Legal update

Stakeholders’ primacy: paradigm shift confirmed

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Corporate governance

Canada recently passed Bill C-97,¹ which included changes to the Canada Business Corporations Act (CBCA). Bill C-97 stipulates that when acting in the best interests of the corporation, directors and officers may consider, but are not limited to the interests of shareholders and certain other stakeholders.

At first glance, the new provision appears consistent with the Supreme Court's reasoning in cases on director liability, but, given a heightened climate for director accountability and recent focus on stakeholder interests in Canada and abroad, it is imperative to review the potential implications of these changes for corporate leaders.

From shareholder's to stakeholder's primacy?

Under the CBCA, directors have a fiduciary duty to act honestly, in good faith and in the corporation’s best interest.² Until a few decades ago, the corporation's shareholders were often considered its primary beneficiaries. This shareholder-centric form of corporate governance was known as the shareholder primacy model, a model that would, theoretically, obviate managerial self-dealings.³

However, at the end of the last century a shift to include non-shareholder interests began to emerge. Many attribute this shift to the hostile takeover wave of the 1980s, which increased shareholder wealth efficiently but left employees scrambling for work and government institutions struggling to respond.⁴ The shareholder primacy model came under further scrutiny, in both Canada and the US, after the burst of the tech bubble in 2002 and the 2008 financial crisis.⁵

In response, Canadian courts evolved corporate law principles to the view that directors may consider various stakeholder interests and should not be confined to the immediate benefits of shareholders. It was in the landmark Supreme Court of Canada decisions Peoples Department Stores Inc. (Trustee of) v Wise (2004) (Wise) and BCE Inc. v 1976 Debentureholders (2009) (BCE) where a director's responsibility to act in the corporation's best interest was remodeled.

The court in Wise emphasized directors and officers should strive to make the corporation a "better corporation"⁶ and when determining what is in the corporation's best interests, directors may look to the interests of, “inter alia, shareholders, employees, creditors, consumers, governments and the environment to inform their decisions.”⁷ The Supreme Court in BCE affirmed what was reasoned in Wise and further deviated from the shareholder primacy model.⁸

Recently in the US, some prominent actors in the business world emphasized the importance of accounting for various stakeholder interests. In August 2019, a contingent of 181 CEOs released a statement⁹, acknowledging in particular that “while each […] individual compan[y] serves its own corporate purpose, we share a fundamental commitment to all of our stakeholders” and “each of our stakeholders is essential. We commit to deliver value to all of them, for the future success of our companies, our communities and our country.” One may argue this denotes the crystallization of a new paradigm.
CBCA now expressly recognizes stakeholder interests

Through Bill C-97, the Canadian government took action to assert an inclusive vision of stakeholder interests. The amendments may appear to be a “codification” of Wise and BCE. In many respects, they are. Just as in these cases, the new provisions articulate that directors may consider, but are not limited to, the interests of shareholders, employees, creditors, consumers, governments and the environment.  

However, the amendments go beyond these cases to include retirees and pensioners in the list. According to the federal government, the reason for the amendment was to “set higher expectations and better oversight of corporate behaviour” and to emphasize that federally incorporated businesses are able to consider diverse interests, such as those of workers and pensioners, in corporate decision-making.

Differences between the CBCA and US corporate statutes

Enumerating these stakeholders in the CBCA is consistent with many US constituency statutes. Thus, as in several US constituency statutes, the new CBCA amendments specifically recognize the interests of various stakeholders in a corporation.

Nevertheless, we have identified some variations between what is found in many US constituency statutes and the amended CBCA. One difference is the new CBCA provision only stipulates that directors may consider the “long-term interests” when deciding what is in the corporation’s best interest. It makes no mention of short-term interests. This legislative choice is not benign. In BCE, it was found a director’s fiduciary duty is not confined to short-term profit or share value. Where the corporation is an ongoing concern, it looks to the long-term interests of the corporation.

However, it is important to note that in BCE, when the court considered a transaction’s impact on debentureholders, it stated that one would expect the directors, acting in the corporation’s best interests, to consider the “short and long-term interests in the course of making their ultimate decision.”

