CANADIAN INSTITUTIONAL SHAREHOLDER ACTIVISM

IN AN ERA OF GLOBAL DEREGULATION

by

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INTRODUCTION

> *"...we regard informed, measured, and responsible institutional shareholder activism to be one of the linchpins of a modern system of corporate governance. We are also of the opinion that, given the right legal framework, Canadian institutional investors can play a constructive and responsible role in corporate governance."*[1]

One of the most profound transformations in modern North American society has been the shift of institutional power from the nation-state to corporate enterprise. This changing dynamic in governance is attributable to the diminished role of the state in neoliberal societies through deregulation, and the emergence of the multinational corporation. The coming into favour of free market, neo-liberal ideology has facilitated a virtually global deregulation agenda. Nation states around the world continue to support a "market friendly system of regulation, in which governments often delegate numerous responsibilities to the private sector."[2] International agreements, such as the World Trade Organization and the Free Trade Agreement of the Americas, seek to establish an international rules-based system for facilitating trade, eliminating existing trade barriers thereby reducing the ability of state governments to take unilateral actions to protect local economies.[3] For the most part, Canada has adopted this neo-liberal ideology at both federal and provincial levels.[4]

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[1] Ronald J. Daniels & Randall Morck, *Canadian Corporate Governance Policy Options (Discussion Paper Number 3)* (Ottawa: Industry Canada, March 1996) at 101.

[2] Virginia Haufler, *A Public Role for the Private Sector: Industry Self-Regulation in a Global Economy* (Washington D.C.: Carnegie Endowment for International Peace, 2001) at 1 citing Alfred Aman, "Administrative Law for a New Century" in Aseem Prakash and Jeffrey A. Hart, eds., *Globalization and Governance* (London: Routledge, 1999).

[3] *See e.g.* Robert Boyer & Daniel Drache, *States Against Markets: the limits of globalization* (New York: Routledge, 1996); Saskia Sassen, *Globalization and Its Discontents* (New York: The New Press, 1998).

[4] The Federal Government's 2000 APEC Report states in part "The Canadian government continues to look for ways to move away from the "command and control" model of rules and regulations towards a performance model where governments are held accountable for meeting performance targets and government intervention only occurs where absolutely necessary. Canada is continuously examining the scope for both the international harmonization of regulations and the reduction of barriers to trade." In the corporate and securities context, the Canadian Securities Administrators' have initiated the Uniform Act Project to harmonize securities regimes across the country, and the British Columbia Securities Commission has commenced a parallel "Deregulation Project" to produce a new Securities Act and Rules by the end of 2003. *See* British Columbia Securities Commission, *BC Notices* (November 20, 2001) (Doc. No. 2001/78).

Second, as Ron Davis details in his paper, the emergence of the multinational enterprise (MNE) has made it increasingly difficult for incorporating states to govern MNE activities in other jurisdictions.[5] The United Nations' *World Investment Report 2000* estimates "that there are approximately 63,000 parent firms with around 690,000 foreign affiliates and a plethora of inter-firm arrangements,…, rendering it [the multinational corporation] a formidable force in today's world economy."[6] Of the 100 largest economies in the world, 51 are corporations.[7] These larger enterprises carry on increasingly more complex activities and transactions, often in remote locations without independent oversight by host states.

As a result of these changes, increasing attention is being placed on the development and implementation, both by the state and industry, of national and international corporate governance standards.[8] To date, developments in this area have focused on the creation of standards to support the fiduciary duties of directors to act in the best interest of the corporation, and to protect shareholder value. The establishment of corporate governance standards has been accompanied by the formulation of corporate responsibility benchmarks (i.e. corporate codes of conduct, reporting standards and process-based standards).[9] While it remains to be seen how effective these various initiatives will be in engendering a more responsible corporate sector, their voluntary nature (with the exception of binding trade-related agreements) and process-based perspective raise doubts about their sufficiency as an adequate accountability framework

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[5] Ronald B. Davis, "Investor Control of Multi-national Enterprises: A Market for Corporate Governance Based on Justice and Fairness?" (to be cited to this journal). *But see* Doremus, Paul N., et al., *The Myth of the Global Corporation* (Princeton, New Jersey: Princeton University Press, 1998).

[6] United Nations Conference on Trade and Development, *World Investment Report 2000: Cross-border Mergers and Acquisitions and Development* (New York: United Nations, 2000) at 1.

[7] Sarah Anderson & John Cavanagh, *Top 200: The Rise of Corporate Global Power*, (Institute for Policy Studies, December 2000). Online: www.ips-dc.org/top200.htm.

[8] Report of the Toronto Stock Exchange Committee on Corporate Governance in Canada, *Where Were The Directors? – Guidelines for Improved Corporate Governance in Canada* (Toronto: TSE, 1994); Joint Committee on Corporate Governance, *Beyond Compliance: Building a Governance Culture* (Toronto: TSE, November 2001); OECD, *OECD Guidelines for Multinational Enterprises,* online: <http://www1.oecd.org/daf/investment/guidelines/mnetext.htm>; *Global Reporting Initiative,* online: www.globalreporting.org.

[9] Rhys Jenkins, *Corporate Codes of Conduct: Self-Regulation in a Global Economy* (United Nations Research Institute for Social Development, April 2001); TCCR Benchmark project.

for free enterprise that addresses the potential impacts of corporate activity on all stakeholders, including employees, communities and the environment.

In their books *The Rise of Fiduciary Capitalism* and *The New Global Investor,* James P. Hawley and Andrew T. Williams and Robert G. Monks identify the institutional investor as a new voice for promoting prudent corporate governance.[10] Hawley and Williams characterize the institutional investor as a "universal owner", one that "…holds in its portfolio a broad cross section of the economy, holds its shares for the long term, and on the whole does not trade except to maintain its index."[11] Universal owners are concerned with minimizing investor risk by maintaining adequate diversification and minimizing externalities through the application of a portfolio-based approach to investment management.[12] As fiduciaries, long-term investors and majority owners, they not concerned with short-term returns on investment, but rather long-term performance to meet the needs of present and future beneficiaries. Accordingly, corporations in which they invest must operate in a financially, socially and environmentally responsible manner that supports a healthy and sustainable economy. Consequently, "a universal owner's cumulative long-term return is determined not merely by the performance of each individual firm it owns, but by the performance of the economy as a whole."[13]

This paper considers the validity of the universal owner hypothesis in the context of the Canadian economy and the theoretical and policy justifications for enhanced institutional shareholder activism in Canadian corporate governance.[14] It begins by considering whether the Canadian institutional investor reflects the nature of its American counterpart. It then posits a

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[10] James P. Hawley & Andrew T. Williams, *The Rise of Fiduciary Capitalism* (Philadelphia: University of Pennsylvania Press, 2000); Robert A.G. Monks, *The New Global Investors* (Oxford: Capstone Publishing Limited, 2001).

[11] Hawley & Williams, *ibid.* at xv.

[12] *Ibid.* at 5.

[13] Hawley & Williams, *supra* note 10 at xv.

