

**Giving Voice to Reality: Michael Trebilcock and Pension Governance Issues**

**Ronald B. Davis and Janis P. Sarra**

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**Ronald B. Davis: [davis@law.ubc.ca](mailto:davis@law.ubc.ca)**

**Janis P. Sarra: [sarra@law.ubc.ca](mailto:sarra@law.ubc.ca)**

## I. Introduction – Michael Trebilcock – Multi-Dimensional Scholar

Michael Trebilcock has refused to adopt a one-dimensional approach to any problem, preferring instead to incorporate the frailties and irrationalities of human behaviour into his analytical approach. This approach is evident in his articles on topics such as the appropriate approach to limited liability for corporations and protecting the employment bargain in the context of business failure or restructuring.<sup>1</sup> His adherence to this realistic approach is evidenced in his willingness to advocate unorthodox solutions where his analysis indicated that orthodoxy was not effective.

Thus, we find him joining in advocating that limited liability should be restricted to large, publicly traded corporations, with all smaller, private corporations' shareholders being subject to unlimited liability for the corporation's obligations and faults, and that directors of large limited liability corporations should be personally liable for employees' unpaid compensation, tort claims and claims based on misrepresentation.<sup>2</sup> His analysis of the inability of *ex ante* employment contracts to protect employees from *ex post* alterations in the risks they faced led him to join in advocating a number of changes in the employment relationship and the role of private ordering in the labour market. He and his co-author, Robert Howse, suggested that provision be made for greater disclosure during collective bargaining and worker participation in management decision-making. After carefully examining the radical changes in employment leading to the end of life-long employment Trebilcock and Howse rejected reliance on contractual arrangements as

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<sup>1</sup> Paul Halpern, Michael Trebilcock & Stuart Turnbull, "An Economic Analysis of Limited Liability in Corporation Law" (1980) 30 *The University of Toronto Law Journal* 117 and Robert Howse & Michael Trebilcock, "Protecting the Employment Bargain" (1993) 43 *University of Toronto Law Journal* 751.

<sup>2</sup> Halpern, Trebilcock & Turnbull, "Limited Liability", *supra* note 1 at 147 – 150.

a response to these changes and advocated an reduced reliance on the private sector and increased reliance on the welfare state to provide pensions, health care and transitional assistance for workers who had lost employment.<sup>3</sup>

This multi-dimensional, pragmatic stance was also evident in Michael Trebilcock's work as a graduate supervisor at the Faculty of Law, University of Toronto where both of the authors were supervised by him during their doctoral thesis preparation. He demanded rigour in analysis, requiring that his students address all of the implications of the thesis they were pursuing for everyone who might be affected if the thesis were accepted and implemented. This requirement was not a demand for "balance", as he was clearly willing to accept that unorthodox resolutions might be the best one, but rather, it was a requirement that a student must directly confront the implications of his or her position by answering any reasonable objections to her or his thesis. Thus, Michael Trebilcock has provided the authors, by example and through his scholarship, a critical space and framework from which their own scholarship might depart.<sup>4</sup>

This article develops the insights from the Micheal Trebilcock's co-authored works on corporate limited liability and protecting the employment bargain and applies them to a contemporary issue arising in the governance of employees' pension plans. The claim is that the insights from these articles illuminate parallel issues in the governance of a defined benefit pension plan. In Part II, the analysis of Trebilcock and his co-authors regarding the corporate form and its effects on corporate creditors will be set out in a more detailed manner, along with the analysis of the effects of collective bargaining rules

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<sup>3</sup> Howse & Trebilcock, "Employment Bargain", *supra* note 1 at 778 – 792.

<sup>4</sup> Ronald B. Davis,

and the governance of corporations on the employment bargain. Part III utilizes the analytical methods used by Trebilcock and his co-authors to highlight the parallel issues in employees' defined benefit pensions. Once the issues are highlighted, Part IV will apply the insights from this analysis to the governance implications for employees' defined benefit pension plans and propose some means to address the concerns.