In the last few years, the concept of short-term interests has become synonymous with immediate shareholder gain. For many corporations, however, taking into account short-term interests could very well be important for long-term goals. In BCE, for instance, the Supreme Court accepted that a move towards privatization could provide greater freedom for BCE to achieve its long-term goals by removing the pressure on short-term public financial reporting. Taking into account short-term interests does not necessarily harm long-term value. Nevertheless, it appears the federal government has preferred to keep directors focused on the long-term interests of the corporation.

A second difference is a lack of direction on what directors are expected to do when stakeholders don’t see eye to eye. A brief comparison between the CBCA and certain US corporate law provisions can highlight different approaches in reconciling this conflict. Delaware case law seems to reveal a preference for a tempered shareholder primacy model, while in Canada, a more balanced approach between stakeholders prevails.

However, neither Bill C-97 nor the courts have addressed the issue that in the event of director breach of duty, some stakeholders, such as employees, may not possess the same remedies as, say, shareholders. Directors are guided towards the corporation’s long-term interests without favoring a class of stakeholder, yet the liabilities that each stakeholder could bring forward vary. Bill C-97 has acknowledged various stakeholder interests, but did not provide guidelines for situations where various stakeholder interests conflict.

Recommendations

Considering the uncertainty related to competing claims in a time of paradigm shift, open dialogue with various stakeholders is a first step towards shielding directors against liability. Directors who wish to engage various stakeholders should consider introducing an engagement policy or expanding the scope of their current policy, as part of their governance practices. Under the purview of such policy, directors can meet with shareholders and other stakeholders to discuss issues of concern. The engagement policy can act as the foundation for:
• **Identification.** Identifying stakeholder expectations can foster transparent and frank discussions. As the court stated in *BCE*, considering these expectations can help directors discharge their duties, since “the reasonable expectations of the stakeholder in a particular outcome often coincide with what is in the best interests of the corporation.”

• **Categorization.** Once directors are informed and well aware of stakeholder expectations, they can categorize such expectations, in order to map potential dead angles and “hot zones” and determine if further attention is required or otherwise appropriate.

• **Factorization.** After mapping stakeholder expectations, directors can factor hot zones into their decision making and document the process towards determining that a specific course of action is in the corporation’s best interest.

Corporate governance principles have evolved significantly since the 1980s. Recent developments have shown that legislators and corporate protagonists alike seem ready and willing to turn the page on decades of Milton Friedman’s shareholder pre-eminence theory. In Canada, the recent CBCA amendments consolidate the legal principles developed by case law, but raise questions as to what directors should do when faced with competing claims on what is in the corporation’s best interest. The objectives of the recommendations outlined above are to assist directors in crafting business decisions that are well informed and protect them against potential liability.

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**Footnotes**

1. *Bill C-97, An Act to implement certain provisions of the budget tabled in Parliament on March 19, 2019 and other measures*, 1st Sess, 42nd Parl, 2019, cl 141 (1.1) (a) (b) (c) (as passed by the House of Commons on June 21, 2019). [Bill C-97]


9. The full statement is available here: [https://opportunity.businessroundtable.org/ourcommitment/](https://opportunity.businessroundtable.org/ourcommitment/).

10. Bill C-97, s. 1.1 (a).


13. In the US, over 30 states have adopted constituency provisions. New York state’s *Business Corporation Law*, for instance, provides that a director shall be entitled to consider, without limitation, both the long-term and short-term interests of the corporation, its shareholders and a number of other constituents such as employees, retired employees, customers, creditors, and communities. See *New York Business Corporation Law*, s. 717(3)(b). Pennsylvania and Illinois are states with similar statutes. See Pennsylvania’s *Title15 Corporations and Unincorporated Associations* s. 8895 and Illinois *Business Corporation Act of 1983* s. 8.85 [805 ILCS 5/8.85].
14 BCE at para 38.
15 Ibid at para 102.
16 Ibid at para 112.
18 Allaire and Rousseau at 5.
19 Ibid.
21 BCE at para 66.

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