[14] Shareholder activism includes a myriad of activities, including corporate-shareholder dialogue, letter writing to corporations, submission of shareholder proposals, proxy voting, and litigation. Shareholder activism has focused predominantly on the private norms associated with corporate governance, however institutional investors, such as CalPERS, have explicitly defined corporate governance more broadly beyond board process to include the financial, social, and environmental practices of corporations. This paper adopts this expanded scope of shareholder activism.

theoretical framework for institutional shareholder activism and assesses the degree to which the current legal and market conditions, particularly recent amendments to the *Canada Business Corporations Act*[15], support or impede it. It is the observation of this author that while shareholder activism may play a legitimate role in monitoring the activities of the firm, the legal and procedural framework remains fraught with legal and structural barriers.

The approach advocated here is an enhanced role for the shareholder in facilitating responsible corporate governance for several reasons. The particular orientation of the institutional investor towards mitigating long-term risk places it in the position of monitoring the long-term performance of the corporation and the health of the economy, society and natural environment. Institutional shareholders, indeed all shareholders, also possess the ability to engage corporations with respect to international operations outside the purview of state government.

It is important to emphasis that none who advocate for increased shareholder rights view it as a surrogate for government regulation.[16] As Ron Davies points out in his accompanying paper, "investor control is complementary to public regulation, rather than a substitute for the absence of such regulation."[17] The arguments made in this paper fully recognize the limitations of institutional shareholders acting as proxy for the interests of other stakeholders in society.[18] However, as Stéphane Rousseau alludes to in his accompany paper, institutional shareholders provide a mechanism for providing a voice in the debate over corporate governance that goes beyond traditional private norms.[19] Accordingly, while this paper is not to be interpreted as advocating against state involvement in the national economy, it recognizes the diminishing

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[15] *Canada Business Corporations Act,* R.S.C. 1985, c.44 as amended S.C. 2001, c.14.

[16] Hawley & Williams, *supra* note 10 at 3 citing Robert A.G. Monks and Nell Minow, *Corporate Governance* (Cambridge, Mass.: Basil Blackwell, 1995) at 268-270 ("this is an agenda that can be addressed only by government in conjunction with a 'universal shareholder'").

[17] Davis, *supra* note 5, at [reference to page in journal].

[18] Michel Patry & Michel Poitevin, "Why Institutional Investors are not Better Shareholders" in Ronald J. Daniels & Randall Morck, eds., *Corporate Decision-Making in Canada* (Calgary: University of Calgary Press, 1995) 341; Alan Shipman, *The Market Revolution and Its Limits: A Price for Everything* (London: Routledge, 1999) at 288-289.

[19] Stéphane Rousseau, "Canadian Corporate Governance Reform: In Search of a Role for Public Regulation" at [reference to page in journal].

presence of the state and attempts to outline one market-mechanism to assist in mediating amongst stakeholder interests.

THE CANADIAN INSTITUTIONAL INVESTOR AS UNIVERSAL OWNER

The nature of corporate ownership in Canada has changed significantly over the past decade with the replacement of the retail investor by the institutional investor as the major player in Canadian equity markets.[20] It is the unique characteristics of the institutional investor that suggest possibilities in enhancing responsible corporate governance. Unlike individual shareholders, institutional investors are intermediaries investing assets on behalf of beneficiaries. In a trust context, institutional investors must comply with fiduciary duties of prudence and loyalty, which require that investment decisions be made in the best interests of the beneficiaries.[21] Alternatively, institutional investors act as agent on behalf of the collective interest of the *real* owners of capital, which include a majority of individuals in society, particularly through pension plans and retail mutual funds. The result is that the agency model and differentiation of interests between management and owners becomes more complex as owners are supplanted by agents representing their collective interest in the market.[22]

These unique characteristics of the institutional investor as fiduciary and investor in a broad cross-section of the Canadian economy place it in a unique role. It is argued that its responsibility should be to invest with a long-term view to satisfying the financial requirements of beneficiaries *and* ensuring a sustainable social and economic framework necessary to provide adequate returns for future beneficiaries.[23] For each institutional investor, its stock performance

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[20] J.G. MacIntosh, "The Role of Institutional and Retail Shareholders in Canadian Capital Markets" (1993) 32 *Osgoode Hall L.J.* 371 at 411 [hereinafter MacIntosh (1993)].

[21] These fiduciary duties have evolved, albeit slowly, over time and continue to respond to changes in investment practices. *See* Gil Yaron, "The Responsible Pension Trustee: Re-Interpreting the Principles of Prudence and Loyalty in the Context of Socially Responsible Institutional Investing" (June 2001) 20(4) *Estates, Trusts & Pensions J.* 305

[22] Hawley & Williams, *supra* note 10 at 2.

[23] This mandate conflicts with the interests of corporate directors who are charged with acting in the interest of the corporation and money managers under pressure to obtain short-term gains to enhance their placement in the market. Allan Sykes, *Capitalism for Tomorrow: Reuniting Ownership and Control* (Oxford: Capstone Publishing Ltd.,

"depends crucially on the macroeconomic performance of the economies in which it is invested."[24] As articulated by Robert Monks, a leading authority on corporate governance, the universal (or "Global Investor") "…is likely to make good decisions for the long-term of society, because it can afford in most cases to take a long-term view, and a diversified view. An ordinary domestic investor may need to reap profits in the short term."[25]

If one accepts this role for the institutional investor, the question is to what extent Canadian institutional investors have the potential to influence Canadian enterprise, as Hawley, Williams and Monks postulate with respect to their American counterparts? Hawley and Williams identify universal owners by three fundamental common characteristics: size, portfolio composition and investment strategies.[26] While data in Canada is not as robust as that available for American institutional investors, limited information suggests that Canadian institutional investors, particularly trusteed pension funds, are emerging as universal owners within the Canadian equity market.[27]

With respect to size, both the assets and equity ownership of institutional shareholders have increased significantly over the past several decades, although not to the extent of their American counterparts.[28] In 2000, Canadian institutional investors had amassed $2.86 trillion dollars in

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2000) at 105 asserts that it is the short-term interests of shareholders themselves which presents the conflict: "Thus it is in the interests of the real shareholders that neither companies nor fund managers should be *artificially* constrained to perform over periods of less than five years. Certainly the typical three-year periods for managers' so-called 'long-term incentives' fail to reflect shareholders' horizons, as does the two- to three-year period over which fund managers are expected to perform if they are not to be under threat. These represent significant mismatches with the interests of the real shareholders which are likely to affect adversely longer-term corporate performance."

[24] Hawley & Williams, *supra* note 10 at 13.

[25] Monks, *supra* note 10 at 105.

[26] Hawley & Williams, *supra* note 10 at 5, 14. The authors also note that as a group, they also invest in the same large, liquidity-traded companies.

[27] Institutional investors include banks, trusteed pension plans, life insurance companies, trust and mortgage loan companies, local credit unions, caisses populaires, insurance companies, and investment funds. For the purpose of this paper, reference to institutional investors is focused primarily on trusteed pension funds due to their larger presence in the Canadian equity market and their historic leadership in institutional shareholder activism.

