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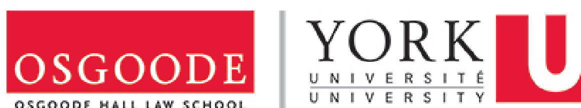

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THE FUTURE OF STAKEHOLDER INTERESTS IN CORPORATE GOVERNANCE

*Poonam Puri**

I. INTRODUCTION

The emphasis of corporate governance evolves as economic, political and social environments change.[1] Since the most recent economic crisis and current downturn, corporate governance has focused on issues such as risk management by boards, executive compensation, shadow banking, credit rating agencies and the appropriate role of direct government ownership in private enterprises.[2]

An effective corporate governance regime involves a spectrum of mechanisms that range from mandatory legal rules to purely voluntary initiatives. Legal mechanisms include the board of directors, the fiduciary duty that directors owe to the corporation,[3] and specific legal obligations that directors have to particular stakeholders.[4] They also include shareholder rights to elect the board,

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1. See generally John Ruggie, "Reconstituting the Global Public Domain — Issues, Actors and Practices" (2004), 10 E.J.I.R. 499, online: SSRN <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=571825>; Cristie L. Ford, "New Governance, Compliance, and Principles-Based Securities Regulation" (2008), 45 Am. Bus. L.J. 1.
2. See generally Brian R. Cheffins, "Did Corporate Governance 'Fail' During the 2008 Stock Market Meltdown? The Case of the S&P 500", online: SSRN <http://papers.ssrn.com>; Simon C.Y. Wong, "Uses and Limits of Conventional Corporate Governance Instruments: Analysis and Guidance for Reform (Integrated Version)", online: SSRN <http://papers.ssrn.com>; Klaus J. Hopt, "Modern Company and Capital Market Problems: Improving European Corporate Governance After Enron", online: SSRN <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=571825>.
3. Canada Business Corporations Act, R.S.C. 1985, c. C-44 (CBCA), s. 122(1)(a).
4. CBCA, *ibid.*, s. 119.

appoint the auditors and receive information, and shareholder and stakeholder remedies such as the oppression remedy and the derivative claim.[5] Securities laws provide additional administrative, quasi-criminal and civil remedies that impose a further governance discipline on public companies. At the other end of the spectrum, market mechanisms include incentives to maintain a good reputation, and shareholder activism by institutional investors such as public pension funds.[6] The value and usefulness of the various legal tools are vigorously debated amongst academics and policymakers, as is the ability of market actors to self-regulate.[7] The separation between state regulation and market forces is not absolute; rather, the relevant issue is where on the continuum between state regulation and market forces our overall system of corporate governance should lie.

An important organ of corporate governance is the board of directors of a public company.[8] Under Canadian corporate law, directors have a duty to act honestly and in good faith with a view to the best interests of the corporation; this is often known as the fiduciary duty or the duty of loyalty.[9] Corporate law statutes provide no guidance on the interpretation of this principle. Thus corporate directors and officers are afforded a high degree of discretion in corporate decision-making. Should the phrase, "the best interests of the corporation" be interpreted as what is best for the shareholders of a corporation? This would be consistent with shareholder primacy models since shareholders are considered the residual owners of the corporation after specific legal obligations to other stakeholders have been discharged.[10] Or should "the best interests of the corporation" involve directors considering the interests of stakeholders even beyond specific legal obligations that are owed to them when making significant corporate decisions? This approach would be more aligned with stakeholder theory.

In the recent case BCE *Inc. v. 1976 Debentureholders*[11] (*BCE*), the Supreme Court of Canada (SCC) attempted to provide guidance on

5. CBCA, *ibid.*, ss. 241 and 239.
6. Poonam Puri, "Pension Funds: Their Role in Capital Markets, Corporate Governance and a Competitive Economy", Report to the Expert Commission on Pensions (2008), online: Expert Commission on Pensions <http://www.pension-review.on.ca/english/summaries/14Puri.html>.
7. Alan Greenspan, "The Evolution of Banking in a Market Economy" (remarks at the Annual Conference of the Association of Private Enterprise Education, Arlington, April 12, 1997), online: Federal Reserve <http://www.federalreserve.gov>.
8. CBCA, *supra*, footnote 3, s. 158.
9. CBCA, *ibid.*, s. 122(1).
10. CBCA, *ibid.*, s. 119.

this issue. However, the decision did not provide sufficient clarity as to whether the SCC supports shareholder primacy or stakeholder theory as the conceptual basis for interpreting "the best interests of the corporation". The decision also does not provide for sufficient practical guidance for directors and officers in the boardroom.

I argue in this article that greater consideration of stakeholder interests in business decision-making is dependent on a range of factors beyond legal rules, and in particular, beyond directors' fiduciary duties. In my view, corporate culture matters. Who the corporate directors and corporate managers are, and their principles, their vision and motivations for their actions are important. Context also matters. The composition of the shareholder base and support or resistance from other stakeholders impacts corporate decision-making, as do pressures facing the industry.[12] I am not suggesting that there is no role for law; quite the contrary, the law provides a general framework but has its limitations. As such, the potential of non-legal mechanisms that can advance stakeholder interests are discussed in this article, with particular reference to two issues: environmental and social issues, and racial and gender diversity issues. By exploring these issues, I argue that businesses regularly engage in initiatives that advance stakeholder interests (and allow them to be socially responsible and good corporate citizens) and that their behaviour can be explained by a complex combination of directors' and management's vision of the right thing to do, their view on long-term value maximization, pressure from shareholders, stakeholders and non-governmental organizations (NGOs), as well as a desire to avoid governmental regulation or mandatory legal rules.

