two aspects: minimizing the costs one imposes on others and treating others with honesty. The "reasonable expectation of privacy" test used in search and seizure law tends to be applied in a way that reflects the first of these aspects. It holds that, where an investigative tactic significantly impinges on society's interest in individual privacy, that tactic must be classified as a "search" that is subject to s. 8 of the Canadian Charter of Rights and Freedoms.[11] This means that police are required to minimize the costs the use of the tactic imposes on society (*e.g.*, by

9. See Bradley H. Kuklin, "The Plausibility of Legally Protecting Reasonable Expectations" (1997), 32 Val. U. L. Rev. 19, at p. 66.
10. See, *e.g.*, Thomas D. Perry, "Dworkin's Transcendental Idea", in Peter A. French, Theodore E. Uehling, and Howard K. Wettstein, eds., *Midwest Studies in Philosophy*, Vol. 7 (Minneapolis, University of Minnesota Press, 1982), p. 255, at p. 266 ("Legally difficult cases often cannot be decided intelligently without having recourse to contemporary ideas of what is practical, fair, morally sensible; and this is so much a part of the texture of legal reasoning that it seems artificial to say that such ideas are not single 'part of the law'").
11. Part I of the Constitution Act, 1982, being Schedule B to the Canada Act 1982 (U.K.), 1982, c. 11.

using the tactic only after obtaining a warrant that confirms that there are reasonable grounds to believe that its use will yield evidence of a crime). While reasonable expectations of privacy often align with existing legal rights — for example, an individual is recognized as having a reasonable expectation of privacy in his or her home[12] — they also regulate tactics that do not impinge on any traditional "ownership" interest — such as the surreptitious recording of another person's conversations and requesting an individual's Internet subscriber information from his or her Internet service provider.[13]

In *BCE*,[14] the Supreme Court of Canada held that reasonable expectations also formed the basis for a "duty of fair treatment" in corporate law, which requires corporate boards of directors to consider the effects their decisions have on corporate stakeholders, and to avoid actions that "unfairly maximize a particular group's interest at the expense of other stakeholders."[15] The interests that must be considered in this context are not limited to legal interests; they include the economic, and possibly social, interests of the affected stakeholders.[16] For example, it has been held that shareholders have a reasonable expectation that executives will not unfairly maximize their own interests at the expense of other stakeholders by awarding themselves "excessive" compensation that is not necessary to the objective of attracting and retaining qualified management.[17] In the United States, judicial reference to

12. *R. v. Evans*, [1996] 1 S.C.R. 8 (S.C.C.) (search of a home impinges on a reasonable expectation of privacy). See also *R. v. Wong*, [1990] 3 S.C.R. 36 (S.C.C.) (search of one's hotel room, which one has a license to use, impinges on a reasonable expectation of privacy). Some violations of legal rights may not offend reasonable expectations if they are viewed as merely "technical" or "trivial" in nature, and the violation served an important objective. For example, police may step onto an individual's property to collect and search garbage that has been left near the curb without impinging on that individual's reasonable expectation of privacy. *R. v. Patrick*, [2009] 1 S.C.R. 579, 2009 SCC 17 (S.C.C.).
13. *R. v. Duarte; R. v. Sanelli*, [1990] 1 S.C.R. 30 (S.C.C.), at p. 44 ("If the state may arbitrarily record and transmit our private communications, it is no longer possible to strike an appropriate balance between the right of the individual to be left alone and the … need to investigate and combat crime."); *R. v. Spencer*, [2014] 2 S.C.R. 212, 2014 SCC 43 (S.C.C.), at para. 66 (noting that refusing to recognize a reasonable expectation of privacy in Internet subscriber records would allow the state to arbitrarily obtain information linking an individual to "intimate or sensitive activities being carried out online, usually on the understanding that these activities would be anonymous").
14. *Supra*, footnote 5.
15. *BCE*, *supra*, footnote 5, at para. 64.
16. *BCE*, *supra*, footnote 5, at para. 102.
17. *König v. Hobza* (2014), 326 O.A.C. 213, 2014 ONCA 691 (Ont. C.A.).

reasonable expectations as a basis for relief under state oppression statutes or in respect of fiduciary duty claims is now the norm.[18]

The controls on corporate behaviour imposed by the duty of fair treatment differ somewhat from the controls imposed on police through the reasonable expectation of privacy test. While the reasonable expectation of privacy test focuses on the interests of society as a whole, the duty of fair treatment focuses only on the interests of corporate stakeholders. The practical difference between these standards may gradually erode over time, as courts lend greater recognition to the interests of the full range of stakeholders listed in corporate fiduciary duty and oppression cases — a list of stakeholders that, as stated in *BCE*, includes employees, governments, and the environment.[19] For example, a court could hold that, where a board of directors pursues a course of action that harms the environment, and that board had an alternative available to it that would have avoided these harms without imposing an undue burden on other stakeholders, that board has acted contrary to reasonable expectations and (subject to there being an eligible claimant, such as an institutional investor with a long-term investment horizon) should be liable for oppression.[20]

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18. For a tabular presentation of authorities by U.S. state, see F. Hodge O'Neal and Robert B. Thompson, *O'Neal and Thompson's Close Corporations and LLCs: Law and Practice*, revised 3d ed. and Supp. (New York, Thomson Reuters, 2004 and 2014), at § 9:18. Many state oppression statutes specifically refer to reasonable expectations, and reasonable expectations have also been used to determine breaches of statutory duties in states without an oppression statute. See Minn. Stat. § 302A.751:

    > [I]n determining whether to order equitable relief, dissolution or buyout, the court shall take into consideration the duty which all shareholders in a closely held corporation owe one another to act in an honest, fair and reasonable manner in the operation of the corporation and the reasonable expectations of the shareholders as they exist at the inception and developed during the course of the shareholders' relationship with the corporation and with each other.

    Brodie v. Jordan, 447 Mass. 866, 857 N.E. 2d 1076 (Mass., 2006), at p. 1080 (noting that "[a] number of other jurisdictions, either by judicial decision or by statute, also look to shareholders' 'reasonable expectations' in determining whether to grant relief to an aggrieved minority shareholder in a close corporation.").

19. *BCE*, *supra*, footnote 5, at paras. 39-40.

20. Oppression claims require a showing that the actions complained of are oppressive, unfairly prejudicial to or unfairly disregards the interests of a shareholder, creditor, director or officer of the corporation. See, *e.g.*, Canada Business Corporations Act, R.S.C. 1985, c. C-44, s. 241(2). An investor with a long-term time horizon that accordingly must take into account environmental and other long-term risks could argue that a corporation that disregards these considerations is treating that investor unfairly relative to other stakeholders with a shorter time horizon.