[28] Hawley & Williams, *supra* note 10 at 5. (Institutional shareholders owned 59.9% of the largest one thousand U.S. firms in 1997.)

assets, 12.49% invested directly in equity.[29] Institutional shareholders owned 30.9% of all Canadian-based corporations on the Toronto Stock Exchange, down from 37.2% in 1990.[30] OECD figures indicate that the financial assets of institutional investors in Canada have risen from 68.6% of the nation's GDP in 1992 to 111.3% in 2000.[31]

By far, the majority of institutional equity is held by trusteed pension plans. At the end of the second quarter of 2001, trusteed pension plans in Canada managed assets valued at $568.6 billion, 40% are invested in stocks, up from 20% in 1990.[32] More than one-third of institutional shares, representing 10.4% of the value of all Canadian-based corporations on the Toronto Stock Exchange (12.9% of the TSE 300), are held by trusteed-pension plans, down from 17.89% (21.50% of the TSE300) in 1990.[33] These represent significant increases over historical asset and equity levels in years dating back to 1961.[34] Similarly, plan portfolios usually reflect broad cross-section of the Canadian equity market through indexation and diversification.

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[29] See Statistics Canada, *National balance sheet accounts - 1806* (Table 378-0004). CANSIM II Database. These figures do not include equity ownership by foreign institutional investors. High levels of ownership concentration in Canadian firms have traditionally undermined these figures. However, recent studies suggest this has become less of a consideration with increased dilution in ownership over recent years. *See infra* note 106.

[30] TSE Review, December 2001; Statistics Canada, *ibid*. The TSE is represented here as a proxy for the Canadian equity market.

[31] OECD, "Recent Trends: Institutional Investor Statistics" (September 2001) 80 *Financial Market Trends* at 46.

[32] Statistics Canada, *Quarterly Estimates of Trusteed Pension Plans (Second Quarter 2001)* (Ottawa: Statistics Canada, 2001); OECD, *supra* note 31 at 47.

[33] *Supra* note 30.

[34] *Supra* note 29. Trusteed pension plans have traditionally been more active in equities with 25.06% of $480 billion in assets invested in companies (off a record high of 29.3% in 1999).

Total dollar value of assets and shares for Canadian institutional investors:

Year	2000	1990	1980	1970	1961
Total Assets ($M)	2,862,398	1,292,933	484,768	111,486	42,007
Total Shares ($M)	357,408	104,301	32,698	10,339	3,268
Shares as % of total assets	12.49%	8.07%	6.75%	9.27%	7.78%

It is also of interest to observe that preliminary empirical surveys suggest a change in the perceptions of beneficiaries regarding the desired objectives of institutional investors and their role as fiduciary agents. A recent national poll conducted after the economic decline in 2001 and the tragic events of September 11th indicates that the interests of a majority of individual shareholders and beneficiaries of pension plans want institutional investments to be made in companies with good social responsibility records, reinforcing findings of an earlier 1997 UK national opinion poll.[35]

A THEORETICAL FRAMEWORK FOR A BROAD-BASED MANDATE FOR INSTITUTIONAL SHAREHOLDER ACTIVISM

Starting with the seminal work of Berle and Means identifying the differentiation between ownership and management, there has been extensive consideration of the place of the shareholder in the theory of the firm.[36] The emergence of the institutional shareholder

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Total dollar value of assets and shares for trusteed pension plans:

Year	2000	1990	1980	1970	1961
Total Assets ($M)	480,235	197,896	51,159	11,109	4,082
Total Shares ($M)	120,335	50,211	9,086	2,416	415
Shares as % of total assets	25.06%	25.37%	17.76%	21.75%	10.17%

These figures do not include investment through various pooled and indexed funds, which are significant given that many plans use indexation as a strategy. See MacIntosh (1993), *supra* note 20 at 443.

[35] Vector Research, public opinion poll (Toronto: Canadian Democracy and Corporate Accountability Commission, 2001). The survey of 2,006 adults conducted between September 28 and October 8, 2001 found that 54% of shareholders want pension funds that invest in firms with a good record of social responsibility even if it resulted in somewhat lower benefits to the shareholder. Fifty-nine percent of wealthy shareholders (i.e. incomes greater than $100,000) endorsed this view. *See also* Russell Sparkes, "SRI Comes of Age" (July 2000) *Pension Investor* citing a national opinion poll conducted in Britain during September 1997 for the Ethical Investment Research Service (EIRIS) that found 73% of 700 adults surveyed wanted ethically-screened pensions; 44% stated that their pension plan should include an ethical policy if that could be done without any reduction in financial return; and a further 29% felt that their pension plan should adopt ethical policies even if this led to reduced returns. Only 19% of those surveyed thought that pension plans should ignore ethics and concentrate on financial return, while 8% didn't know

[36] Adolph A. Berle & Gardiner C. Means, *The Modern Corporation and Private Property* (New York: Macmillan, 1932).

necessitates that we revisit the theoretical context framing the role of the shareholder in the governance of private enterprise?

The prevailing contractual theory of the firm asserts the right of the shareholder as owner to oversee the governance of the corporation by management through the exercise of votes attached to shares in the corporation.[37] It is this rationale that has resulted in the creation of shareholder rights in corporate law, particularly rights pertaining to the submission of shareholder proposals, voting of proxies, and communications between shareholders with respect to the solicitation of proxies.[38] However, this paradigm is limited to considering the rights and responsibilities of shareholders and the individual corporation as between themselves as separate legal entities through their contractual relationships established through statute and private agreement. It fails to incorporate the relationship of these parties to other stakeholders outside of any contractual relationships established by the corporation.

In contrast, the fiduciary responsibilities of the universal shareholder to society, as represented by its beneficiaries, are more fully realized in the context of a concessionist theory of the firm. Concessionism conceives of the corporation "as an artificial entity whose separate legal personality is granted as a privilege by the state."[39] Reflected in the corporate practice of chartering until the middle of the 19th century, concessionist theory includes two key ideas. First, the notion that the corporation is an artificial or fictional entity existing "only in the contemplation of law."[40] The second element is that the corporation is "an emanation of the state, created by revocable grant."[41] This later element gives to the corporation a public character.

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[37] Brian R. Cheffins, *Company Law: Theory, Structure, and Operation* (Oxford: Clarendon Press, 1997).

[38] *See e.g.* Robert W. V. Dickerson et al., *Proposals for a New Business Corporations Law for Canada* (Vol.1) (Ottawa: Information Canada, 1971) at 95: "It is based upon the proposition that shareholders are entitled to have an opportunity to discuss corporate affairs in general meeting, and that this is a right and not a privilege to be accorded at the pleasure of management."

[39] Mary Stokes, "Company Law and Legal Theory" in W. Twining, ed., *Legal Theory and Common Law* (1986) at 162.

[40] Chris Tollefson, *Theorizing Corporate Constitutional Rights: Revisiting 'Santa Clara' Revisited* (LL.M. Thesis, York University, 1992) at 13 citing *Dartmouth College* v. *Woodward*, 17 U.S. 518 (1819) at 636 (per Marshall Ch. J.).

[41] Ibid.

Accordingly, the owners of the firm are responsible not only to achieve the purposes of the corporation itself, but are also accountable to the state to ensure that the corporation does not violate terms of its charter or cause harm in the course of carrying out its activities. Concessionist theory in this manner goes beyond the alternative contractualist theoretical paradigm, which views the firm as a nexus of contracts, where parties define their rights and responsibilities solely with respect to each other through contract, to considering the relationship of the firm to society as a whole.