This article proceeds as follows: Part II provides a brief overview of the BCE transaction and Supreme Court of Canada decision as it relates to the fiduciary duty and the business judgment rule. Part III explores voluntary initiatives undertaken by corporations with a focus on environmental and social issues, and diversity issues. Part IV concludes.

11. [2008] S.C.J. No. 37 (QL), [2008] 3 S.C.R. 560.
12. See generally Roger L. Martin, "The Virtue Matrix: Calculating the Return on Corporate Responsibility" (2002), 80 Harv. Bus. Rev. 68, who writes that it is important to note that legal structures impose certain priorities on senior executives. The perception of failing to maximize shareholder value in favour of corporate social responsibility (CSR) activities may cost a manager or executive his or her job. This may explain the reluctance of CSR from emerging in new areas — senior executives may not want to take the lead and face the corresponding risk.

II. THE *BCE* DECISION

The Supreme Court of Canada's decision in *BCE* was disappointing because the SCC did not seize the opportunity to provide useful guidance to the Canadian legal and business community on how to appropriately balance risks and rewards amongst shareholders and different groups of stakeholders in difficult corporate decisions. Instead, the SCC makes general statements on the fiduciary duty that ring hollow without context; the SCC also articulates the business judgment rule in such a way that corporate directors and officers are effectively insulated from review by the courts, leaving stakeholders with little or no legal recourse or accountability.

BCE involved the largest proposed leveraged buy-out and privatization in Canadian history. In March 2007, BCE confirmed that the company was considering privatization, and was in the process of "[r]eviewing its strategic alternatives and would be guided by the goal of maximizing shareholder value".[13] BCE's Board presented the bidders with rules for the bidding process, indicating a very clear focus on shareholder value.[14]

The $51.7 billion deal with Teachers' Private Capital & Providence Equity Partners (Teachers) (the Transaction) involved selling BCE for a 40% premium over the then-trading price of BCE shares. Bell Canada, a subsidiary of BCE, would guarantee $30 billion of debt to be taken on by BCE to finance the buy-out by Teachers. The deal was unanimously approved by BCE's Board and approved by over 97% of the shareholders of BCE.

However, the guarantee provided by Bell on debt to be issued to BCE fundamentally changed the risk profile of the existing bonds issued by Bell Canada. The market reacted by reducing the trading value of Bell Canada's bonds by as much as 20%, based on the increased risk of default.[15] The subsequent downgrading of the bond ratings underscored the increased investment risk: a non-investment grade status could force some institutional investors to sell because they are required to comply with specified investment restrictions,

13. BCE, "Notice of Special Shareholder Meeting and Management Proxy Circular", August 14, 2007, online: SEDAR <http://sedar.com> at p. 14 (Proxy Circular).
14. Proxy Circular, *ibid.*, at p. 17. The bidding rules required the private equity bidders to make submissions with respect to the details on the proposed purchase price and form of consideration per share for the common shares of BCE, and the proposed treatment of each series of preferred shares of BCE and of the debt securities issued by BCE and its subsidiaries, as well as a detailed mark-up of any proposed changes to the definitive transaction agreement circulated by BCE.
15. Carrie Tait, "Rebels stuck with BCE's hefty legal bills", *Financial Post* (June 23, 2008), online: Financial Post <http://www.financialpost.com>.

possibly putting even further downward pressure on the bonds' trading value.

The Board's focus in negotiating and approving this deal was entirely consistent with shareholder value maximization. The Board looked through the corporation and focused on shareholders over other stakeholders. In its proxy circular, BCE explicitly stated that the Board would not "have fulfilled its duties had it negotiated a transaction that provided less value to Common Shareholders in order to provide debentureholders with additional protections that they did not bargain for or obtain under the terms of the Indentures", with the cost of such protections implicitly being borne by shareholders.[16]

The Supreme Court of Canada allowed the proposed transaction to proceed as structured.[17] Analyzing the Supreme Court's language makes it clear that in terms of fiduciary duty post-*BCE*, a *version* of shareholder primacy remains[18] although consideration should be given to the interests of other stakeholders. Equally clear from the Supreme Court's decision is the broad articulation of the business judgment rule and the breadth of the deference granted to directors in balancing the interests of stakeholders, subject only to certain basic constraints.

While consideration of stakeholder interests is permitted or possibly required,[19] the Supreme Court refused to offer guidance on the priority among stakeholders when interests conflict and directors need to allocate risks and rewards amongst different groups of stakeholders. In this regard, the Supreme Court simply stated that

16. Proxy Circular, *supra*, footnote 13, at p. 23.
17. *BCE*, *supra*, footnote 11, at para. 167.
18. *Ibid.*, at paras. 167 and 66. A version of shareholder primacy remains in that sense that the SCC allowed the BCE transaction to go ahead, thereby prioritizing shareholder interests over other stakeholder interests, but held that other stakeholder interests should also be considered, where specific facts warrant.
19. See, *e.g.*, Jeffrey G. Macintosh, "BCE and the Peoples Corporate Law: Learning to Live on Quicksand" (2009), 48 C.B.L.J. 255. (The court's decision seems unclear on this point: *BCE*, *supra*, footnote 11, at para. 40, the court says that "directors *may* look to the interests of . . . shareholders, employees, creditors, consumers, governments and the environment to inform their decisions" (emphasis added). However, at para. 66 the court seems to suggest that in certain circumstances directors "must consider" stakeholder interests: "Directors, acting in the best interests of the corporation, *may be obliged* to consider the impact of their decisions on corporate stakeholders" (emphasis added), and at para. 82: "the duty of the directors to act in the best interests of the corporation comprehends a duty to treat individual stakeholders affected by corporate actions equitably and fairly". A full discussion of whether directors "must" or "may" consider stakeholder interests is outside the scope of this article; however, it is important to note that this debate exists.)

the fiduciary duty of directors to the corporation is a broad, contextual concept.[20] The content of this duty varies with the situation at hand.[21] "Often the interests of shareholders and stakeholders are co-extensive with the interests of the corporation. But if they conflict, the directors' duty is clear — it is to the corporation."[22] The court's comments here are not very helpful; they provide little guidance to directors as to how they should prioritize interests, and offer very little comfort to any stakeholder group about how much they can reasonably expect from boards, beyond what may be contractually agreed to or specifically provided for in legislation.