## **II. Unflinching Confrontation of the Issues**

### **1. Corporate Limited Liability**

In "An Economic Analysis of Limited Liability in Corporation Law", Trebilcock and his co-authors posited two opposing positions regarding limited liability for a corporation's shareholders. The first is that limited liability enables shareholders to transfer uncompensated business risk to the corporation's creditors and is thus inefficient. The other position is that unlimited liability of shareholders would be inefficient because wealthier investors would be discouraged from investing and because shareholders would increase the resources expended on monitoring managers to prevent their increasing the shareholders' risk exposure.<sup>5</sup>

#### **a. Perfect Capital Market Conditions**

The authors illustrate that, given perfect capital markets, the choice of liability rule would only determine those who would have to shoulder the risk of default, without affecting the risk of the firm's net operating income. Compensation for this risk will take various forms, depending on who bears the risk. Owners in an unlimited liability regime receive compensation in the form of higher return on equity, while creditors who bear the risk in

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<sup>5</sup> Halpern, Trebilcock & Turnbull, "Limited Liability", *supra* note 1 at 126.

a limited liability environment receive compensation in the expected yield on the credit extended. If owners in an unlimited liability regime can purchase insurance, the premiums charged will compensate for the insurance company's assumption of the risk.<sup>6</sup> Under the perfect capital market assumptions, the assumption of the risk of default is completely compensated in the market transactions in which the risk is assumed.

The authors also investigate the effect on capital markets of different liability regimes. Under the present limited liability regime, the market for equity claims is possible because the value of the claim is invariant with the personal wealth of the investor and, thus, the claims are fungible. However, with unlimited liability, even with perfect capital market assumptions, share prices would have a different structure. An investor with personal wealth exceeding all possible claims against the corporation who buys just one share is providing insurance to the other, less wealthy investors, and by doing so, increasing the price of their equity investments. However, in order to induce a wealthy investor to buy a share and provide insurance, the less wealthy investors may have to pay the wealthy investor to invest to the point of the price of the wealthy investor's investment being negative. If a wealthy shareholder buys a greater proportion of the shares, then the insurance provided to the other investors will be reduced and the price of these share purchases may even become positive. Thus, in perfect capital markets with unlimited liability, stock prices will vary depending on the wealth of the purchasers.<sup>7</sup>

**b. With Transaction Costs**

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<sup>6</sup> *Ibid.* at 128 – 29.

<sup>7</sup> *Ibid.* at 130 – 31.

Without perfect capital markets, the differences in the form of liability regime may require those with claims against the corporation to assume uncompensated risks. The authors analyze a number of factors that may contribute to this phenomenon under the alternative liability arrangements of limited liability, unlimited liability, and unlimited liability with shareholder-purchased insurance. The factors analyzed include bankruptcy costs, costs of information, insurance markets, and involuntary creditors.

**(i) Bankruptcy Costs**

Bankruptcy costs involve the opportunity costs and losses that follow the corporation's default. Creditors reflect the probability that these costs will be incurred in their lending terms and accordingly, the market value of equity investments is reduced by lowering expected net earnings. The authors suggest that bankruptcy with unlimited liability will result in greater bankruptcy costs involved in the trustee determining which of the shareholders to pursue. In such a regime, the creditors would receive a lower rate of return to reflect the lower risk of loss, while shareholders' expected return would be higher than under limited liability to compensate them for the personal liability assumed. If the shareholders can purchase insurance, then bankruptcy costs will likely not exceed those under a limited liability regime as there is only one entity to be dealt with in insolvency proceedings. As a result, the authors suggest that limited liability or unlimited liability with insurance would minimize bankruptcy costs, although bankruptcy costs differentials would not decisively favour limited liability in the case of small or closely held companies.<sup>8</sup>

**(ii) Information Costs**

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<sup>8</sup> *Ibid.* at 130 – 32.