A concessionist view acknowledges responsibility of shareholders, their fiduciary agents and the firm to beneficiaries and the national economy. Within this model, investors and firms take into consideration the implications of company decisions on internal performance *and* externalities as they impact the corporation's ability to operate in the long-term interest of society. It is in this framework that institutional shareholder activism becomes viewed not only as a mechanism to protect shareholders against investment risk, but a vehicle for directing firm governance in a way which optimizes long-term benefits and minimizes risk for beneficiaries, the firm and the economy as a whole.

INSTITUTIONAL SHAREHOLDER ACTIVISM

The active engagement of the investor in corporate governance in Canada has matured quite rapidly in the last several years. Survey data from the Shareholder Association for Research and Education (SHARE) indicates the number of shareholder proposals considered by shareholders increased from less than three in each year from 1982 to 1996 to 63 and 39 in 2000 and 2001 respectively.[42] In addition, numerous institutional investors have implemented investment policies and proxy voting guidelines that direct trustees and money managers on corporate-

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[42] Shareholder Association for Research and Education, "Shareholders Back Calls for Disclosure on Board Independence" (Fall/Winter 2001) 1(2) *Prospectus* 2; Moira Hutchinson, *The Promotion of Active Shareholdership for Corporate Social Responsibility in Canada* (Toronto: Michael Jantzi Research Associates, November 1996) at appendices. These figures do not include management proposals successfully opposed by shareholders, shareholder proposals that were withdrawn prior to a vote, or shareholder proposals not circulated by the corporation on grounds that the subject matter of the proposal was excludable. Nor does it capture shareholder involvement through corporate-shareholder dialogue, which is the preferred mode of institutional engagement.

shareholder dialogue and the voting of proxies.[43] Academics[44], religious institutional investors[45] and shareholders from across Canada[46] have been advocating for a more equitable regime to address concerns regarding the business and affairs of corporations in Canada. Increasing interest has been expressed in shareholder activism particularly by institutional investors as a means of managing risk and enhancing investment performance. As Professor Jeffrey MacIntosh asserts "The concentration of economic power, expertise, and incentives in the hands of institutional investors is a means of overcoming collective action problems and ensuring that both corporate managers and controlling shareholders are well monitored."[47] [48] The evidence reviewed in this section suggests that improvements to the framework for institutional shareholder activism in Canada could have positive implications for investors, companies and positive macro implications on the well being of national and global economies.[49]

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[43] *See e.g.* Ontario Teachers' Pension Plan that publicly discloses its proxy voting guidelines and proxy voting records on its website (www.otpp.com); Canadian Press, "OMERS airs ethical guidelines" (January 28, 2002) *Globe & Mail* B3. For additional examples *see* Shareholder Association for Research and Education, *Statements of Investment Policies and Procedures and Trustee- Directed Investment Practices* (Vancouver: SHARE) [forthcoming in 2002].

[44] *See e.g.* MacIntosh (1993), *supra* note 20 at 411; Jeffrey G. MacIntosh, "Institutional Shareholders and Corporate Governance in Canada" (1995-96) 26 *Can. Bus. L.J.* 145 at 167 [hereinafter MacIntosh (1995-96)].

[45] For the history of the Churches in Canadian shareholder activism *see* Hutchinson, *supra* note 41. See also P.A. Koval, "Trends in Canadian Shareholder Activism" in The Canadian Institute*, Duties and Liabilities of Officers and Directors* (19 November 1992).

[46] During government hearings, various investor and civil society organizations made submissions in support of the proposed amendments to the Senate Standing Committee on Banking, Trade and Commerce. *See* Canada, Senate Standing Committee on Banking, Trade and Commerce, "Proceedings of the Senate Standing Committee on Banking, Trade and Commerce, First Session, Thirty-seventh Parliament" (14 March and 4 April 2001).

[47] MacIntosh (1993), *supra* note 20 at 376.

[48] MacIntosh (1993), *supra* note 20 at 438. Paltry & Poitevin, *supra* note 18 at 364 also point out additional efficiencies with respect to institutional shareholder activism, including the presence of professional management, scale, and the ability to share information with other institutional investors. MacIntosh addresses various concerns about increased institutional investor presence in the market including concerns regarding the diminished the pool of savings available for investment (at 434), impairment of the allocative efficiency of primary markets (at 434), impact on the efficiency of the price discovery mechanism (at 434), and the impairment of secondary market liquidity (at 440).

[49] See Bernard S. Black, "Shareholder Passivity Reexamined," (1990) 89 *Michigan L.R.* 520; Jeffrey G. MacIntosh, "Institutional Investors and Corporate Governance in Canada", paper prepared for Canadian Corporate Governance: An Interdisciplinary Perspective, C.D. Howe Institute (February 10-11, 1994); Mark J. Roe, "A Political Theory of American Corporate Finance" (1991) 91 *Columbia L. Rev.* 10; Jeffrey G. MacIntosh & Lawrence P. Schwartz, "Do Institutional and Controlling Shareholders Increase Corporate Value?" (1995) in Ronald J. Daniels & Randall Morck, *Corporate Decision-Making in Canada* (Calgary: University of Calgary Press, 1995) at 332.

The issue is to what extent can institutional shareholder activism improve corporate performance through enhancement of governance, social and environmental practices?[50] While it is premature to draw conclusions or causal relationships between institutional shareholder activism and corporate performance, studies conducted to date indicate a positive correlation with respect to shareholder engagement on traditional corporate governance matters.[51] One study by Stephen L. Nesbitt concluded that the value of California Employment Retirement Services' (CalPERS') investments improved relative to the S&P index in the years following activist intervention.[52] A

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[50] The issue of whether good corporate governance improves corporate performance is beyond the scope of this paper and debated elsewhere in the literature. Limited studies have endeavoured to demonstrate the correlation between institutional shareholder activism and corporate performance, although results to date are mixed. Several studies demonstrate a positive correlation. Others show no correlation in Canada, but a positive correlation in the United States. These studies only contemplate the relationship between conventional corporate governance issues and corporate performance. For a review of American data see Hawley & Williams, *supra* note 10 at chapter 6. *See also* MacIntosh & Schwartz, *supra* note 50 at 303; J. McConnell & H. Servaes, *supra* note 58; Paul A. Gompers, Joy L. Ishii & Andrew Metrick, *Corporate Governance and Equity Prices* (Cambridge, Mass.: National Bureau of Economic Research, August 2001), online: <http://papers.nber.org/papers/W8449> (This August 2001 study demonstrated a positive correlation between strong shareholder rights and superior firm performance. The survey built a "Governance Index" based on 24 different corporate governance provisions and ranked 1,500 American firms against the index. Firms in the highest decile (the "Management Portfolio") had the weakest shareholder rights or the highest management power. Those in the lowest decile (the "Shareholder Portfolio") had the strongest shareholder rights and the lowest management power. In performance-attribution time-series regressions from September 1990 to December 1999, the Shareholder Portfolio outperformed the Management Portfolio by a statistically significant 8.5 percent per year. The Governance Index was also highly correlated with firm value.); R. LaPorta, F. Lopez-de-Silanes, A. Schleifer and R. Vishny, *Investor Protection and Corporate Value* (NBER Working Paper 7403) (This 1999 study of nearly 400 companies in 27 developed countries found that better investor protections are commensurate with higher share values, but when shareholders have more power than their investments entitle them it is usually detrimental to the company and its shareholders.); Ronald F. Felton, Alex Hudnut and Jennifer van Heeckeren, "Putting a value on board governance" (1996) 4 *McKinsey Quarterly* (A study conducted by McKinsey & Company, an international management consulting firm, found that two-thirds of participants surveyed would be willing to pay a premium averaging 11% for corporations passing a five-point governance test. Moreover, investors with low portfolio turnovers would pay more than those with high portfolio turnovers indicating that well-governed companies are worth more to long-term investors. The study also found that investors managing funds for wealth individuals, foundations and public sector pension plans were willing to pay more for good governance that those running corporate pension funds leading the authors to speculate that the latter group are less willing to be confrontational with corporate boards.)