In other passages, the court seemed to endorse a *stakeholder* conception of the corporation by making important aspirational comments and used language such as "good corporate citizen"[23] and "responsible corporate citizen".[24] The court engaged in an analysis of reasonable expectations of stakeholders, referring to them as "the cornerstone of the oppression remedy".[25] It went further to recognize that stakeholders and corporations engage in relationships based on expectations and understandings, and that stakeholders are entitled to rely on these expectations, provided they are reasonable in context.[26] However, where reasonable expectations of stakeholders compete with the best interests of the corporation, the duty is owed to the corporation.[27] The difficulty comes in reconciling the reasonable expectations of stakeholders with the best interests of the corporation.

Given the Supreme Court's lack of clarity[28] in respect of how boards are to prioritize stakeholders' reasonable expectations as against shareholders' expectations, the board benefits from a significant increase in discretion and decrease in litigation risk. In these instances, directors will be further insulated by judicial deference: "Courts should give appropriate deference to the business judgment of directors who take into account these ancillary interests, as reflected by the business judgment rule."[29]

20. BCE, *supra*, footnote 11, at para. 38.
21. *Ibid.*
22. *Ibid.*, at para. 37. (For this proposition, the Supreme Court cites *Peoples Department Stores Inc. (Trustee of) v. Wise*, [2004] 3 S.C.R. 461, 244 D.L.R. (4th) 564, as authority.)
23. *Ibid.*, at para. 66.
24. *Ibid.*, at para. 82.
25. *Ibid.*, at para. 61.
26. *Ibid.*, at para. 63.
27. *Ibid.*, at para. 66.
28. *Supra*, footnote 19.
29. BCE, *supra*, footnote 11, at para. 40. (The Supreme Court adopts the articulation

The Supreme Court has therefore managed to avoid the major policy decision of prioritizing a corporation's stakeholders; instead, it has made the major policy decision of delegating the matter to directors.[30]

The *BCE* decision can in many ways be seen as a hollow victory for advocates of stakeholder rights, and leaves a question unanswered: if the decision of how to reconcile conflicting stakeholder interests is delegated to directors, how and on what basis should they undertake such decisions? It is credible to argue that director decision-making, in general, will be guided by corporate norms, which historically have favoured shareholders. But norms, culture and context change over time, and this is where the Supreme Court's aspirational comments about businesses being good corporate citizens and acting fairly and responsibly to other stakeholders create an opportunity for directors to advance stakeholder interests.

The next part of this paper explores environmental and diversity initiatives undertaken by businesses, as examples of stakeholder considerations which are not mandated by any specific legal obligations or by the general fiduciary duty, but are voluntary initiatives that have been undertaken by corporations as being consistent with the long-term interests of the business.

III. VOLUNTARY INITIATIVES WITHIN THE PARAMETERS OF THE LEGAL FRAMEWORK

When organizations engage in activities or initiatives, which are not required by specific legal obligations or by the general fiduciary duty of directors and officers, they do so on the basis that the decision is good for the long-term interests of the corporation. Benefits of engaging in these initiatives typically include reduced risk, lower cost of capital, less waste, improved employee productivity, improved brand equity and strengthened relationships with regulators.[31] Poor

of the business judgment rule from *Pente Investment Management Ltd. v. Schneider Corp.* (1998), 113 O.A.C. 253, 42 O.R. (3d) 177 *sub nom. Maple Leaf Foods Inc. v. Schneider Corp.* (C.A.); and *Kerr v. Danier Leather Inc.*, [2007] 3 S.C.R. 331, 286 D.L.R. (4th) 601 (*Danier Leather*): "The 'business judgment rule' accords deference to a business decision so long as it lies within a range of reasonable alternatives.")

30. See generally Lynda Oswald, "Shareholders v. Stakeholders: Evaluating Corporate Constituency Statutes Under the Takings Clause" (June 1998), online: SSRN <http://ssrn.com>. (It should be noted that Canada does not have stakeholder statutes, as do approximately 30 U.S. states. Stakeholder statutes permit managers to consider the interests of non-shareholder stakeholders in the corporation. This includes parties such as employees, customers, suppliers, and/ or the local community.)

risk management systems in organizations can lead to depressed share price, higher insurance premiums, reduced market share, and reduced customer loyalty.[32] Other factors relevant in adopting measures or initiatives not specifically required by law can include appeasing shareholders, employees, NGOs and other stakeholder groups, as well as avoiding or pre-empting governmental regulation. Corporate accountability, especially among multinational corporations, may be driven more by pressure from consumer and financial markets, and less by government or regulatory pressure.[33]

Some commentators dismiss voluntary initiatives as nothing more than "PR" or "greenwashing",[34] arguing that their impact on, for example, environmental sustainability and other social objectives is not as great as intended;[35] however, by publicly adopting voluntary initiatives, corporations are opening themselves up to be held accountable for their commitments.[36] Voluntary initiatives also raise an important issue from a legal perspective: in light of *BCE*, can stakeholders' expectations be reasonably heightened and eventually legally protected based on initiatives that are undertaken voluntarily by businesses?