Tort law provides another example of how reasonable expectations have been used to prevent the imposition of unnecessary costs on others. In *T.J. Hooper*,[21] a leading American tort case, "reasonable prudence" was held by Learned Hand J. to require a tugboat operator to carry radio sets (a then relatively new technology), even though they were not required to do so by statute, on the basis that doing so had become a nearly universal safety practice. In other words, the duty of care is a relative concept that adapts to new technology, and the operator should have weighed the risk of injury created by its lack of "compliance", and the gravity of the possible injury, against the costs that would have been associated with mitigating this risk by adhering to general practice.[22] The Court of Appeal for Ontario more recently enunciated the same concept in *Kreutner v. Waterloo-Oxford Co-operative Inc.*,[23] stating that, where a product or service placed on the market creates a "substantial likelihood of harm" and "there exists an alternative design that is safer and economically feasible", the party offering that product or service will be held to have failed to act in accordance with reasonable expectations of prudence.[24]

The goal of preventing powerful actors from imposing unnecessary or disproportionate costs on society guides a number of other areas of law where reasonable expectations play a less prominent role. For example, environmental law has been justified as a means of limiting the environmental harms private firms impose on society.[25] Zoning law is similarly viewed as being intended to minimize the costs heavy industry and other commercial activities impose on residential neighborhoods.[26]

Recent regulatory responses to high-frequency trading ("HFT") provide a timely example of how regulators seem to be guided by reasonable expectations. While the advent of electronic trading has led to more liquid and efficient markets, there is widespread

21. *The "T.J. Hooper"*, 60 F.2d 737 (2d Cir., 1932).
22. *The "T.J. Hooper"*, *supra*, footnote 21, at p. 740.
23. (2000), 50 O.R. (3d) 140 (Ont. C.A.).
24. *Kreutner*, *supra*, footnote 23, at para. 8.
25. See, *e.g.*, Henry N. Butler and Jonathan R. Macey, "Externalities and the Matching Principle: The Case for Reallocating Environmental Regulatory Authority" (1996), 14 Yale L. & Pol'y Rev. 23, at p. 29 ("The economic goal of government regulation of pollution is to force polluters to bear the full costs of their activities.")
26. See, *e.g.*, William A. Fischel, *The Economics of Zoning Laws: A Property Rights Approach to American Land* (Baltimore, Johns Hopkins University Press, 1985), at p. 234 ("The traditional story, at least as it is understood by economists, is that zoning is necessary because in the absence of public controls, activities that adversely affect the value of housing will locate in residential neighborhoods").

concern that the costs incurred in the "arms race" towards the faster execution of trades may outweigh the benefits these efforts have historically created for the market.[27] Likewise, while society arguably benefits from allowing the organizations that generate important market-moving information to collect fees to support their information-gathering efforts, the calculus changes when these organizations allow HFT firms to obtain this data earlier than other market participants.[28] The latter activity would seem to impose significant costs on non-HFT market participants, some of whom would inevitably be on the losing end of trades with HFT firms for the period during which HFT firms enjoy an informational advantage. Actions by regulators to discontinue the early release of market data,[29] as well as other proposals to reduce the advantages HFT firms enjoy in the market,[30] may be seen as an attempt to find alternative means of facilitating price discovery that impose fewer costs on market participants and society as a whole.

In addition to imposing a duty to minimize the costs one imposes on others, fair treatment entails standards of honest conduct. For example, in *Bhasin v. Hrynew*,[31] the Supreme Court of Canada recognized, on the basis of "reasonable expectations", a "general duty of honest contractual performance."[32] The court was careful to explain that this duty does not require contracting parties to "put the interests of the other contracting party first" or to "forego advantages flowing from the contract."[33] Rather, it simply requires that the party to a contract not "lie or otherwise knowingly mislead [the other party] about matters directly linked

27. See, *e.g.*, Jeffrey MacIntosh, "In praise of high frequency traders", *Financial Post*, November 22, 2013, online: <http://business.financialpost.com/2013/11/20/in-praise-of-high-frequency-traders/> ("At some point, the commitment of ever-larger sums of money to slicing ever-smaller fractions of time off trading times, just to be first in line, becomes socially counter-productive"); Larry Harris, "Stop the high-frequency trader arms race", *Financial Times*, December 27, 2012, ("If actions are not taken to stop this arms race, investors will be worse off and economic welfare will decline").
28. See Edward J. Waitzer and Douglas Sarro, "Fiduciary Society Unleashed: The Road Ahead for the Financial Sector" (2014), 69 Bus. Law. 1081, at p. 1086.
29. *Ibid.*
30. See, *e.g.*, Eric B. Buddish, Peter Cramton and John J. Shim, "The High-Frequency Trading Arms Race: Frequent Batch Auctions as a Market Design Response", Chicago Booth Research Paper No. 14-03 (December 23, 2013), online: <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2388265>.
31. [2014] 3 S.C.R. 494, 2014 SCC 71 (S.C.C.).
32. *Bhasin*, *supra*, footnote 31, at para. 92.
33. *Bhasin*, *supra*, footnote 31, at para. 73.

to the performance of the contract",[34] so that, "if the contract does not work out, they will have a fair opportunity to protect their interests."[35]

The link between reasonable expectations and honesty has also been recognized in the context of administrative law and corporate law decisions dealing with the implications of promises and representations by government and corporate actors. Courts have held that, where a government official, agency or tribunal promises to follow a particular process before making an administrative decision, those affected by that decision have a reasonable expectation that this process will be followed before the decision is made.[36] Further, where the promise made is substantive (*e.g.*, to grant a licence or an exemption from a legal requirement), the government must provide heightened procedural protections to the beneficiaries of that "promise" before it decides whether the public interest requires it to renege.[37] In *BCE*, it was similarly recognized that, where a corporation makes representations in promotional material, prospectuses, or other communications, stakeholders will likely have a reasonable expectation that these representations will be true.[38]

2. Reinforcing the integrity of social institutions

Courts have also used reasonable expectations to address "avoidance tactics" that, if successful, would frustrate the purpose of a legal regime by allowing an actor to avoid obligations that ordinarily come with that regime, and accordingly undermine the social institutions the regime was intended to uphold. Consider the following examples:

- An insurance company purports to provide coverage for an outdoor swimming pool, but includes an exclusionary clause that would deny coverage for any "settling, expansion, contraction, moving, bulging, buckling or cracking" of the pool, which would seem to be the most obvious risks that could result in damage to an outdoor pool.

34. *Bhasin*, *supra*, footnote 31.
35. *Bhasin*, *supra*, footnote 31, at para. 86.
36. *Baker v. Canada (Minister of Citizenship & Immigration)*, [1999] 2 S.C.R. 817 (S.C.C.), at para. 26. See also *Bendahmane v. Canada (Minister of Employment & Immigration)*, [1989] 3 F.C. 16 (Fed. C.A.).
37. *Cook v. Alberta (Minister of Environmental Protection)* (2001), 293 A.R. 237, 2001 ABCA 276 (Alta. C.A.).
38. *BCE*, *supra*, footnote 5, at paras. 79-80.

- A financial advisor gives a client the impression that he or she is providing advice that serves the client's best interests, but seeks to avoid the obligation to serve the best interests of that client by sending the client a letter with lengthy, complicated disclaimers.

In each of these cases, courts have resorted to reasonable expectations to prevent these avoidance tactics from succeeding. In *Cabell v. Personal Insurance Co.*,[39] the Court of Appeal for Ontario noted that, where the plain terms of an exclusion within a policy operate in such a way as to nullify the type of coverage that the parties reasonably expected would have flowed from the policy, the terms of the policy will yield to the reasonable expectations of the parties.[40] Because the disclaimer in the policy covered the most obvious risks that could result in damage to the pool, giving effect to it would frustrate the purpose for which the insurance policy was purchased. The court refused to do so, and required the insurer to compensate the insured for the damage to the outdoor pool.[41]

In *Hodgkinson v. Simms*,[42] the Supreme Court of Canada concluded that, because the advisor held himself out as independent and as an expert on the particular subject matter on which the client sought advice (real estate tax shelters), and effectively chose his client's investments for him, he had invited a reasonable expectation that he would act in his client's best interests, and accordingly was subject to fiduciary obligations notwithstanding disclaimers to the contrary.[43] In doing so, the court noted that the purpose of fiduciary law is to promote public trust and confidence in financial advisors and others that provide specialized services to the public or that are entrusted with the property of others.[44] Allowing the advisor to solicit clients' trust, but then avoid

39. (2011), 104 O.R. (3d) 709, 2011 ONCA 105 (Ont. C.A.).
40. *Cabell*, *supra*, footnote 39, at paras. 28-31.
41. *Cabell*, *supra*, footnote 39. A further means of incorporating reasonable expectations into insurance law may arise from recent legislative reforms implemented in British Columbia or Alberta, which explicitly authorize courts to set aside insurance policy exclusions, in whole or in part, where these exclusions are unreasonable or contrary to public policy. See generally Nigel P. Kent, "Excluding Exclusions: The Role of Reasonableness in the Interpretation of Insurance Policies", Clark Wilson LLP, 2011, online: Clark Wilson LLP <https://www.cwilson.com/publications/insurance/excluding-exclusions-the-role-of-reasonableness.pdf>.
42. [1994] 3 S.C.R. 377 (S.C.C.).
43. *Hodgkinson v. Simms*, *supra*, footnote 42, at pp. 428-429, 431 and 433-434.
44. *Hodgkinson v. Simms*, *supra*, footnote 42, at p. 422.

fiduciary obligations through the use of disclaimers, would likely undermine the public trust and confidence fiduciary law seeks to encourage. Recognizing a fiduciary relationship, on the other hand, allowed the court to uphold this purpose.