Researchers have only begun to place attention on the impacts of externalities on investment performance. *See* Glen Dowell, Stuart Hart & Bernard Yeung, "Do Corporate Global Environmental Standards Create or Destroy Market Value?" (Washington, DC: Social Investment Forum, October 2001) (Contrary to the supposition that pursuing lower environmental standards would be profitable for multinational firms, firms choosing to employ their own strict global environmental standard abroad were found to have an individual value of approximately $10.4 billion higher than those using less stringent U.S. standards.)

[51] *See* B.S. Black, "The Value of Institutional Investor Monitoring: The Empirical Evidence (1992) 39 *U.C.L.A. L. Rev.* 895; J.J. McConnell & H. Servaes, "Additional Evidence on Equity Ownership and Corporate Value" (1990) 27 *J. Fin. Econ.* 595.

[52] Wilshire Associates, *The CalPERS Effect* (July 19, 1995) [unpublished]. The study examined the performance of

second, by Professors Tim Opler and Jonathan Sokobin arrived at the same conclusion for a group of public and private pension funds, which collectively own over $800 billion in financial assets.[53] Hawley and Williams observe that “active ownership matters even if specific governance features do not,” suggesting that the performance of all firms may be improved by the targeting of a few firms with shareholder proposals.[54] It is possible that shareholder activism has simply put pressure on corporations to increase short-term returns at the expense of long-term considerations that may have adverse impacts on the economy, society and/or the environment. However, the studies to date do reinforce the neutral proposition that shareholder activism does in principle have the capacity to influence corporate decision-making and performance.

Studies also support the conclusion of pension regulators that proxies are valuable pension plan assets.[55] Recent American studies have demonstrated that proxy activities by institutional investors targeted at underperforming firms can lead to desired changes in corporate behaviour, although findings to date have found little or no general effect from proxy activity.[56] Hawley & Williams suggest that this may be due to the unrelatedness of the measures to performance or the obfuscation of the relationship by other factors.[57] Clearly, more study in all of these areas is warranted.

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62 companies targeted by CalPERS over a five-year period. Results indicated that while the stock of these companies trailed the Standard & Poor's 500 Index by 89 percent in the 5-year period before CalPERS acted, the same stocks outperformed the index by 23 percent in the following five years, adding approximately $150 million annually in additional returns to the Fund. This survey has been regularly updated since 1995 with results showing the same positive impact of active critical minority shareholding on the share relative valuation on the market.

[53] Tim C. Opler & Jonathan Sokobin, *Does Coordinated Institutional Activism Work? An Analysis of the Activities of the Council of Institutional Investors* (October 1995), online: <http://fisher.osu.edu/fin/journal/dice/papers/1995/95-5.pdf>. The study documents the performance of 96 firms that appeared on the Council’s focus lists in 1991, 1992 and 1993 relative to several control groups. Firms on Council focus lists experienced poor share price performance in the year before being included on a focus list. In the year after being listed, these firms experienced an average share price increase of 11.6% above the S&P 500. Given that the mean equity market value of Council listed firms was $3.42 billion, total abnormal dollar gain of these firms was estimated at $39.7 billion.

[54] Hawley & Williams, *supra* note 10 at 123.

[55] Office of the Superintendent of Financial Institutions Canada, Guideline for the Development of Investment Policies and Procedures for Federally Regulated Pension Plans (Ottawa: OSFI, April 2000).

[56] Hawley & Williams, *supra* note 10 at 122-3.

[57] Ibid.

LEGAL FRAMEWORK

Having put forward a possible theoretical framework for institutional shareholder activism and some initial empirical support to suggest its relevance in improving corporate performance, it remains to consider whether the legislative and market framework in Canada, specifically recent amendments to the *CBCA*, achieve the intended effect of "…improv[ing] the legal framework for federal corporations by enhancing shareholder decision input in decision making…"[58] Here I consider the extent to which the new legal framework provides an effective and efficient mechanism for facilitating corporate-shareholder dialogue, mitigating investor risk and promoting a sustainable economy.

Shareholder activism has its roots in the earliest governance frameworks of the modern corporation. In common law days, the corporation was largely a communal venture. The shareholder meeting was vitally important to the operation of the business corporation. It provided the forum for stockholders to avail themselves of the judgment and acumen of all those participating in the company meeting. Common law placed no obligation on corporate management to reference views of non-management in any corporate documents on matters to be discussed at shareholder meetings.[59] Corporate management also did not have to provide notice of dissident proposals in a notice of meeting.[60] The only recourse for shareholders was to requisition a special meeting. Assigning proxies was frowned upon on the belief that voting by proxy would likely encourage absences from meetings and non-participation in corporate affairs.[61]

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[58] CBCA Regulatory Impact Analysis Statement at 1.

[59] Campbell v. Australian Mutual Provident Society (1908) 24 T.L.R. 623.

[60] Gower, *Modern Company Law,* 3rd ed. (1969) at 479.

[61] Frank D. Emerson and Franklin C. Latchman, *Shareholder Democracy: A Broader Outlook for Corporations* (Cleveland: The Press of Western Reserve University, 1954) at 6. Interestingly, Britain's *Myners Report on Institutional Investment and* South Africa's *King Report on Corporate Governance for South Africa 2001* (Institute of Directors, July 2001)(draft) both suggest a return to this view by recommending the imposition of sanctions on directors, management and shareholders who fail to attend shareholder meetings of companies in which they are invested. Similar censure is recommended for directors and managers of financial institutions who do not personally attend or send representatives to shareholder meetings of companies in which they have a certain prescribed level of investment.

Statutory rules governing shareholder proposals and shareholder communications were introduced into federal law with the enactment of the *Canada Business Corporations Act* in 1975.[62] With the growth of the corporate form and the separation of ownership from management, shareholders had the need for their rights in the governance of the corporation to be spelt out.[63] The accepted view was that the statutory rights of shareholders, including the ability to circulate shareholder proposals and communicate amongst shareholders, was necessary to balance the interests of owners with those of management.[64] More generally, the *CBCA* established a new model reducing government oversight of corporate management through regulation and advancing various mechanisms under which shareholders and other actors could directly enforce their rights and engage more actively in the governance of the firm.