The next two sections explore environmental and social governance and diversity issues in the workplace as examples of voluntary initiatives undertaken by businesses outside of specific legal obligations and outside of the general fiduciary duty.

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31. Geoffrey M. Heal, "Corporate Social Responsibility — An Economic and Financial Framework" (December 2004), online: SSRN <http://ssrn.com>.
32. S.G. Badrinath and P.J. Bolster, "The Role of Market Forces in EPA Enforcement Activity" (1996), 10 J. Regul. Econ. 165; Anthony Herbst, "An Analysis of the Stock Market's Response to the Exxon Valdez Disaster" (1996), 7 Global Finance Journal 101 at p. 102; Gordon L. Clark and Tessa Hebb, "Why Should They Care? The Role of Institutional Investors in the Market for Corporate Global Responsibility" (2005), 37 Environment and Planning A 2015.
33. Clark and Hebb, *ibid.*, at p. 2016.
34. See generally, John M. Conley and Cynthia Williams, "The Corporate Social Responsibility Movement as an Ethnographic Problem" (October 16, 2008), online: SSRN <http://papers.ssrn.com>.
35. See generally J. Van Oosterhout and Pursey P.M.A.R. Heugens, "Much Ado About Nothing: A Conceptual Critique of CSR", (2006) ERIM Report Series, online: <http://hdl.handle.net/1765/7894>; Neil Gunningham and D. Sinclair, *Leaders & Laggards, Next Generation Environmental Regulation* (Sheffield: Greenleaf Publishing, 2002); Rhys Jenkins, "Corporate Codes of Conduct: Self-Regulation in a Global Economy" (2001) United Nations Research Institute for Social Development, online: UNRI <http://www.unrisd.org>; Banks, Climate and Energy, BankTrack, online: BankTrack <http://www.banktrack.org>.
36. "Contact Ombudsman", online: Tyco <http://www.tyco.com>. Some organizations such as Tyco have initiated a corporate ombudsman whose role it is to respond to questions and challenges from external stakeholder groups.

1. Environmental and Social Governance Initiatives

Numerous international initiatives exist which address corporate social responsibility, with a particular focus on environmental and social governance (ESG) issues. Each has its own perspective, mandate, and guidelines for behaviour. Some are industry-specific, some are driven by the public sector, some by the private sector; almost all have mechanisms in place to ensure senior management support.[37]

Based on the high level of support that many of these voluntary initiatives enjoy, it seems the global business community accepts — at least to some degree — the argument that good corporate citizenry contributes to profitability. Businesses also enter into these initiatives to avoid mandatory governmental regulation on these matters. The UN Global Compact, the Carbon Disclosure Project, the Equator Principles and the Principles for Responsible Investing are four of the more prominent examples of voluntary initiatives. They are discussed below.

The UN Global Compact is a policy platform and practical framework, founded in 2001, which strives to align business strategies and operations with a set of 10 principles specifically addressing human rights, labour, the environment and anti-corruption.[38] The underlying rationale is that business is the primary driver of globalization; incorporating these principles into business strategies and operations can "help ensure that markets, commerce, technology and finance advance in ways that benefit economies and societies everywhere".[39]

It is voluntary and network-based, and advocates active engagement of the corporate sector, in cooperation with organized labour and civil society. It requires a commitment by the corporation's CEO (or equivalent) and their highest oversight body, typically the Board of Directors.[40] Participating corporations are expected to integrate the UN Global Compact and its principles into

37. Sheila Bonini, David Court and Alberto Marchi, "Rebuilding Corporate Reputations" (June 2009) McKinsey Quarterly, online: McKinsey Quarterly <http://www.mckinseyquarterly.com> (EBSCOHOST). Research by McKinsey & Company indicates that in the current environment in which reputational issues threaten both shareholders and a corporation's ability to achieve its goals, a corporation's strategy for managing reputational risk must be led by the CEO, ideally with the support of a dedicated board committee.
38. "Overview of UN Global Compact", online: UN Global Compact <http://www.unglobalcompact.org>.
39. *Ibid.*
40. "Business Participation", online: UN Global Compact <http://www.unglobal-compact.org>.

their business strategy, day-to-day operations, and organizational culture. Corporations commit to producing an annual public document, such as a sustainability report, that describes the ways in which the organization is implementing the 10 principles and how it supports broader development objectives.[41] The UN Global Compact benefits from broad acceptance, with over 7,700 participants, over 5,200 of which are businesses, from over 130 countries.[42]

While the UN Global Compact is one of the more prominent public-sector initiatives; the three initiatives discussed below were each instigated by the private sector, to encourage and facilitate private sector support for ESG schemes.