The duty of good faith contractual performance recognized in *Bhasin* is another means by which courts use reasonable expectations to address avoidance tactics. One of the components of the duty is an obligation not to "use a contractual power . . . to evade a contractual duty."[45] For example, when a vendor in a real estate transaction holds a contractual right to repudiate the transaction where he or she is "unable or unwilling" to remove a defect in title, the vendor is not entitled to exercise this right simply because he or she regrets having entered into the transaction.[46] As noted by the Supreme Court in *Bhasin*, these types of controls on the behaviour of contractual parties are "necessary to the proper functioning of commerce."[47]

Concern about avoidance tactics has permeated into areas of law that are not explicitly guided by reasonable expectations, or in which reasonable expectations have traditionally played only a limited role. For example, the concept of "good faith", which is central to the interpretation of contracts in Quebec,[48] has long been instrumental in preventing contractual parties from avoiding obligations that flow from the purpose of their contract.[49]

Another tool used to remedy conduct that undermines the purposes of individual contracts and of contract law more broadly

45. *Bhasin*, *supra*, footnote 31, at para. 51. See also *Freedman v. Mason*, [1958] S.C.R. 483 (S.C.C.), at pp. 486-487.
46. *Bhasin*, *supra*, footnote 31, at para. 51.
47. *Bhasin*, *supra*, footnote 31, at para. 60.
48. *Domtar Inc. v. ABB Inc.*, [2007] 3 S.C.R. 461, 2007 SCC 50 (S.C.C.), at para. 1: The development of Quebec's law of obligations has been marked by efforts to strike a proper balance between, on the one hand, the individual's freedom of contract, and, on the other, adherence by contracting parties to the principle of good faith in their mutual relations.
49. Sébastien Grammond, "Reasonable Expectations and the Interpretation of Contracts Across Legal Traditions" (2010), 48 Can. Bus. L.J. 345, at p. 363. See also *Hôtel de l'Aéroport de Mirabel inc. c. Aéroports de Montréal*, [2003] R.J.Q. 2479 (C.A. Que.), at p. 2484 (holding, under the doctrine of good faith, that an airport authority that granted a lease to the operator of a hotel adjacent to the airport had implicitly guaranteed that the authority would maintain a passenger airport near the hotel for the duration of the lease). Some courts, in determining what good faith requires, have explicitly used the reasonable expectations of the parties as a reference point. See Grammond, *ibid.* See also *Beaudoin c. Université de Sherbrooke*, [2007] R.J.Q. 1343 (C.S. Que.), at p. 1358; Hugh Collins, *The Law of Contract*, 4th ed. (London, Butterworths, 2003), at p. 290.

is art. 1437 of the Québec Civil Code,[50] which empowers a court to nullify, or reduce any obligation arising from, an "abusive clause in a consumer contract or contract of adhesion" (such as an insurance contract).[51] An "abusive clause" is defined as "a clause which so departs from the fundamental obligations arising from the rules normally governing the contract that it changes the nature of the contract."[52] For example, in *Allendale*,[53] the Quebec Court of Appeal struck down as "abusive" a clause in the standard Hydro-Quebec power supply contract that would have exempted the supplier from any liability towards its client, noting that the clause not only diverged from industry practice, but undermined the principle of "[a]ccountability", which is "a fundamental precept of the civil law of Quebec."[54] Article 1437 also has been said to "imply a 'duty of clarity' that would fall on the shoulders of those who want to impose contractual terms that are considered unusual or harsh",[55] a duty that has long been recognized in common law jurisdictions on the basis of reasonable expectations.[56]

Another example of reasonable expectations permeating into other areas of law can be found in tax law, which traditionally has been interpreted strictly, so as to allow taxpayers to organize their affairs in a way that minimizes tax obligations.[57] Parliament stepped in to address tax avoidance by amending the Income Tax Act[58] to include a "general anti-avoidance rule", whereby a taxpayer that engages in a transaction that results in a "misuse" or "abuse" of a provision of the Income Tax Act (*i.e.*, avoiding its application despite the fact that the sort of conduct the individual

50. Civil Code of Québec, C.Q.L.R. c. C-1991.
51. *Ibid.*
52. *Ibid.*
53. *Allendale Mutual Insurance Co. c. Hydro-Québec* (2001), [2002] R.J.Q. 84 (C.A. Que.).
54. *Allendale Mutual Insurance Co.*, *supra*, footnote 53, at paras. 18, 29, 46-47.
55. Grammond, *supra*, footnote 49, at p. 361. See, *e.g.*, *9127-3870 Québec inc. (Domaine Témi Kami) c. Deschamps*, 2010 QCCQ 5422 (C.Q.), at para. 26; *Caron c. Évasion Hors-piste inc.*, 2009 QCCQ 6954 (C.Q.), at para. 21; *Chartrand c. Groupe PPP ltée*, 2006 QCCQ 3484 (C.Q.), at para. 24.
56. *Tilden Rent-A-Car Co. v. Clendenning* (1978), 18 O.R. (2d) 601 (Ont. C.A.); *Turczinski Estate v. Dupont Heating & Air Conditioning Ltd.* (2004), 246 D.L.R. (4th) 95 (Ont. C.A.) at para. 39, leave to appeal refused (2005), 208 O.A.C. 397 (note) (S.C.C.) ("Nor can contracting parties necessarily rely on a standard form limitation of liability or damages clause in a consumer contract, unless the specific clause has been brought to the attention of the consumer").
57. See *Canada Trustco Mortgage Co. v. R.*, [2005] 2 S.C.R. 601, 2005 SCC 54 (S.C.C.), at para. 11.
58. R.S.C. 1985, c. 1 (5th Supp.).

is engaged in is contemplated by that provision) may be subject to tax obligations as if the transaction never occurred.[59]

In summary, reasonable expectations, by "look[ing] beyond legality to what is fair" and addressing conduct that is "wrongful, even if it is not actually unlawful",[60] operates to close gaps in the law by requiring individuals and organizations to consider the interests of others and to minimize the costs they impose on their stakeholders as well as on society as a whole. It also empowers courts to reinforce the integrity of legal relationships and regimes, along with the social institutions that rely on them, by preventing attempts to avoid the obligations imposed by these relationships and regimes.

One author notes that reasonable expectations are "not about what courts say, but rather what they do"[61] — that reasonable expectations can explain patterns of decision-making even when they are not explicitly invoked by decision-makers.[62] The similarities between the rules imposed in areas of law where reasonable expectations are explicitly invoked and those imposed in other areas of law or regulation would seem to support this thesis, further establishing the importance of reasonable expectations in shaping the trajectory of the law.