The paucity of shareholder actions in the last 25 years is undoubtedly the consequence of numerous factors. Commentators have provided various explanations for this including the difficulty in coordinating and communicating amongst shareholders, agency costs, free rider problems, and concentration of ownership amongst publicly traded Canadian corporations.[65] However, academics and investors agree that the primary impediment, aside from institutional capacity[66], has been the hostile legislative framework in federal and provincial corporate statutes.[67]

The old federal rules allowed registered shareholders only to file proposals of up to 200 words in length with corporations provided that they were filed on time and were not submitted for the purpose of redressing a personal grievance or "promoting general economic, political, racial,

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[62] Canada Business Corporations Act, S.C. 1974-75, c.33.

[63] *Supra* note 37.

[64] *See* clause-by-clause analysis of the proposed changes to the CBCA, part 12 (June 4, 2001), online: <http://strategis.ic.gc.ca/SSG/cl00178e.html>.

[65] Koval, *supra* note 45; MacIntosh (1995-96), *supra* note 44.

[66] Shareholder proposals increased significantly in the last 5 years with the stronger coordination of the Churches through the Taskforce on the Churches and Corporate Responsibility, the creation of l'Association de protection des épargnants et investisseurs du Québec, the Shareholder Association for Research and Education, and various institutional investors with activist mandates. See SHARE survey findings, *supra* note 42.

[67] MacIntosh (1993), *supra* note 20 at 382; Koval, *supra* note 45 at 34-43; Senate Committee on Banking, Trade and Commerce, *supra* note 46.

religious, social or similar causes."[68] Communication between shareholders was permitted but severely restricted by virtue of the definition of "solicitation" in relation to the soliciting of proxies under the Act.[69] Restrictive interpretations of the rules by the courts narrowed their interpretation even further.[70]

The recent amendments to the *Canada Business Corporations Act (CBCA)* brought into force on 24 November 2001 after nine years of lobbying by shareholders led by faith-based institutional investors through the Taskforce on the Churches and Corporate Responsibility, represent a significant and positive change to the framework governing federally-incorporated corporations in Canada.[71] However, both their scope and content are insufficient. With respect to scope, the CBCA applies to more than 155,000 corporations in Canada, but only 800 publicly-traded corporations and 144 of the TSE300 index. This leaves a majority of large cap corporations incorporated under provincial corporate statutes. Yet, only 6 provinces provide rules for shareholder proposal and communications.[72] Requirements in each jurisdiction differ, in some cases significantly.[73] Lack of uniformity could potentially have a distorting effect on the market to the extent that corporations use the difference as a factor in deciding to move their place of incorporation to avoid such rules. While British Columbia and Alberta both contemplate revising their corporate statutes in the next few years, there is no indication yet of their intentions to harmonize with the federal regime.

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[68] CBCA, *supra* note 15, s. 137.

[69] *Ibid.*, s.150(1)(b).

[70] See e.g. *Verdun* v. *Toronto-Dominion Bank,* 139 D.L.R. (4th) 415 (S.C.C.)(beneficial owner not entitled to submit proposals); *Re Varity Corp. and Jesuit Fathers of Upper Canada et al.*, (1987) 41 D.L.R. (4th) 384 (Ont. C.A.), *aff'g* 38 D.L.R. (4th) 157 (Ont. H.C.J.) (proposal excluded as being politically motivated).

[71] For a detailed history of shareholder activism in Canada see Hutchinson, *supra* note 42. *See also* Koval, *supra* note 45.

[72] Aside from federal legislation, the jurisdictions with shareholder proposal provisions include Ontario, Manitoba, Alberta, Newfoundland, New Brunswick and the North West Territories.

[73] For example, Ontario's filing deadline for shareholder proposals is 60 days prior to the anniversary date of the company's Annual General Meeting. Other provinces set the deadline at 90 days. The CBCA's recent amendments make the deadline 90 days prior to the anniversary date of the company's Notice of Meeting. See CBCA, *supra* note 15, s.137(5)(a) and *Canada Business Corporations Regulations 2001,* SOR/DORS/2001-512 (22 November 2001), s.50 (Canada Gazette Part II, v.135(25) at 2683) [hereinafter *CBCA Regulations*].

Nevertheless, the amendments to the *CBCA* go some way to addressing the concerns identified. Of significance are five changes to the rules governing shareholder proposals and communications:

- Beneficial shareholders may now file shareholder proposals.[74]
- The word count for proposals is increased to 500 words.[75]
- Shareholders now have to meet eligibility requirements. Shareholders must have held a minimum of $2,000 worth of shares or 1% of total outstanding shares for a period of no less than 6 months prior to submitting a proposal.[76]
- Proposals must be submitted at least 90 days prior to the anniversary date of the Notice of Meeting of the corporation.[77]
- The definition of "solicitation" has been clarified allowing shareholders to communicate freely with each other without issuing a dissident proxy circular provided that the shareholder is not seeking to obtain the ability to vote another shareholder's proxy on their behalf.[78]

However, the most important change is the elimination of the exclusion regarding the subject matter of proposals. Under the new rules, proposals must "relate in a significant way to the business or affairs of the corporation", and are no longer excludable merely because they address matters of a general economic, political, racial, religious, social nature.[79] This ground for exclusion was severely constraining on shareholders (as evidenced by the number of proposals challenged and rejected by corporations) and set an unreasonable threshold for shareholders to meet. While existing American jurisprudence suggests how this American-based threshold is to be construed, Canadian shareholders will have to wait to see how it is applied and interpreted by Canadian courts.

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[74] CBCA, *ibid.*, s.137(1).
[75] *Ibid.*, s.137(3); *CBCA Regulations*, s.49.
[76] *CBCA*, *ibid.,* s.137(1.1); CBCA Regulations, s.47.
[77] CBCA, ibid., s.137(5)(a); CBCA Regulations, s.50.
[78] CBCA, ibid., s.147.
[79] *CBCA, ibid.,* s.137(5)(c).

Unfortunately, the piecemeal application of the American framework[80] and unique approaches taken by the federal government to address certain concerns of shareholders and industry leave various problems unlikely to be addressed until the Act's five-year review in 2007.[81]

(a) Dispute resolution forum

In the United States, where a dispute arises between shareholders and management regarding the circulation of a proposal, the matter is referred to the SEC to provide a non-binding ruling on the acceptability of the proposal's content. In most instances, the parties accept this ruling, thereby avoiding costly and time-consuming recourse to the courts. No such administrative process exists in Canada. Shareholders of both federally and provincially incorporated companies must apply to the courts in instances where a company refuses to circulate a proposal or challenges the rights of shareholders in this area. The cost and time requirements associated with legal challenges entrenches the problem of free ridership and fiduciary apathy since only the largest institutional investors could possibly find it economically justifiable in balancing the costs of pursuing the issue and the potential benefits to their beneficiaries.[82]

(b) Filing reference date

The new CBCA rules introduce a new deadline for submitting shareholder proposals that has caused considerable confusion for shareholders. Under the new rules, the corporation must receive proposals 90 days prior to the anniversary date of the Notice of Meeting.[83] Those advancing this new reference date argue that corporations require more time to process proposals before circulating them. However, the new reference date is problematic for a number of reasons. First, shareholders do not receive the Notice of Meeting at the time it is issued. The

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[80] *Proposals of Security Holders,* 17 C.F.R. 240, Rule 14-8 (2001).