The Carbon Disclosure Project (CDP)[43] is an initiative by private enterprise that encourages voluntary disclosure of corporate data relevant to climate change. The underlying theory is that measuring and disclosing greenhouse gas (GHG) emissions will facilitate the reduction of GHGs by participants.[44] In 2008, 385 institutional investors representing $55 trillion in assets under management participated in the CDP.[45] The project enjoys the support of some very high-profile organizations and individuals: Walmart has instructed its suppliers to disclose their carbon emissions through the CDP, in an effort to measure the GHG emissions of its extensive supply chain.[46]

While the CDP specifically measures GHG emissions, the Equator Principles (EPS) are a set of principles for managing environmental and social risks specifically in project finance. They are an investor-driven, voluntary, private sector initiative, negotiated and developed by banks, based on the standards of the World Bank and the International Finance Corporation (IFC), with participation and input from other stakeholders. As of January 11, 2010, 68 financial institutions, including all of the Canadian banks, had adopted the EPS.[47]

41. *Ibid.*
42. *Ibid.*
43. Home Page, online: Carbon Disclosure Project <http://www.cdproject.net>.
44. *Ibid.*
45. *Ibid.*
46. "Walmart: Reporting through CDP revealed valuable insight into its greenhouse gas footprint" What We Do, online: Carbon Disclosure Project, *supra*, footnote 43; Edward J. Waitzer *et al.*, *Corporate Social Performance: Reporting Roundtable Consultation Paper, Toronto 2009* (Toronto: Hennick Centre for Business and Law and Jantzi Sustainalytics, 2009) at 15, online: SSRN <http://papers.ssrn.com> (Waitzer *et al.*).
47. "Become an Adopting Institution", online: The Equator Principles <http://www.equator-principles.com/join.shtml>.

To the extent that banks are significant lenders in project finance, they must conduct due diligence, including critical environmental and social evaluation. In this vein, the EPS are consistent with profit maximization and rational due diligence behaviour. Boards recognize that their reputation and profitability could suffer by not addressing these risks when making lending decisions: Royal Bank of Canada (RBC) signed the EPS to show its support for the need to better assess, mitigate, document and monitor the credit risk and reputational risk associated with financing development projects with capital costs over US$10 million.[48] In 2006, the EPS added a requirement stating that each EP bank must publicly report on its implementation processes and experiences.[49] Empirical studies have shown a reflexive relationship between disclosure of non-financial information (whether mandatory or voluntary disclosure), firm performance on social and environmental issues, and a firm's overall value.[50] It should also be noted that, in adopting the EPS, banks may be opening themselves up to increased risk through lender liability theory and doctrines, stemming from their increased role in evaluating social and environmental issues arising in project finance.[51]

The Principles for Responsible Investing (PRI) sit between the public sector UN Global Compact and the private sector CDP and EPS in the sense that the PRI are an investor-driven initiative, partnering with the UN Global Compact and UNEP FI (United Nations Equator Principles Financial Institutions).[52] The PRI represent over 670 institutions globally, representing asset owners, investment managers, and professional service partners. They provide a guideline for incorporating ESG considerations into investment

48. "Project Finance and the Equator Principles", online: Royal Bank of Canada <http://www.rbc.com>.
49. "The Equator Principles": A financial industry benchmark for determining, assessing and managing social & environmental risk in project financing" (July 2006), online: Equator Principles <http://www.equator-principles.com>.
50. Alyson Slater and Sean Gilbert, "The Evolution of Business Reporting: Make Room for Sustainability Disclosure" (2004) Envtl. Qlty Mngmt., online: Global Reporting Initiative <http://www.globalreporting.org>. While this paper is not on the Equator Principles specifically, its concepts are nonetheless applicable.
51. See generally Benjamin J. Richardson, "Mandating Environmental Liability Insurance" (2002), 12 Duke Env. L. & Pol'y F. 293 (HeinOnline); Ryan Hansen, "The Impact of the Equator Principles on Lender Liability: Risks of Responsible Lending" (2006) London School of Economics and Political Science LL.M. Dissertation, online: SSRN <http://papers.ssrn.com>.
52. About, online: United Nations Principles for Responsible Investment <http://www.unpri.org>.

decision-making, while not unduly compromising performance of investment portfolios.

Application of the PRI is intended to lead to better long-term financial rewards, and better alignment of objectives between institutional investors and society at large.[53] The underlying theory is that in encouraging investors to become more active owners, senior corporate leadership will take a more active interest in extra-financial drivers of risk and reward. This approach is anticipated to define corporate profitability over the medium to long term.[54]

The sanctions for non-compliance with the PRI, or any other voluntary initiative, do not rely on legal or regulatory underpinnings. Rather, they rely on a corporation's voluntary and public acceptance of certain principles, or a certain code of conduct; consequently, the sanctions for non-compliance lie fundamentally in terms of reputational risk.

A report released in 2005 by Freshfields Bruckhaus Deringer (Freshfields Report),[55] on behalf of the Asset Management Working Group of UNEP FI examined the legality of including ESG considerations in investment decision-making practices among institutional investors across nine countries. In Canada, the Report focused on pension funds, life insurance companies and mutual funds,[56] and concluded that there was no specific guidance with respect to boards contemplating ESG considerations in their decision-making, either at common law, or in jurisprudence.[57] They concluded that trustees are not barred from including ESG considerations, provided these considerations do not constrain the ultimate goal of profit maximization.[58]

A follow-up report known as Fiduciary II[59] aims to provide legal guidelines for fiduciaries seeking to integrate ESG considerations into

53. *Ibid.*
54. Frequently asked questions, online: United Nations Principles for Responsible Investment, <http://www.unpri.org>.
55. Paul Watchman *et al.*, "A legal framework for the integration of environmental, social and governance issues into institutional investment" (Geneva: Asset Management Working Group, 2005), online: United Nations Environment Programme Finance Initiative <http://www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf>.
56. *Ibid.*, at p. 49.
57. *Ibid.*, at pp. 49-52.
58. *Ibid.*, at pp. 52-54.
59. Paul Watchman *et al.*,"Fiduciary Responsibility: Legal and practical aspects of integrating environmental, social and governance issues into institutional investment" (Geneva, Asset Management Working Group, 2009), online: United Nations Environment Programme Finance Initiative <http://www.unepfi.org/fileadmin/documents/fiduciaryII.pdf>.

their investment decision-making.[60] The Report recommends that ESG considerations should 'enhance and supplement' the investment decision-making process, and should aid in identifying the best investments in terms of risk/reward, as required by U.S. fiduciary law.[61] The authors go so far as to suggest that institutional investment consultants and asset managers have a professional duty of care to proactively raise ESG considerations with their clients, and that a failure to discharge this duty could give rise to negligence claims.[62] I am not suggesting that Canadian fiduciaries necessarily have a duty of care at this time to proactively raise ESG considerations with their clients; however, it is interesting to note the direction of international discourse on this issue.