IV. MAPPING THE TRAJECTORY OF THE LAW

Having described the principles that have given content to the doctrine of reasonable expectations, we now discuss some of the implications these principles, and their continued development, could have for market participants. In particular, we believe that regulators' and courts' enhanced understanding of the link between private law and the public interest will lead them to use reasonable expectations to extend the scope of legal protections available to stakeholders, including future generations and the environment, in the following ways: (1) broadening rules relating to standing and intervenor status to make it easier for environmental and other groups to challenge harms to stakeholders caused by powerful actors; (2) expanding materiality and corporate reporting requirements relating to environmental and other social

59. *Ibid.*, s. 245(4); see also *Canada Trustco*, *supra*, footnote 57, at para. 66.
60. *BCE*, *supra*, footnote 5, at para. 71.
61. Barry J. Reiter, "A Study in Reasonable Expectations: A Rebuttal to Geoff R. Hall" (2007), 46 C.B.L.J. 95.
62. John Swan, *Canadian Contract Law* (Markham, LexisNexis, 2006), at pp. 500-501.

issues; (3) adopting intergenerational equity as a paradigm for assessing whether defined benefit plan pension fund trustees have met their fiduciary duties to their beneficiaries; (4) piercing the corporate veil to hold parent companies liable for environmental and human rights harms caused by their subsidiaries; and (5) exercising statutory "public interest" powers to remedy unfair market conduct.

1. Broadening Standing and Intervenor Status

Public interest standing is an important vehicle by which environmental and other public interest groups can challenge government actions that defy reasonable expectations. Courts have significantly reduced the barriers to obtaining public interest standing so as to ensure that government actions are not "immunized from judicial review" due to an absence of persons whose private interests are directly affected by these actions and who have the resources necessary to mount an effective challenge to these actions in court.[63] Under the current test, a public interest group can obtain standing to challenge a government action if it raises a "serious justiciable issue" and has a "genuine interest" or "real stake" in the issue, so long as "in all the circumstances, the proposed suit is a reasonable and effective way to bring the issue before the courts."[64]

Though public interest standing exists only in the context of public law, courts have increasingly recognized that private law often has a public dimension. The Supreme Court has recognized that one of the reasons legislators enacted insolvency legislation was because "[r]eorganization serves the public interest by facilitating the survival of companies supplying goods or services crucial to the health of the economy or saving large numbers of jobs."[65] Accordingly, courts frequently consider the "social and economic" consequences of bankruptcy before making orders in insolvency proceedings.[66] Further, the Supreme Court has

63. *Downtown Eastside Sex Workers United Against Violence Society v. Canada (Attorney General)*, [2012] 2 S.C.R. 524, 2012 SCC 45 (S.C.C.), at para. 31, quoting *Thorson v. Canada (Attorney General) (No. 2)* (1974), [1975] 1 S.C.R. 138 (S.C.C.), at p. 145.

64. *Downtown Eastside*, *supra*, footnote 63, at para. 37.

65. *Re Ted Leroy Trucking Ltd.; Century Services Inc. v. Canada (A.G.)*, [2010] 3 S.C.R. 379, 2010 SCC 60 (S.C.C.), at para. 18. See also *Nova Metal Products Inc. v. Comiskey (Trustee of)* (1990), 41 O.A.C. 282 (Ont. C.A.), at para. 57, Doherty J.A. (dissenting).

66. See, *e.g.*, *Re Clothing for Modern Times Ltd.*, 2011 ONSC 7522 (Ont. S.C.J.

acknowledged that the "underlying purpose" of fiduciary law "may be seen as protecting and reinforcing the integrity of social institutions and enterprises" that are of significant public importance.[67] Courts have recognized that pension law engages issues of intergenerational equity,[68] and pension trustees commonly acknowledge an obligation to consider the interests of future generations when making investment decisions.[69] Finally, as discussed above, the stakeholders whose interests corporate directors should consider in discharging their fiduciary duties and their duty of fair treatment include not only shareholders and creditors, but also "employees, … consumers, governments and the environment."[70]

The acknowledged link between the private sector and the public interest indicates that, just as courts have broadened public interest standing in public law, so may they become more willing to permit public interest groups to participate in corporate, insolvency or pension litigation. One avenue may be intervenor status. Where litigation has already been commenced by a private party, a public interest group may be able to influence the outcome of that litigation by seeking appointment as an intervener. Such status is often granted in both public and private litigation, so long as the intervener is able to bring a fresh perspective on issues relevant to the litigation, and so long as the litigation itself has some public importance.[71] The relevance of corporate and

[Commercial List]), at para. 13; *Re Great Basin Gold Ltd.*, 2012 BCSC 1773 (B.C. S.C. [In Chambers]), at para. 13; *Re Comstock Canada Ltd.*, 2013 ONSC 4756 (Ont. S.C.J.), at para. 38.

67. *Perez v. Galambos*, [2009] 3 S.C.R. 247, 2009 SCC 48 (S.C.C.), at para. 70, quoting *Hodgkinson v. Simms*, *supra*, footnote 42, at p. 422.

68. See, *e.g.*, *Bennett v. British Columbia* (2009), 77 C.C.P.B. 56, 2009 BCSC 1358 (B.C. S.C.), affirmed (2012), 96 C.C.P.B. 268 (B.C. C.A.); *B.C.N.U. v. British Columbia (Municipal Pension Board of Trustees)* (2006), 50 C.C.P.B. 77, 2006 BCSC 132 (B.C. S.C.); *Withers v. Teachers' Retirement System of City of New York*, 447 F.Supp. 1248 (S.D. N.Y., 1978) at pp. 1257-1258.

69. See, *e.g.*, Don Raymond, Senior Vice President, Public Market Investments, Canadian Pension Plan Investment Board, "Responsible Investing: An Investor's Perspective" (Speech given at the Conference Board of Canada, March 26, 2007), at p. 12, online: <http://www.cppib.com/content/dam/cppib/public-media/news-releases/2007/2007_March26_DonRaymond_CSR.pdf>:

> Often when people talk about sustainability and responsible investing, they talk about our obligation to future generations. As investors with a mandate to help sustain the Canada Pension Plan for the benefit of more than 16 million Canadians, we talk about that obligation every day. We have a long-term investment horizon and a very deep commitment to managing long-term portfolio risks.

70. *BCE*, *supra*, footnote 5, at para. 40.

71. *Reference re Workers' Compensation Act, 1983 (Newfoundland)*, [1989] 2 S.C.R. 335 (S.C.C.), at p. 340 ("an intervention is welcomed if the intervener will provide

insolvency law to the public interest would appear to provide an opening for public interest groups to intervene in corporate or insolvency cases that have environmental, labour, or human rights implications. The link between pension law and the goal of intergenerational equity may provide an avenue by which advocates for future generations could obtain standing in pension cases that raise issues that have implications for multiple generations.

Legislative and regulatory reforms could also expand the range of claimants that can initiate proceedings (as opposed to intervening in existing proceedings) to seek a remedy for breaches of reasonable expectations. For instance, in recognition of the intergenerational nature of pension obligations, one could envision reforms that create an ombudsperson for future generations with standing to represent the interests of future generations of pension beneficiaries in pension litigation.[72]

It also is not difficult to imagine judicial or legislative reforms that allow a form of limited "public interest" standing as a means of addressing significant environmental or human rights harms caused by business organizations. The Supreme Court has suggested that the Crown has not only a right, but a duty, to prevent and remedy severe environmental harm.[73] In doing so, the court discussed the "public trust doctrine" that operates in a number of American states and holds both that the government has a duty to protect natural resources for the benefit of future generations and that individuals are entitled to sue their government when it fails to act in accordance with this duty.[74] This decision could provide a basis for granting standing to private parties seeking to challenge failures by government to protect the environment, or for reforms that allow public interest groups to seek leave from the court to stand in the shoes of the government and directly challenge actions by private actors that cause significant environmental harm.

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the Court with fresh information or a fresh perspective on an important constitutional or public issue").