One of the areas that the authors' analysis suggests that the choice of liability regime will have an important impact is that of information costs, in particular costs associated with the acquisition of information required by creditors, shareholders and participants in securities markets.

For creditors in a limited liability regime, information about the firm's expected earnings and cash flow are necessary to set the expected rate of return. In addition, monitoring of activities that might change the earning power of the firm and the liquidation value of its assets will be necessary. Some of the surveillance costs can be shifted to the firm in constraints on certain activities or requirements for frequent financial reporting. In an unlimited liability regime, the authors suggest that both the earning power of the firm and the personal wealth of its shareholders must be assessed and monitored in order for the creditors to receive the benefit of the insurance provided by unlimited liability. They suggest that the total information costs are likely to be higher under unlimited liability. With shareholder-purchased insurance and unlimited liability, the creditors' information costs are shifted to the insurance company, however, the authors did not discover any cost advantage in obtaining information as between creditors and an insurer.

As you would expect, the authors suggest there are dramatic differences in the information costs to shareholders between limited and unlimited liability arrangements. Limited liability merely requires a shareholder to assess the earnings of the firm in various potential future scenarios, since the amount of any loss resulting from bankruptcy is already known. However, unlimited liability requires they obtain additional information about the potential magnitude of unpaid creditors' claims and the wealth of

other shareholders at all times in the future. If shareholders are able to purchase insurance they would only require the same information as under limited liability.

In assessing the implications of these different costs of information, the authors concluded that with unlimited liability, securities markets would not exist or would be dominated by corporations in which a majority shareholder controls the firm. The costs of ascertaining the identity and wealth of other investors would be so great that purchasing a minority stake in a corporation would not be worth the costs involved in obtaining the necessary information. Other possible arrangements to try and reduce these costs, such as contracting with management to constrain their risk enhancing activity, or contracting with creditors for limited liability for the shareholder would likely be as expensive as monitoring fellow shareholders, if not more expensive. The market would dry up because less wealthy potential shareholders would have to assume the worse case scenario of being responsible for the claims against the corporation up to the limits of their personal wealth.

One means of dealing with this problem might be to include pro-rata unlimited liability in which each shareholder would be liable for the corporation's debts to the amount of their original investment plus a proportion of the unsatisfied claims equal to the proportion of the total shares held by the shareholder.<sup>9</sup> In such a system, the expected returns and share prices will be based on the firm's non-diversifiable risk not the wealth of the shareholders and there will be less need to monitor wealth of other shareholders. Nevertheless, the shareholder is still providing insurance to the creditors through a claim on the

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<sup>9</sup> This concept is explored in more detail in the context of liability for corporate torts in Henry Hansmann & Reinier Kraakman, "Toward Unlimited Shareholder Liability for Corporate Torts" (1991) 100 *Yale Law Journal* 1879.

shareholder's personal assets in proportion to the percentage of total shares held by the shareholder.

**(iii) Insurance**

It is noteworthy that the authors have used insurance as the vehicle through which to illustrate the risk allocation arrangements in various forms of liability regimes for corporations. Its use is not confined to formal contracts of insurance with an insurance company, but rather, is applied to the relationship between various stakeholders in the corporate enterprise with respect to the risk of default during bankruptcy. Thus, under limited liability, creditors are the insurance providers, while with unlimited liability, it is the shareholders. If shareholders can purchase bankruptcy insurance under unlimited liability, then an insurance company insures the default risk.

Their use of the insurance concept allows them to compare various liability regimes with respect to whether or not there is a market for default risk insurance and whether that market allocates default risk to the least-cost risk bearer. The authors evaluate the effect of the costs of information, moral hazard, adverse selection and ability to diversify on the existence of an insurance market for bankruptcy risk. They point out that as between creditors and insurance companies, some types of creditors may have cost advantages over insurance companies in obtaining and evaluating information about the probability and costs of default, while other creditors are not so advantaged. For example, trade creditors familiar with an industry may be able to gauge and respond to changing default risk due to short term contracts, while insurance companies cannot due to the longer term of most such contracts. On the other hand bond holders would not have any cost

advantages over insurance companies. The authors conclude there is no obvious advantage to creditor provided insurance on information cost grounds.