Further to these voluntary initiatives, pressure for *mandatory* disclosure on environmental, social and governance issues by governments and regulators is mounting. The US Social Investment Forum and the European Sustainable Investment Forum, supported by investor coalitions, are pushing for mandatory ESG disclosure by the Securities and Exchange Commission (SEC) in the United States and the European Commission (EC). Under current Ontario securities regulation, reporting issuers are required, under continuous disclosure obligations, to disclose information about environmental matters and risks, if that information is material.[63] In December 2009, the Ontario Securities Commission (OSC) provided the Minister of Finance with recommendations regarding these disclosure requirements:[64] the regulator is not recommending any *additional* disclosure requirements for issuers; however, they are recommending enhanced compliance guidance and education for issuers, and a compliance review in Spring 2010. Issuers that are not fully compliant then may face greater compliance costs than in the past.[65] Essentially,

60. *Ibid.*, at p. 14.
61. *Ibid.*, at p. 15.
62. *Ibid.*, at p. 16.
63. Ontario Securities Commission Staff Notice 51-716, online: Ontario Securities Commission <http://www.osc.gov.on.ca/en/SecuritiesLaw_sn_20080229_51-716_enviro-rpt.jsp>; National Instrument 51-102 Continuous Disclosure Obligations (December 31, 2008), online: Ontario Securities Commission <http://www.osc.gov.on.ca/documents/en/Securities-Category5/rule_20081231_51-102_unofficial-consolidated.pdf>; *Danier Leather*, *supra*, footnote 29.
64. Waitzer *et al.*, *supra*, footnote 46; Ontario Securities Commission Notice 51-717, *Report to the Minister of Finance* (December 18, 2009), online: OSC <http://www.osc.gov.on.ca> (OSC *Report to Minister of Finance*). This report was issued in response to a resolution passed in April 2009 calling on the province's securities regulator to report back to the Minister of Finance with recommendations for enhanced disclosure requirements for issuers.

the recommendations entail stepped-up policing. The push for enhanced and/or mandatory ESG disclosure is partly a result of the view that global investment markets did not understand or voluntarily take into account the ESG risks that contributed to the 2008/2009 global financial crisis.

Institutional investors have also been pushing for enhanced disclosure through shareholder resolutions. In 2009 alone, a minimum of six ESG-related shareholder resolutions[66] resulted in commitments from corporations to enhanced disclosure and/or further steps to monitor or change corporate behaviour. The supporting statement of Meritas Mutual Funds' shareholder proposal to Toromont Industries Ltd. specifies that "[i]ncreasingly, investors are demanding improved disclosure by companies of how they assess, manage and mitigate the multiple risks associated with climate change in order to protect long-term shareholder value."[67]

This section highlighted a few of the ESG initiatives taking place outside of formal mandatory legal rules; each voluntary initiative involves corporate acceptance, behaviour modification, and voluntary compliance. While these initiatives have been undertaken in the absence of a fiduciary obligation imposed on directors and officers, there is mounting pressure for governments and regulators to develop specific mandatory disclosure rules on ESG issues, highlighting the reflexive and complex relationship between hard law and voluntary or market-based initiatives. The next section explores similar themes relating to racial and gender diversity issues.

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65. OSC *Report to Minister of Finance*, *ibid.*, at pp. 10-12. Corporate governance disclosure recommendations include a follow-up compliance review in Spring 2010, and continued educational outreach to issuers. Recommendations in respect of environmental disclosure include additional guidance for issuers, and enhanced training for OSC staff.
66. Shareholder Association for Research & Education, Shareholder Resolution Database, online: SHARE <http://www.share.ca> (SHARE). The proposals range from requesting that the corporation participate in the Carbon Disclosure Project (Toromont Industries Ltd.), monitor GHG emissions (Suncor Energy), reduce the environmental effects of the business (Potash Corporation of Saskatchewan, Agrium Inc.) and report on the effects of climate change on the company (Sherritt international Corporation, E-L Financial Corporation).
67. SHARE, *ibid.*, online: SHARE <http://www.share.ca>. Meritas Mutual Funds' shareholder resolution to Toromont Industries, in advance of the AGM April 23, 2009.

2. Diversity

Diversity in this context is a term that encompasses the view that a workforce, diverse in terms of gender, age and ethnicity, is better able to understand the marketplace, including customers, suppliers and investors, thereby positively impacting profitability.