72. For a discussion on how such a proposal could work, as well as examples of similar institutions established internationally, see Waitzer and Sarro, "Fiduciary Society Unleashed", *supra*, footnote 28, at p. 1108.
73. *British Columbia v. Canadian Forest Products Ltd.*, [2004] 2 S.C.R. 74, 2004 SCC 38 (S.C.C.), at paras. 67-68 and 81.
74. *British Columbia v. Canadian Forest Products Ltd.*, *supra*, footnote 73, at paras. 78-80.

2. Piercing the Corporate Veil

A basic tenet of corporate law is limited liability. Notwithstanding its clear articulation in virtually every corporate law statute,[75] courts have developed the concept of "piercing the corporate veil" to address concerns about abuse of the corporate form. A recent Ontario judgment described a number of widely accepted grounds for piercing the corporate veil:[76]

> (a) where the corporation is "completely dominated and controlled and being used as a shield for fraudulent or improper conduct"; (b) where the corporation has acted as the authorized agent of its controllers, corporate or human; and (c) where a statute or contract requires it [citations omitted].

Courts have shown an increased willingness to pierce the veil in tort claims, where in addition to individual liability, an employer is often vicariously liable for the actions of its subsidiaries — such as breaches of pension, environmental and human rights obligations — even when there is little or no evidence that the subsidiaries at issue were established or used for the express purpose of avoiding obligations. This was the basis for the *Choc v. Hudbay Minerals Inc.* decision in which, on a preliminary motion, the Ontario Superior Court did not reject the argument that the Canadian parent company could be held liable for the torts allegedly committed by its defunct subsidiary in Guatemala.[77]

Not surprisingly, many commentators have called for a more disciplined framework. Professor Neyers argues that "[w]hen the court is asked to justify [piercing the corporate veil], its only response seems to be because 'the situation demands' or 'I feel like

75. For example, s. 45 of the Canada Business Corporations Act provides that "the shareholders of a corporation are not, as shareholders, liable for any liability, act or default of the corporation."

76. *Choc v. Hudbay Minerals Inc.*, [2013] O.J. No. 3375, 2013 ONSC 1414 (Ont. S.C.J.), at para. 45. There are other circumstances in which the corporate veil will be pierced. One is when a business owner does not maintain the formalities required by corporate law with respect to the distinct legal personality of the corporation. *Kobes Nurseries Inc. v. Convery* (2011), 98 B.L.R. (4th) 234, 2011 ONCA 662 (Ont. C.A.).

77. *Choc v. Hudbay Minerals Inc.*, *supra*, footnote 76. See also *Sun Capital Partners III, LP v. New England Teamsters & Trucking Industry Pension Fund*, 724 F.3d 12956 (1st Cir., 2013) (private equity company held liable for unfunded pension liabilities of one of its portfolio companies); Alcoa Inc., Exchange Act Release No. 71261, 2014 WL 69457 (Jan. 9, 2014) (international aluminum producer charged under U.S. Foreign Corrupt Practices Act for bribery carried out by its subsidiaries in Bahrain; agrees to pay $384 million fine). See also *Yaiguaje v. Chevron Corp.*, 2013 ONCA 758 (Ont. C.A.), affirmed (2015), 388 D.L.R. (4th) 253, 2015 SCC 42 (S.C.C.).

it.'"[78] It may be useful to better define specific criteria that would provide guidance, perhaps by statute, both with respect to the risk of personal liability in particular circumstances and as to standards of conduct required to benefit from the protection of limited liability. That said, two widely held observations as to the current state of the law — that it is very difficult to predict how a court will rule in any particular case and that courts should take a more cautious approach to the veil-piercing "doctrine"[79] — appear to be out of step with the trajectory of the law.

Judges recognize the extraordinary nature of the veil-piercing remedy in the face of statutes that expressly limit shareholder liability for corporate misconduct. Hence their tendency to resort to detailed, albeit highly contextual, rationalizations of "exceptional" circumstances in which the remedy is invoked. Perhaps the most detailed analysis of late was that of Lord Sumption in *Petrodel*.[80] He proposed the following test:[81]

> [W]hen a person is under an existing legal obligation or liability or subject to an existing legal restriction which he deliberately evades or whose enforcement he deliberately frustrates by interposing a company under his control . . . [t]he court may then pierce the corporate veil for the purpose, and only for the purpose, of depriving the company or its controller of the advantage that they would otherwise have obtained by the company's separate legal personality.

This is, in itself, uncontroversial. As a recent comment on *Petrodel* notes, courts have long exercised their equitable jurisdiction "to preclude the use of a legal institution . . . to effect a fraudulent or dishonest evasion of the law."[82] What is significant about recent Canadian and American veil-piercing decisions is that they seem to discard the notion that only a "deliberate" or "fraudulent" evasion of the law will justify piercing the corporate veil. What appears to have informed decisions like *HudBay* is that, regardless of the *purposes* intended by the corporate structures at issue, these structures had the *effect* of undermining the purposes of the legal regimes alleged to have been infringed. In respect of tort law, this means ensuring that those who suffer reasonably

78. J.W. Neyers, "Canadian Corporate Law, Veil Piercing and the Private Law Model Corporation" (2000), 50 U. Toronto L.J. 173, at p. 182.
79. See Thomas G. Heintzman and Brandon Kain, "Through the Looking Glass: Recent Developments in Piercing the Corporate Veil" (2013), 28 Banking & Fin. L. Rev. 526, at pp. 539-542.
80. *Prest v. Petrodel Resources Ltd.*, [2013] UKSC 34 (U.K. S.C.).
81. *Prest v. Petrodel Resources Ltd.*, *supra*, footnote 80, at para. 35.
82. Heintzman and Kain, *supra*, footnote 79, at p. 538.

foreseeable harm as a result of the tortious actions of a corporation can access a remedy for that harm.[83] In respect of breaches of statutory or regulatory schemes, a leading Canadian veil-piercing decision notes that the goal of giving effect to a statutory or regulatory scheme has been recognized as an independent justification for piercing the corporate veil.[84] A recent study of corporate veil-piercing in the United States concludes that "the most straightforward theory that explains courts' decision to pierce the corporate veil is furthering a regulatory or statutory scheme whose purpose would be undermined by upholding the corporate form."[85]

The jurisdiction to pierce the corporate veil can be thought of as a particular application of the principle that one should not be permitted to act in a way that undermines the integrity of legal relationships and institutions, a principle that responds to "reasonable expectations". In this manner, it has become an instrument to accelerate the legal legitimization of social norms and encourage good corporate citizenship.

3. Materiality and Corporate Reporting Requirements

The evolution of public company disclosure requirements is another illustration of the trajectory we have outlined. As a general proposition, public companies are required to make timely disclosure of "material" information. "Materiality" has been defined by the courts and securities regulators in terms of there being a "substantial likelihood that the information would have been viewed by the 'reasonable investor' as having significantly altered the total mix of information made available."[86] Likewise, the U.S. Securities and Exchange Commission ("SEC") has stated that information is material if "there is a substantial likelihood that

83. It should be noted that, unlike those harmed by breaches of contract, who have an opportunity in negotiating the relevant contract to ensure that it can reach through the corporate veil to access a remedy (*e.g.*, through a guarantee of a corporation's obligations by its parent), those harmed by a corporation in tort have no prior opportunity to ensure that they can access a remedy for such harm.

84. *Transamerica Life Insurance Co. of Canada v. Canada Life Assurance Co.* (1996), 28 O.R. (3d) 423, [1996] O.J. No. 1568 (Ont. Gen. Div.) at p. 433, affirmed 1997 CarswellOnt 3496, [1997] O.J. No. 3754 (Ont. C.A.) ("It is also the case that the courts will look behind corporate structures where necessary to give effect to legislation, especially taxation statutes").

85. Jonathan Macey and Joshua Mitts, "Finding Order in the Morass: The Three Real Justifications for Piercing the Corporate Veil" (2014), 100 Cornell L. Rev. 99, at p. 115.