[81] *CBCA*, *supra* note 15.

[82] Industry Canada is presently inquiring into the creation of a dispute resolution mechanism, however it is not expected to be considered for inclusion in the federal regime the five-year review of the CBCA in 2007.

[83] *Supra* note 73. Under the old rules, proposals had to be received 90 days prior to the anniversary date of the company's Annual General Meeting.

Notice is circulated to shareholders but only with other management proxy circular materials distributed several months after the Notice of Meeting is issued.[84] Second, a review of corporate Notices of Meeting reveals that companies sometimes issue Notices of Meeting in English and French on different days, and in some instances do not issue a Notice at all. The new *CBCA* regulations do require that companies publish the submission deadline in their annual proxy circular, however it remains to be seen how many corporations will adhere to this requirement.[85] If companies do legitimately require more time to review proposals submitted by shareholders, this need for more time should be accommodated using the more transparent reference date of the company's annual general meeting rather than the obscure date of the Notice of Meeting, and simply increasing the prescribed number of days the proposal must be filed in advance.

(c) Identifying and communicating with beneficial owners

As noted, the new CBCA rules permit beneficial shareholders to file proposals, however shareholders continue to be thwarted in their efforts to communicate with beneficial shareholders because they are not identified on the company's register of shareholders. Furthermore, registered shareholders are not required to provide lists of their beneficial shareholders. Without being able to identify beneficial shareholders, it is exceedingly difficult to communicate information about issues pertaining to the corporation.

Another emerging wrinkle is the problem of identifying the beneficial shareholder for the purpose of submitting proposals. Under the *CBCA,* beneficial shareholders must provide pursuant to the Act upon the corporation's request.[86] In many instances, pension funds and mutual funds in Canada are established pursuant to a trust agreement. In this context, the beneficiaries of the fund are the plan beneficiaries and unit holders respectively, not the board of trustees or the investment manager. One would therefore presume that the unitholders *collectively,* or more typically the manager on their behalf by virtue of assignment of the

[84] Notices of Meeting are generally posted earlier on the SEDAR website.
[85] CBCA Regulations, *supra* note 73, s.58(z.8).
[86] CBCA, *supra* note 15, s.137(X).

unitholders rights to the manager in the trust agreement, have the right to submit a shareholder proposal. However, uncertainty regarding who actually maintains beneficial ownership in the property of the shares has resulted in certain custodians, as registered shareholders, refusing to provide a statement of proof of beneficial ownership. This problem has been remedied in the United States, where beneficial owners have had the right to file proposals for years, by the inclusion of a more expansive definition of beneficial owner.[87]

INSTITUTIONAL AND MARKET FACTORS

In addition to concerns pertaining to the law, significant market barriers identified nearly a decade ago persist to a greater or lesser extent, impeding the effectiveness and efficiency of institutional shareholder activism.[88]

(a) Disclosure of information

As Ron Davis identifies in his accompanying paper, one of the principal problems facing investors is the lack of access to adequate information in a timely and continuous manner.[89] Presently, securities regulation requires disclosure of "material changes" in the corporation in a timely and continuous manner, but does not apply this standard of disclosure to "material facts".[90] As evidenced by the impacts of workplace discrimination lawsuits and environmental liabilities[91], policies and activities in these areas can have significant impacts on shareholder value and shareholders should be informed about them in a full, continuous and timely manner.

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[87] *Definition of Beneficial Ownership*, 17 C.F.R. 240, Rule 13b-3 (2001).

[88] MacIntosh (1995-96), *supra* note 44 at 158.

[89] Davis, *supra* note 5 at 10 [page reference based on journal numbering].

[90] For a discussion of possible information contained under the definition of material fact, see Memorandum from Director of Division of Corporation Finance to Acting Chairman Laura Unger on the subject "Response to letter dated April 2, 2001 from Congressman Wolf" (SEC, May 8, 2001) at 2 (attached).

[91] See Professor Cheryl Wade, "The Relevance of Securities Regulation to Corporate Governance: Shareholder Activism, the Shareholder Proposal Rule, and Corporate Compliance with Law" (to be cited to this journal); Davis, *supra* note 5.

(b) Dual class share structures

A significant number of public Canadian companies continue to maintain dual class share structures, allowing a relatively small number of shareholders to wield control even though they only own a small percentage of the firm. In 2000, 126 out of 795 companies listed on the TSE maintained dual class share structures, compounded by the fact that 90 (72%) of these companies also had a controlling shareholder with more than 50% of outstanding voting shares.[92] This arrangement persists despite empirical evidence demonstrating that dual-class recapitalizations tend to lead to entrenchment of management and depressed firm value.[93] Canadian corporate law requires special shareholder votes when dual-class structures are created thereby enabling shareholders to object to opportunistic dual-class recapitalizations. Yet, dual-class structures persist within Corporate Canada, in part due to vested interests and management control of proxies.

(c) Control of proxy voting mechanism

The apparatus for managing proxies continues to be retained in the hands of management rather than an independent third party.[94] Consequently, management is able to communicate with beneficial shareholders directly, lobby shareholders in advance of votes, and monitor advance voting leading up to an annual general meeting. Furthermore, in many instances, public companies in Canada do not allow for confidential voting, which adds indirect pressure on various institutional investors to vote in line with management's recommendations.

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[92] William M. MacKenzie, "Out of Control" (October/November 2000) 12(6) *Corporate Governance Review* 1 at 2; MacIntosh (1995-96), *supra* note 44 at 162 citing K.E. Montgomery and D.S.R. Leighton, "The unseen revolution is here" (1993), 58(1) *U.W.O. Bus. Quar.* 38 (In the early 1990s, approximately 200 companies listed on the TSE had dual-class share structures, while 18% of the TSE Composite Index had restricted or non-voting shares.)

[93] G. Jarrell & A. Poulson, "Dual Class Recapitalizations as Antitakeover Mechanisms: The Recent Evidence" (1988) 20 (1/2) *Journal of Financial Economics* 129-52.

[94] Emerson & Latchman, *supra* note 61 at 4; Michael J. Whincop, *An Economic and Jurisprudential Genealogy of Corporate Law* (England: Dartmouth Publishing Company, 2001) at 124.

(d) Concentration of ownership

While ownership concentration of public companies in Canada has lessened in recent years[95], a significant number are still owned by a small group of controlling shareholders.[96] Studies in both Canada and the United States suggest that this phenomenon is detrimental to corporate performance for various reasons, including the entrenchment of management, the extraction of private benefits from firms by majority shareholders, and the tendency of controlling shareholders, particularly second-generation controllers, to perform poorly as managers.[97]

(e) Investor apathy

Institutional investors have traditionally taken a passive role in the investment process, despite statements by Canadian and American regulators affirming that proxy votes are valuable plan assets and that voting or delegating the voting of plan assets is part of the duties of plan fiduciaries.[98] Many attribute this to the "free-rider" phenomenon where efficiencies dictate that

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[95] R. Daniels & J. MacIntosh, "Toward a Distinctive Canadian Corporate Law Regime" (1991) 29 *Osgoode Hall Law Journal* 863; R. Daniels and P. Halpern, "The Role of the Closely Held Public Corporation in the Canadian Economy and the Implications for Public Policy (1995) *Can. Bus. L.J.*; MacIntosh (1993), *supra* note 20; Patry & Poitevin, *supra* note 18 at 352-353.