Academic debate on this point has been longstanding and robust.[68] Not surprisingly, the issue is more nuanced than a simple yes/no answer would suggest; however, generally, the answer seems to be yes, depending on a number of factors.[69] It has been empirically shown that diversity on corporate boards drives corporate performance.[70] Specifically, benefits of diversity have been articulated as:

- increasing the board's ability to monitor managers, due to its increased independence;
- improving board decision-making based on new perspectives, creative approaches, and innovative, non-traditional thinking;
- improving quality of information to managers, due to diverse knowledge held by directors;
- access to significant resources and constituencies externally;
- positive messages to labour, consumers and the financial markets;
- legitimacy with both internal and external stakeholders.[71]

In Canada, regulatory organizations such as the TSE[72] (as it then was) have come out with their own reports on good governance, such as the 1994 Dey Report,[73] the 1999 five-year review of the Dey Report's recommendations,[74] and the 2001 Saucier Report.[75] Each

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68. For an insightful analysis of the relevant literature, see Aaron Dhir, "Towards a Race and Gender-Conscious Conception of the Firm: Canadian Corporate Governance, Law and Diversity" (2010), 35 Queens L.J. [forthcoming], online: SSRN <http://papers.ssrn.com>.
69. See generally, David A. Carter, Frank D'Souza, Betty J. Simkins, W. Gary Simpson, "The Diversity of Corporate Board Committees and Financial Performance" (March 2008), online: SSRN <http://papers.ssrn.com> (Carter); Cristian L. Dezsö and David Gaddis Ross, "'Girl Power': Female Participation in Top Management and Firm Performance" (August 2008), online: SSRN <http://papers.ssrn.com>.
70. Carter, *ibid.*, at p. 9; Dezsö and Ross, *ibid.*
71. Carter, *ibid.*, at p. 9.
72. "Benefits of Going Public and Listing With Us", online: TMX Group: <http://www.tmx.com> The Toronto Stock Exchange (TSE) has been known as the TSX since 2000. Its functions include regulatory oversight of its listing issuers.
73. Peter Dey, "'Where were the Directors?' Guidelines for Improved Governance in Canada" (December 1994), online: European Corporate Governance Institute <http://www.ecgi.org/codes/documents/dey.pdf>.

of these has encouraged diversity on boards specifically to bring diverse perspectives to bear on issues.[76]

Nonetheless, women in Canada remain severely underrepresented on boards, relative to their numbers in society; over 40% of Financial Post 500 companies have no female directors at all.[77] The same story, though more dramatic, exists for visible minorities: 16% of Canada's population self-identify as visible minorities[78] while they account for only 1.7% of Canadian corporate directors.[79]

Gender and ethnic diversity at the board level and senior management levels is an area that has not been legislated in Canada nor does the fiduciary duty impose any such obligation;[80] however, a bill recently before the Canadian Senate would have required gender parity on boards of most public corporations and Canadian financial institutions.[81] A number of countries have either current (Norway,[82] Finland,[83] Spain)[84] or proposed (France)[85] legislation to this effect;

74. Dr. Ruth Corbin, "Report on Corporate Governance, 1999: Five Years to the *Dey*" (1999), online: European Corporate Governance Institute <http://www.ecgi.org>.
75. Guylaine Saucier *et al.*, "Beyond Compliance: Building a Governance Culture" (November 2001), online: <http://www.ecgi.org/codes/documents/beyond_compliance.pdf>.
76. *Ibid.*, at p. 15.
77. Laura Jenner, Monica Dyer and Lilly Whitham, "2007 Catalyst Census of Women Board Directors of the FP500: Voices from the Boardroom" (New York: Catalyst, 2008), p. 7, online: Catalyst <http://www.catalyst.org>. In Canada, although women account for just over 50% of the population, they hold only 13% of the director positions of Financial Post 500 companies.
78. "Canada's Ethnocultural Mosaic, 2006 Census: Findings" (Statistics Canada, 2006), online: Statistics Canada <http://www12.statcan.ca>.
79. Spencer Stuart and Joseph L. Rotman School of Management, "The Canadian Board Index: Board Trends and Practices at Leading Canadian Companies — Building and Retaining Director Talent in Challenging Times" (2003), as cited in Conference Board of Canada, "Business Critical: Maximizing the Talents of Visible Minorities" (2005) at p. 86.
80. Canadian corporations must comply with human rights legislation, including the Constitution Act, 1982, being Sch. B to the Canada Act 1982 (U.K.), 1982, c. 11 s. 15.
81. Canada, Senate, *Board of Directors Gender Parity Act*, 40th Parliament, 2nd Sess., S-238; online: Senate of Canada <http://www2.parl.gc.ca>. The bill, S-238, died on the order table when Parliament was prorogued in December 2009.
82. Norwegian Public Limited Liability Companies Act, 1997, Del K:1, ss. 6-11a., online: Ministry of Children, Equality and Social Inclusion <http://www.regjeringen.no>. (Norwegian corporate law requires public limited liability companies to comply with varying degrees of gender representation, depending on the size of the board.)
83. Finnish Corporate Governance Code of October 28, 2008, online: Securities Market Association <http://www.cgfinland.fi>. As of January 1, 2010, Finland requires listed companies to have at least one woman on the board.
84. Spanish Constitutional Act 3/2007 of 22 March for Effective Equality between

other countries (Switzerland)[86] have debated and rejected such legislation.

While legislating diversity at the board and senior management levels is one approach, another approach is to contemplate diversity through a regulatory disclosure regime. The SEC has recently adopted a new set of rules governing disclosure, one of which would require nominating committees to disclose whether they consider diversity as a factor in evaluating potential board nominees.[87]

Many public corporations recognize the importance of diversity, and are voluntarily embracing such principles. A few corporations stand out as actively promoting diversity: one Canadian bank reports that diversity is essential to their success as an organization; it strengthens their relationships with their customers, clients, employees, shareholders and other stakeholders, as well as attracting and retaining top talent.[88] Another Canadian bank has included diversity as one of its corporate values, and articulates a focus on increasing women and minorities in senior management.[89]

Some corporations are adopting the concept of a more diverse board as a result of shareholder proposals and pressure from NGOs and advocacy groups. There is evidence to suggest that shareholder proposals, even when not initially accepted, may in the future become part of corporate policy.[90] In the U.S., studies have shown that in recent years, boards have become more willing to implement shareholder proposals.[91] Recently, only a few shareholder

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Women and Men, 2007, Article 75, online: Council of Europe <http://www.coe.int>. Spanish legislation recommends, but does not require, a "sufficient number" of women on the boards of their reporting issuers.