86. *TSC Industries Inc. v. Northway Inc.*, 426 U.S. 438 (U.S. Ill. S.C., 1976), at p. 449.

a 'reasonable person' would consider it important."[87] Canadian law takes a similar approach.[88]

As with "reasonable expectations", the concept of a "reasonable person" or "reasonable investor" (and, therefore, of "materiality") is somewhat circular and, therefore, path-dependent.[89] While standards have evolved around financial reporting, it would be hard to argue that a "reasonable investor" seeking to maximize long term risk-adjusted returns would not also have regard for a variety of non-financial (*e.g.*, environmental, social, reputational, relational and governance) information.

It has been argued that the singular focus of the investor community on mandated financial reporting enables massive wealth destruction.[90] To the extent that a company's ability to survive and prosper depends on its success in creating value through strong stakeholder relations, this information is clearly "material". Moreover, such disclosure serves a broader, systemic purpose — as noted in 1913 by U.S. Supreme Court Justice Louis Brandeis, "publicity" is "justly commended as a remedy for social and industrial diseases. Sunlight is said to be the best of disinfectants; electric light the most efficient policeman."[91]

Cynthia Williams has noted that the U.S. Congress provided the SEC with the authority to require disclosure of facts concerning how companies were being managed. In her view, this necessarily requires "information that tracks compliance with a comprehensive array of statutes and international treaties" and "information about activity that is legal, though controversial."[92] Others have

87. SEC Staff Accounting Bulletin No. 99 – Materiality, 64 Fed. Reg. 45,150 (Aug. 12, 1999).

88. See *Sharbern Holding Inc. v. Vancouver Airport Centre Ltd.*, [2011] 2 S.C.R. 175, 2011 SCC 23 (S.C.C.), at para. 61 (in which the Supreme Court of Canada adopts a "reasonable investor" standard for determining materiality); CSA National Policy 51-201 (Disclosure Standards) (in which the Canadian Securities Administrators note that the "market impact" and the "reasonable investor" standards are likely to converge, for practical purposes, in most cases).

89. Wendy Gerwick Couture, "Materiality and a Theory of Legal Circularity" (2015), 17 U. Pa. J. Bus. L. 453.

90. John Graham, Campbell Harvey and Shiva Rajgopal, "Value Destruction and Financial Reporting Decisions" (2006), 62:6 Fin. Analysts J. 27, at p. 27 ("[T]he destruction of shareholder value through legal means is pervasive, perhaps even a routine way of doing business. Indeed, the amount of value destroyed by companies striving to hit earnings targets exceeds the value lost in high-profile fraud cases").

91. Louis D. Brandeis, *Other People's Money, and How the Bankers Use It* (New York, F.A. Stokes, 1914), at p. 92.

92. Cynthia A. Williams, "The Securities and Exchange Commission in Corporate Social Transparency" (1999), 112 Harv. L. Rev. 1199, at pp. 1274-1275.

argued that, to the extent public companies "assume obligations of public trust and accountability when they sell stock to the public", such obligations include full disclosure of material information necessary "to promote investor confidence in the truth and accuracy of issuing companies' financial statements."[93] This logic suggests that changing expectations (and market conditions) have overtaken the current accounting and regulatory framework, creating a situation in which a broad range of non-financial information is material but not yet mandated or consistently reported on.

Historically, securities regulators have resisted the characterization of such information as material. Consider, for example, the protracted confrontation that the SEC had with the Natural Resources Defence Council during the 1970s over proposals for increased social and environmental disclosure, during which the SEC claimed that such information was not material to investors and that the costs of such disclosure outweighed its benefits.[94] Through several years of rule-making, hearings and court proceedings, the SEC's opposition to these increased disclosure requirements prevailed,[95] and for a generation, the SEC's pronouncements on environmental disclosure lagged public sentiment, which came to view governance and environmental matters as having risen to a level of materiality for investors, and disclosure thereof as responsive to the "reasonable expectations" of other stakeholders and the general public.

Regulators now recognize this gap. The SEC has addressed the issue of climate change by issuing an interpretive release which provides guidance as to how the "materiality" threshold may require disclosure of relevant environmental information.[96] The release notes that the actual or potential impacts of the physical effects of climate change on an issuer's business, as well as the risks

93. David Monsma and Timothy Olsen, "Muddling through Counter-Factual Materiality and Divergent Disclosure: The Necessary Search for a Duty to Disclose Material Non-Financial Information" (2007), 26 Stan. Envt'l L.J. 139, at p. 141.

94. For a detailed discussion of the NRDC case and the SEC's rationale for opposing increased disclosure, see Williams, *supra*, footnote 92, at p. 1257.

95. See Disclosures Pertaining to Matters Involving the Environment and Civil Rights, Exchange Act Release No. 9252 (July 19, 1971); Steve Lydenberg, "On Materiality and Sustainability: The Value of Disclosure in the Capital Markets" (Cambridge, Massachusetts, Initiative for Responsible Investment, Hauser Center for Nonprofit Organizations at Harvard University, September 2012), at p. 20.

96. SEC Guidance Regarding Disclosure Related to Climate Change, 75 Fed. Reg. 6,290 (February 2, 2010).

and opportunities arising from scientific, legal and political developments relating to climate change, may be material to an issuer's business and should therefore be discussed in that issuer's disclosure documents.[97]

Securities and other regulators have addressed not just climate change but other social and governance issues.[98] The volume of mandated governance disclosure continues to explode in response to demand for corporate and market accountability.[99] A number of stock exchanges have or are planning to launch sustainability indices and are requiring or encouraging listed companies to publish corporate social information (or explain why they are not doing so).[100] Several countries require sustainability reporting for certain domestic corporations.[101] The European Parliament has passed legislation requiring publicly traded companies with more than 500 employees to report on non-financial sustainability factors effective in 2017.[102]

The private sector is also taking proactive steps to address social and environmental issues. The majority of the companies in the S&P 500 and the Fortune 500 indices are reporting voluntarily on their environmental, social and governance impacts.[103] Financial institutions with combined assets under management of over U.S.$59 trillion have become signatories to the U.N. Principles for Responsible Investment.[104] Several have adopted investment beliefs which include a commitment to "consider risk factors, for example climate change and natural resources availability, that

97. *Ibid.*
98. Recent examples of mandated disclosure include the sourcing of "conflict minerals", payments to governments by resource extraction issuers and disclosure of business with certain governments, persons and entities subject to specific U.S. trade sanctions. See, respectively, Conflict Minerals, 77 Fed. Reg. 56,274 (September 12, 2012); Disclosure of Payments by Resource Extraction Issuers, 77 Fed. Reg. 56,365 (September 12, 2012); 15 U.S.C. § 78m(r).
99. See, *e.g.*, Ontario Securities Commission Notice 51-717, "Corporate Governance and Environmental Disclosure" (December 18, 2009).
100. See, *e.g.*, Robert Kropp, "Brazilian Stock Exchange Recommends that Companies Report or Explain", *socialfunds.com*, January 7, 2012).
101. See, *e.g.*, "Corporate Social Responsibility Reporting in Denmark: Impact of the Legal Requirement for Reporting on CSR in the Danish Financial Statements Act" (Danish Business Authority, August 2010).
102. Press Release, European Commission, Disclosure of Non-Financial Information (September 29, 2014), online: <http://europa.eu/rapid/press-release_STATEMENT-14-291_en.htm>.
103. Governance and Accountability Institute, Inc., *2012 Corporate ESG/Sustainability/Responsibility Reporting, Does it Matter?* (December 15, 2012).
104. *United Nations Principles on Responsible Investment*, online: <http://www.unpri.org>.

emerge slowly over long time periods, but could have a material impact on company or portfolio returns."[105]

The mandated disclosure of material sustainability data is a logical next step in the evolution of corporate reporting requirements, one that is responsive to the reasonable expectations of investors — who increasingly understand the connections between their interests and those of other stakeholders — and, by mitigating existing incentives for public companies to underinvest in sustainability, one that serves a greater public interest.