Moral hazards would arise under an insurance contract because the payment will be made irrespective of the actions of the insured and there are no constraints on the insured taking actions that increase the risk of the payment being made after insurance has been obtained. A similar moral hazard arises from the insurance offered by creditors under limited liability.<sup>10</sup> Once the credit is granted at a price based on the risk profile of the firm at the time, nothing prevents the managers from undertaking new projects that materially increase the default risk insured by the creditors. The exposure to moral hazards does not differ significantly between bondholders and insurance companies; although the authors suggest that trade creditors and some employees should have better access to information about changes in risk. However, the moral hazard exposure does vary with size, according to the authors. Smaller firms' owners obtain the "full benefit" of alterations in the firm's operations and thus there is a greater moral hazard with limited liability. The prevalence of some creditors requiring that small firm owners provide personal guarantees for a corporation's debt is recognition by creditors of this greater moral hazard and a refusal to provide the insurance that attaches to limited liability.

Presumably, the authors viewed the moral hazard exposure as less in larger publicly traded companies because the managers cannot receive the "full benefit" of the potentially higher returns generated by increasing the risks through new projects because

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<sup>10</sup> As the authors' point out, Halpern, Trebilcock & Turnbull, "Limited Liability", *supra* note 1 at at 140, note 44, what they categorize as a moral hazard is sometimes seen as the agency costs or incentive effects of debt, see Jensen and Meckling, "Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure" (1976) 3 *Journal of Financial Economics* 305

the equity claims were spread throughout at large number of non-managerial shareholders.

Adverse selection is the process whereby the premiums for insurance are calculated based on the average expected losses amongst all firms eligible to purchase the insurance, but only the riskier firms actually purchase the insurance, leading to a higher than expected average loss. This selection process leads to increased premiums based on this higher average loss and after the increase, a smaller number of even more risky firms being the ones to purchase insurance, leading to even higher than expected losses, etc. This issue will not arise under limited liability because creditors will look at the risks in an individual firm, not the average risk of a group of firms, in setting their expected rates of return. In order to overcome adverse selection, insurance companies will have to set their bankruptcy risk premiums for each firm individually, essentially reproducing the same evaluation as that done by creditors under limited liability.

The last criteria on which an evaluation of the different forms of insurance is required is that of the ability of the insurance provider to diversify the risk posed by the insurance through other forms of investment. The theory behind diversification is that if you can invest other assets in claims whose returns vary independently with those of the bankruptcy insurance provided to the firm, then a loss on the insurance contract has a good chance of being offset by gains in the other independently varying investments. For trade creditors, the authors were unable to determine if their diversification risk from specializing in one type of business would be outweighed by the improved information about risks in that industry. However, employees cannot diversify their risks of investing their “human capital” in a firm, although a few may have superior information and some

may be in occupations where mobility is easy. Insurance companies are able to diversify their risks through their capital investments and other lines of insurance, however, the authors point out that long-term contracts increase their risk exposure through changes in the firm's risks.

The authors conclude that there are circumstances where neither the market nor long-term creditors will provide insurance against firm default and, as a result, shareholders face unlimited liability through personal guarantees. Only trade creditors and employees provide credit in these market failure conditions.<sup>11</sup>

**c. Implications for Limited Liability**

Trebilcock and his co-authors conclude that the limited liability regime generates moral hazard problems for creditors. Some protection may be available through constraints on risk-increasing investment decisions in credit granting contracts or from an interest of the owners in the long-run viability of the company. However, there are incentives in limited liability for owners to “undertake excessively (inefficiently) risky projects, especially in closely held companies”. Where the credit granting transaction is not voluntary, such as where someone is injured and has a tort claim, the authors suggest that unlimited liability is more efficient. The owners can obtain sufficient insurance at a more reasonable cost than those who might have suffer an injury through corporate actions because of superior information and control over the risks and fewer transactions will be required to obtain insurance.