85. France, Assemblée nationale, bill no. 2140, "Equal representation of women and men on boards of directors", online: assemblée nationale <http://www.assemblee-nationale.fr>. A bill was introduced on December 3, 2009, which would require 20% representation of women on corporate boards within 18 months, and full gender parity within five years.
86. Curia Vista — Objets parlementaires, The Federal Assembly, The Swiss Parliament June 20, 2003, online: Swiss Parliament <http://www.parlament.ch>. Switzerland considered legislating 30% representation of women on corporate boards of companies over which the Swiss government has some control. Ultimately, it was decided that board composition is a decision best left to the corporation.
87. U.S., Securities and Exchange Commission, *Proxy Disclosure Enhancements* (2009), at p. 38-39, online: SEC <http://www.sec.gov>.
88. "How is TD Embracing and Building Diversity", online: Toronto Dominion Bank <http://www.td.com>. On TD Bank's board of 17 members, four are women.
89. "Vision & Priorities for Diversity", online: Royal Bank of Canada <http://www.rbc.com>. (On RBC's board of 15 members, two are women.)
90. Dhir, *supra*, footnote 68, at p. 49.
91. Fabrizio Ferri, Yonca Ertimur and Stephen Stubben, "Board of Directors' Responsiveness to Shareholders: Evidence from Shareholder Proposals" (paper

proposals advocating diversity on boards[92] have been adopted in Canada. Lundin Mining Corporation agreed to include diversity as part of its board selection criteria, ahead of its 2008 Annual General Meeting (AGM) which was to see a shareholder proposal calling for this. However, the following is a list of 2009 AGMs where shareholder proposals calling for 50% female representation on the board failed: Bank of Montreal, Bank of Nova Scotia, BCE, Bombardier, Canadian Imperial Bank of Commerce (CIBC), Laurentian Bank, Manulife Financial, Power Corporation of Canada, Royal Bank, and TD Bank.[93] The most support for these shareholder proposals — at 9.44% — came from Power Corporation shareholders.[94] National Bank, when faced with the same proposal, agreed in advance of its February 2009 AGM to continue its efforts to recruit more women candidates for the board, with the goal of half of all board candidates being women.[95]

This section has canvassed a number of different approaches to promoting diversity, from legislation, to voluntary adoption of guidelines and targets. While we may or may not see specific legislation on gender parity in Canada in the near future, gender or racial parity in Canada is not currently required under any specific law or the general fiduciary duty. Nonetheless, some organizations are voluntarily taking the initiative to make their boards more representative, as they see this introduction of diverse perspectives as being in the best interests of the corporation, and/or they see it as an effective response to stakeholder groups advancing this position.

IV. CONCLUSION

This article has argued that an effective corporate governance regime involves a spectrum of mechanisms that range from purely legal or hard law to purely voluntary or market-based initiatives. Society's acceptance of where we lie on the spectrum changes over

presented to the AAA 2007 Management Accounting Section (MAS) Meeting; 3rd Annual Conference on Empirical Legal Studies, December 2007), online: SSRN <http://ssrn.com>; James F. Cotter and Randall S. Thomas, "Shareholder Proposals in the New Millennium: Shareholder Support, Board Response, and Market Reaction", J. Corp. Fin., [forthcoming], online: SSRN <http://ssrn.com>.

92. It should be noted that diversity in this context is almost always couched in terms of gender diversity, and does not typically address ethnic diversity.

93. SHARE, *supra*, footnote 66.

94. *Ibid.* online: SHARE <http://www.share.ca/en/node/1801>. (MEDAC-sponsored shareholder proposal to Power Corporation of Canada Annual General Meeting, May 13, 2009.)

95. *Ibid.* online: SHARE <http://www.share.ca/en/node/1796>.

time and is connected to the economic and political events of the day.[96] The global financial crisis of 2008/2009 has been attributed, at least in part, to a failure of corporate governance, seen as a failure of institutional investors to "act as owners" in holding management and the board of directors accountable for their decisions.[97]

While the board of directors is considered an important organ of corporate governance, Canadian jurisprudence — with the most recent pronouncement in *BCE* — has developed in such a way that directors have wide discretion in making decisions. I have argued in this paper that greater consideration of a broader range of stakeholder interests in business decision-making is necessarily dependent on a range of factors beyond legal rules. In my view, corporate culture matters, as does who the corporate directors and corporate managers are. The composition of the shareholder base and the power and support from other stakeholders also have tremendous impact on the advancement of stakeholder interests in business organizations. This paper has not attempted to suggest that there is no role for law, but rather to point out its limitations, and at the same time highlight the power of non-legal mechanisms — voluntary initiatives — in corporate governance, and the interplay between the two.

96. Poonam Puri and Stephanie Ben-Ishai, "Proportionate Liability under the CBCA [Canada Business Corporations Act] in the Context of Recent Corporate Governance Reform: Canadian Auditors in the Wrong Place at the Wrong Time?" (2003), 39 C.B.L.J. 36 at pp. 40-45 (WLeC).

97. Stephen Davis, Jon Lukomnik and David Pitt-Watson, "Active Shareowner Stewardship: A New Paradigm for Capitalism" (2009), 2 R.I.J.P.M. 10 at p. 11; online: SSRN <http://papers.ssrn.com>.