4. Intergenerational Equity – the Duty of Impartiality

A striking example of the power of "reasonable expectations" as a legal compass is in respect of the fiduciary duties of trustees of defined benefit pension plans. In the course of a generation, we have seen a dramatic shift from a narrow economic focus which conflated "prudence" and "rationality" to legal standards based on reasonable expectations.[106] The former was rooted in beliefs about efficient markets and rational behaviour — at the individual and systemic level. The latter acknowledges that markets often miss that part of freedom that has to do with the ability of participants to have a say in shaping our society.[107] More specifically, "rational" investors have been required by regulation to focus on short-term investment returns, measured by market price, rather than on the objective well-being of beneficiaries, the sources of investment reward in the real economy or their obligation to allocate benefits impartially between current and future beneficiaries. In contrast, reasonableness supposes that decision-makers act with reference to others in society and to agreed-upon principles and norms — *i.e.*, concern with the protection or enhancement of the common good.[108]

During the 1990s, modern portfolio theory (MPT) provided the theoretical foundation for significant reforms in the duties of fund

105. See, *e.g.*, California Public Employees' Retirement System, *CalPERS Investment Beliefs* (2013), at p. 6, online: <https://www.calpers.ca.gov/eip-docs/investments/policies/invo-policy-statement/investment-beliefs.pdf>.

106. See, *e.g.*, CalPERS Investment Beliefs, *supra*, footnote 105.

107. See Michael Sandel, *What Money Can't Buy: The Moral Limits of Markets* (New York, Farrar, Straus and Giroux, 2012).

108. As John Rawls explains, persons can be said to act reasonably when "they are ready to propose principles and standards as fair terms of cooperation and to abide with them willingly, given the assurance that others will likewise do so." John Rawls, *Political Liberalism* (Cambridge, Massachussets, Harvard University Press, 1991), at p. 49.

fiduciaries.[109] By assuming efficient capital markets and substituting portfolio level diversification and risk control for judgment-based securities selection as the basis for prudent investment, trustees were enabled to pursue investment policies that promised less risk and better returns.[110] Coincidently, MPT benefited financial service providers, by reducing their exposure to liability for imprudent investments.[111] As with many of the classes of investments made by trustees under the "prudent investor" regime, the regulatory framework proved too good to be true. While it focused fiduciaries' attention on the maximization of portfolio-level returns and their obligation to avoid personal conflicts of interest, it also led to herd-like behaviour, with most fiduciaries focusing on "beating the markets" in the short-term.[112]

"Beat the market" strategies tend to take two forms. One approach is to take advantage of informational asymmetries (*e.g.*, insider trading, high frequency trading or other ways of trading "ahead" of others). The other is passive investing — "buying the market" and keeping costs as low as possible to ensure that one doesn't underperform the benchmark indices.

Both strategies disconnect the investment process from the real economy. The former is disconnected from the underlying forces driving value-creation in society. As Peter Bernstein observed, investment "has to be a positive-sum game to some extent, or else no one would play."[113] The latter increases systemic risk through herding behaviour and the short-termism of markets.[114] The consequence of herding behaviour has been visible in markets — increased volatility and a narrow focus on short-term market prices. These effects have become matters of concern for society as a whole (and for the interests of future generations) because of the dislocations and imbalances they create.[115]

109. Stewart E. Sterk, "Re-Thinking Trust Law Reform: How Prudent is Modern Prudent Investor Doctrine?" (2010), 95 Cornell L. Rev 851.
110. James Hawley, Keith Johnson and Ed Waitzer, "Reclaiming Fiduciary Duty Balance" (2011), 4 Rotman Int'l J. of Pension Mgmt. 4, at p. 5.
111. *Ibid.*, at p. 9.
112. *Ibid.*, at pp. 7-8.
113. Peter L. Bernstein, *Capital Ideas: The Improbable Origins of Modern Wall Street* (Hoboken, New Jersey, John Wiley & Sons, 2005), at pp. 120-121.
114. While passive investors think of themselves as "long-term", they are, in fact, invested in largely indexed-linked funds which are constantly adjusting to the relevant index. Simon Zadek describes this as making them perpetual investors in short-term investments. Simon Zadek, Presentation at World Economic Forum, 2005.
115. Steve Lydenberg, "Reason, Rationality and Fiduciary Duty", draft manuscript

Robert Skidelsky (citing John Maynard Keynes) explains how price volatility is profoundly harmful to society and a source of fundamental unfairness:[116]

> [P]eople cannot be expected to take proper account of the consequences of their economic acts if the standard of value [(*i.e.*, price)] is constantly fluctuating. [Keynes wrote that] "[u]nemployment, the precarious life of the worker, the disappointment of expectation, the sudden loss of savings, the excessive windfalls of individuals, the speculator, the profiteer — all these proceed, in large measure, from the instability of the standard of value."

Just as the duty of corporate directors to act in the "best interests of the corporation" is no longer solely focused on the interests of shareholders,[117] reasonable expectations (and the duty of impartiality) require fund fiduciaries to consider and balance the divergent interests of current and future beneficiaries.[118] This means recognizing that the benefits of short-term financial returns are impossible to measure without referring to a beneficiary's circumstances — such as quality of life, availability of public services — and that fund fiduciaries should examine the effects their investment decisions will have on these circumstances when determining whether their decisions will leave beneficiaries objectively better off. In other words, it requires fiduciaries to "consider questions of future value rather than price",[119] and "consider[. . .] how their investments impact positively or negatively the stability of the financial system, the direction of the economy, and the sustainability of the environment."[120]

The intergenerational dimension to this challenge is that the relationships will never be based on reciprocity — we depend on the behaviour of those who precede us but they are not dependent on ours.[121] Rawls justifies the aim of intergenerational justice by stating that it is "demanded as a condition of bringing about the full realization of just institutions and the fair value of liberty."[122] He illustrated the distinction between the concepts of reason and rationality by referencing when people make remarks such as

(February 2012), at p. 30, online: <http://hausercenter.org/iri/wp-content/uploads/2012/06/Lydenberg_ReasonRationality.pdf>.

116. Robert Skidelsky, *Keynes: The Return of the Master* (New York, Public Affairs, 2009), at p. 149.
117. *BCE*, *supra*, footnote 5, at para. 81.
118. Hawley, Johnson and Waitzer, *supra*, footnote 110, at p. 12.
119. Lydenberg, *supra*, footnote 115, at p. 28.
120. *Ibid.*, at p. 24.
121. John Rawls, *A Theory of Justice* (Cambridge, Massachussets, Harvard University Press, 1971), at p. 126.
122. *Ibid.*, at p. 290.