[96] William M. MacKenzie, *supra* note 92. A review of 795 corporations listed on the TSE300 in 2000 found that 25% of companies had no shareholder with more than 10% of all outstanding voting shares in the company; 52% of companies had no shareholder with more than 20% of outstanding voting shares; and 77% had no shareholder with more than 50% of voting shares. This, however, does not account for the cooperation of shareholders in practice. The current data contrasts starkly with early studies that found in more than 3/4 of Canadian corporations reviewed, one large blockholder controlled 20% or more of the voting shares, and in over half of the firms a single blockholder controlled more than 50% of the voting shares. *See also* P. Someshwar Rao & Clifton R. Lee- Sing, "Governance Structure, Corporate Decision-Making and Firm Performance in North America" in Ronald J. Daniels & Randall Morck, eds., *Corporate Decision-Making in Canada* (Calgary: University of Calgary Press,1995).

[97] R. Morck & D. Stangeland, "Large Shareholders and Corporate Performance in Canada" (1994) [unpublished] (Canadian firms whose dominant shareholders are their founders' heirs perform significantly worse than other firms of the same age and size in the same industries.) *See also* B. Johnson, R. Magee, N. Nagarajan, and H. Newman, "An Analysis of the Stock Price Reaction to Sudden Executive Deaths: Implications for the Managerial Labour Market" (1985) 7 *J. Acct. & Econ.* 151; M. Barclay and C. Holderness, "The Law and Large Block Trades" (1992) 35 *Journal of Law and Economics* 265-294; M. Barclay, C. Holderness & J. Pontiff, "Private Benefits from Block Ownership and Discounts on Closed End Funds", (1993) 33 *Journal of Finance* 263-291. These US studies show that large blocks of stock are generally transferred at prices higher than those prevailing on the open market for the same shares. Additionally, prices of many closed end funds in the US are depressed because controlling blockholders extract private benefits.

[98] OSFI, *supra* note 55; Letter from Department of Labour re: Employees' Retirement Program (23 February 1994)

smaller shareholders rely on the efforts of larger institutional investors to assert their rights and interests. Less discussed is the institutionalized subjugation of beneficial shareholders through their inability to submit shareholder proposals in all provincial jurisdictions and the delegation of voting rights to investment managers. According to one British author, "…there is no history or expectation that pension fund trustees will exercise any active ownership role in relation to the shares held. That has never been seen as their role and it would be frowned upon by their corporate managements."[99] This perception is supported by results of a 1992 American survey that found that a "perceived or explicit mandate as passive owner" was the fourth top reason given by institutional investors for not engaging in shareholder activism.[100]

(f) Conflict of Interest

A much-neglected and tabooed issue is conflict of interest at both the institutional and individual fiduciary level. Professor MacIntosh refers to "institutional co-option" where "…the administrators of the pension fund of corporation A will not become activists in respect of the fund's holdings of corporation B in the expectation that the administrators of the pension fund of corporation B will show similar restraint in respect of its holdings in corporation A."[101] Similarly, MacIntosh notes that insurance companies may see their corporate clients withdraw their business if the fund managers do not vote with management.[102] While virtually impossible to verify, these assertions are particularly serious with respect to management trustees of pension plans that allow the interests of a given corporation to override those of plan members.

("Avon letter"), online: < http://www.lens-library.com/info/dolavon.html>.

[99] Sykes, *supra* note 23 at 51.

[100] K.E. Montgomery, "Survey of Institutional Shareholders" (1992) 4(4) *Corp. Gov. Rev.* 5 at 10.

[101] MacIntosh (1995-96), *supra* note 44 at 160 citing R. Romano, "Public Pension Fund Activism in Corporate Governance Reconsidered" (1993) 93 *Colum. L. Rev.* 795.

[102] MacIntosh (1995-96), *ibid.*

(g) Resources

Institutional investors have traditionally cited limited time and resources as the two major reasons for not engaging in shareholder activism.[103] While these reasons continue to be of issue, the relaxing of rules governing shareholder activism in Canada, changing interpretations of the duties of fiduciaries, increasing trustee education, greater coordination of engagement efforts, and evidence demonstrating superior performance by actively trusteed investments all point towards growing acceptance of shareholder activism amongst institutional investors.

(h) Other issues

Commentators have identified a number of additional concerns about the role of institutional investors in corporate governance including agency-related problems (i.e. agency accountability, moral hazards associated with failures to monitor investment managers, adverse selection of investment management, historical under-performance of investment managers, political pressure in the case of public pensions, and management compensation structures)[104], institutional concerns beyond ownership concentration (i.e. free ridership and cross-ownership)[105] and other market-related factors (i.e. lack of liquidity and corresponding increased exit costs)[106]. These issues are beyond the scope of this effort but merit renewed consideration in the context of new investor realities.

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[103] K.E. Montgomery, *supra* note 109 at 10.

[104] Patry & Poitevin, *supra* note 18 at 354-363; MacIntosh (1993), *supra* note 20 at 443; Romano, *supra* note 101. *But see* Keith Ambachtsheer, "Public Pension Power in Canada: For Good… or For Evil?" (Summer 2000) *Canadian Investment Review*.

[105] Patry & Poitevin, *ibid.* at 355, 365; MacIntosh (1993), *ibid*.

[106] Patry & Poitevin, *ibid.*

CONCLUSION

This paper has considered the case for a broader role for the institutional investor in governance of publicly-traded Canadian corporations in the context of global deregulation. It is suggested that acceptance of a concessionist paradigm of the firm in contrast to the classical contractualist framework, the fiduciary relationship of institutional investor to beneficiary, and empirical support linking shareholder activism with enhanced corporate performance, collectively demonstrate the potential role of the institutional investor in supporting healthy corporate governance in a deregulated and global economy.

The recent amendments to federal corporate legislation in Canada represent part of a trend to acknowledging the role of shareholders in corporate governance. These advances are coupled with increased interest by institutional investors, increasing institutional capacity to coordinate shareholder activism, and the development of proxy guidelines by pension and mutual funds. While existing studies provide some evidence in this regard, additional study is necessary to better understand this dynamic.

These initiatives are driven by a belief that institutional shareholder democracy is supportive of both improved specific investment performance and the possibility of long-term benefits for beneficiaries by mobilizing investment capital in a manner that promotes a sustainable economy. However, significant legal and institutional barriers remain preventing efficient and effective engagement between shareholders and management. In the context where the corporation has become the primary institution in society, it remains the challenge for Canadian corporate law to not only provide a proper framework for shareholder democracy, but to embrace a broader notion of corporate democracy that accounts that acknowledges the involvement of all stakeholders in the governance of the firm.