"their proposal was perfectly rational given their strong bargaining position, but it was nevertheless highly unreasonable, even outrageous."[123] In contrast, *Black's Legal Dictionary* defines a "reasonable person" as "a person who exercises the degree of attention, knowledge, intelligence and judgment that society requires of its members for the protection of their own and others' interests."[124]

5. Exercise of Public Interest Powers

Like many empowering statutes, securities legislation confers on the Ontario Securities Commission (OSC) the ability to make a wide range of punitive and remedial orders if "in its opinion it is in the public interest" to do so.[125] Despite numerous references to the "public interest" in the Ontario Securities Act,[126] there is no statutory definition of the term or guidance as to the scope of such power and how it should be exercised. In recent years, the scope of orders made by the OSC using its public jurisdiction has expanded considerably.[127]

In *Canadian Tire*[128] the OSC noted that a breach of securities laws is not a precondition to a public interest order and characterized as "facts that demand some relief" cases involving "an abusive transaction that will have a deleterious effect on a class of investors in particular, or on capital markets in general", or "a transaction that is clearly abusive of investors and of the capital markets, whether or not that transaction constitutes a breach of the Act, the regulations or policy statement."[129] In upholding this decision on judicial review, the Ontario Divisional Court noted that the transaction under scrutiny confounded the "justifiable expectations" of investors and the marketplace.[130] In *Asbestos*, the Supreme Court confirmed that the OSC may act in the absence of

123. Rawls (1991), *supra*, footnote 108, at p. 48.
124. *Black's Law Dictionary*, 8th ed. (2004), s.v. "reasonable person".
125. Securities Act, R.S.O. 1990, c. S.5, s. 127(1).
126. *Ibid.*
127. See Paul Davis, *Justifiable Expectations Standard: The Basis for the Exercise of the Public Interest Power of the Ontario Securities Commission* (Toronto, McMillan LLP, 2014), at pp. 2-3.
128. *Canadian Tire Corp. v. C.T.C. Dealer Holdings Ltd.* (1987), 10 O.S.C.B. 857 (Ont. Securities Comm.), affirmed (1987), 37 D.L.R. (4th) 94 (Ont. Div. Ct.), leave to appeal refused (1987), 35 B.L.R. xx (note) (Ont. C.A.) ("*Tire* (OSC)").
129. *Tire* (OSC), *supra*, footnote 128, at paras. 128-130.
130. *Canadian Tire Corp. v. C.T.C. Dealer Holdings Ltd.* (1987), (*sub nom.* C.T.C. Dealer Holdings Ltd. v. Ontario (Securities Commission)) 59 O.R. (2d) 79 (Ont. Div. Ct.), leave to appeal refused (1987), 35 B.L.R. xx (note) (Ont. C.A.).

a breach of securities laws to address conduct that is abusive of investors and capital markets or designed to avoid the animating principles behind securities regulation.[131]

Since *Canadian Tire*, the Commission has exercised its public interest jurisdiction in a wide range of take-over and enforcement decisions. In doing so, the Commission has been prepared to make determinations with respect to the exercise by directors of their statutory duties under corporate law, particularly in respect of change of control situations.[132] In one case, despite having determined that the making of a materially misleading statement by an issuer did not technically violate securities law, the Commission issued sanctions on the basis that "there should be no doubt in the minds of market participants that the Commission is entitled to exercise its public interest jurisdiction where any inaccurate, misleading or untrue public statement is made, whether or not the statement contravenes Ontario securities law."[133] More recently, the Commission sanctioned an officer of a public company for trading in shares of another company that was subsequently acquired by the officer's company. After finding that there was no breach of the Securities Act, the Commission exercised its public interest powers to sanction the officer on the basis that, as a market participant, he was expected (and failed) to adhere to a high standard of behaviour.[134]

The "justifiable expectations"[135] standard, employed by the Divisional Court in *Canadian Tire*, has proven to be a reasonably accurate litmus test for Commission intervention. While many have urged the Commission to develop more transparent standards and principles for when its public interest power will be exercised, the doctrine of reasonable expectations, to the extent that it incorporates the idea that courts and regulators should examine

131. *Committee for Equal Treatment of Asbestos Minority Shareholders v. Ontario (Securities Commission)*, [2001] 2 S.C.R. 132, 2001 SCC 37 (S.C.C.) at para. 36.
132. See Sean Vanderpol and Ed Waitzer, "Mediating Rights and Responsibilities in Control Transactions" (2010), 48 Osgoode Hall L.J. 639.
133. *Re Biovail Corp.* (2010), 33 O.S.C.B. 8914 (Ont. Securities Comm.), at para. 383.
134. *Re Donald* (2012), 35 O.S.C.B. 7383 (Ont. Securities Comm.) at para. 319. In contrast, the Commission decided not to intervene on public interest grounds in *Re Magna International Inc.* (2010), 34 O.S.C.B. 1290 (Ont. Securities Comm.), noting that, while "certain investors or shareholders may consider the price proposed to be paid [in the impugned transaction] to be outrageous", shareholders had already been given an opportunity to approve the proposed transaction and contest its "fairness" in court under corporate law, and accordingly, the objecting shareholders could not argue that their reasonable expectations had been defeated.
135. *Tire* (OSC), *supra*, footnote 128, at para. 78.

the effect of market participants' conduct on investor confidence in Ontario capital markets, has proven to be a powerful predictor of the Commission's willingness to exercise this extraordinary authority.[136]

Given the Commission's explicit adoption of a "reasonable expectations" standard, the increased frequency with which the Commission has invoked its public interest jurisdiction[137] and the increasingly broad scope of circumstances in which it has done so should not come as a surprise. As noted previously, there is a degree of circularity embedded in the standard. Over time, it has become "reasonable" to expect the Commission's willingness to intervene, even absent a statutory breach, when investor confidence is at stake.

Market participants seeking to act in compliance with the "public interest", as viewed by the Commission, can use reasonable expectations as a guide. Instead of only asking whether a proposed course of action is "legal", they should also consider whether that course of action is likely to be seen as undermining the integrity of the capital markets — by, for instance, undermining an important principle (*e.g.*, that statements to investors should not be materially misleading) or undermining confidence in the officers of public companies or other classes of market participants who rely on such confidence to perform their duties and create economic and social value.

V. CONCLUSION

Rebecca Henderson and Karthik Ramanna recently argued that the traditional view that managers have a duty to take every opportunity (within the bounds of the law) to maximize profit may be compelling if there is an active, or "thick" political market, in which diverse interests are meaningfully represented, and legislators and regulators have access to the information necessary to promulgate rules that serve the public interest, as this political market could check the consequences of self-interested profit-seeking that would otherwise distort the conditions for capitalism.[138] "Thin" political markets, on the other hand — in which

136. Davis, *supra*, footnote 127, at p. 2.

137. *Ibid.*

138. Rebecca Henderson and Karthik Ramanna, "Do Managers Have a Role to Play in Sustaining the Institutions of Capitalism?" (Washington, D.C., Brookings Institution Center for Effective Public Management, February 2015), online: <http://www.brookings.edu/~/media/research/files/papers/2015/02/managers-

political processes are dominated by special interest groups, or in which legislators' and regulators' ability to promulgate or anticipate the need for new rules is impeded by a lack of information or political will — create a need for duties to be reframed so as to require corporations and their managers to play an active role in maintaining the conditions that sustain capitalism.[139] "This duty might at times require subverting the [short-term] profit interests of the firm itself."[140] The scale of the environmental and societal challenges we face eclipses the capacity of individual governments and frameworks for governmental co-operation to address these challenges remain nascent at best. Our era of "thin" political markets creates an obligation, and an opportunity, for market participants to help address these challenges, using reasonable expectations as a guide.

The use of reasonable expectations as a legal benchmark will continue to grow in importance. Indeed, this trend may well be amplified by big data, smartphone, and other technologies that enhance transparency by making it easier to identify misconduct or conduct that has unintended negative effects on society (and, accordingly, provide an evidentiary basis on which to justify regulatory or judicial action to address conduct that violates reasonable expectations). It therefore would be prudent for market participants to use reasonable expectations as a guide when making decisions that affect the interests of others.

This article has aimed to provide a framework for understanding the doctrine, by noting its consistent focus on requiring powerful actors to avoid courses of action that cause unnecessary or disproportionate harm to others, and on upholding the integrity of legal and regulatory regimes, as well as the social institutions that rely on these regimes. Given the broader trends discussed above, the doctrine of reasonable expectations will likely continue to develop into a central instrument for requiring market participants to consider the effects their actions have on their stakeholders, as well as the environment and society as a whole.

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sustainable-capitalism-henderson-ramanna/brookingsinstitutionsofcapitalismv5.pdf>, at p. 3.

139. *Ibid.*, at pp. 12-14.

140. *Ibid.*, at p. 14.