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<sup>11</sup> Halpern, Trebilcock & Turnbull, “Limited Liability”, *supra* note 1 at 143.

In setting out their views regarding an efficient liability regime for corporations, the authors differentiate between the large, publicly traded corporation and smaller corporations that are not traded. They would apply limited liability to these large corporations because the securities markets would be threatened if unlimited liability prevailed. As well, they saw the moral hazard problem in these corporations as “attenuated” They come to an opposite conclusion in the case of small, closely held companies because of the moral hazard exposure generates costly attempts by creditors to reduce the risk that the owners will transfer uncompensated business risks to them. They visualized this change in policy as leading to explicit negotiations to reduce the owner’s liability that would increase the information flows to creditors regarding the risks involved. They did recognize that for many such small firms, the small number of creditors had already led to the contractual abolishment of limited liability, at least for some creditors, through personal guarantees of the firm’s debts obtained from the firm’s owners. However, though the authors thought the change might be inconsequential, given the existence of personal guarantees, it might lead to major changes for some classes of creditors such as employees and trade creditors where personal guarantees do not typically form part of the contract.<sup>12</sup>

Finally, the authors suggested a number of exceptions for limited liability applicable to large, widely held corporations for cases involving misrepresentation, involuntary creditors, and employees. However, instead of all shareholders, liability to these classes of creditors would attach to the corporation’s directors. The basis for this policy was that such liability would give directors incentives to take steps to avoid the liability, obtain

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<sup>12</sup> For example, the trade creditors in *Peoples Department Stores*. Should secured interests be seen as uncompensated risk transfers?

appropriate insurance and increase the recovery of the most vulnerable creditors without incurring the large wealth monitoring costs that would accompany unlimited liability for these large corporations.

## **2. Protecting the Employment Bargain**

Published thirteen years after the analysis of limited liability for corporations, “Protecting the Employment Bargain” was a response by Michael Trebilcock and his co-author Robert Howse to the problems that arose for employees as a consequence of the “wave of mergers, acquisitions, corporate restructurings and plant closings” in North America over the previous decade.<sup>13</sup> It addressed the proposal that workers should participate in the management of the firm as a remedy for the failure of the employment bargain to protect their “human capital” investment in the firm during a takeover or restructuring.<sup>14</sup> Trebilcock and his co-author begin with the “nexus of contracts” model of corporate finance in which the firm is viewed as the means by which diverse stakeholders contract about the conditions under which the economic activity of the firm will be conducted. Trebilcock and Howse’s approach starts from the premise that agency theory would be an obvious candidate to deal with the opportunities for strategic behavior inherent in long-term contractual relationships and should be open to any approaches that reduce the transaction costs of such contracting. They point out that, although this model is neutral on its face about the desirability of employee participation in management, theorists who subscribe to the model tend to be very skeptical about employee participation and almost

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<sup>13</sup> Robert Howse & Michael Trebilcock, “Protecting the Employment Bargain” *supra*, note 1 at 751.

<sup>14</sup> *Ibid.* at 752.

none have examined employee ownership in depth.<sup>15</sup> In order to test other scholars' skepticism about employee participation, the co-authors first assess the adequacy of contractual arrangements to protect employees against strategic behaviour by other stakeholders, analyze the ability of alternative arrangements to enhance protection, and then explore the limitations of these alternative arrangements together with the public policy imperatives generated by these limitations.

**a. The Adequacy of *Ex Ante* Contractual Terms**

Trebilcock and Howse treat the plant closings and labour-shedding that can follow large-scale restructuring as an "end-game" of the long-term contractual employment relationship in which implicit or explicit commitments to life-time employment are disregarded. The co-authors review contractual terms that might protect employees against such end game behaviour, such as including a bankruptcy or restructuring risk premium in wages or bargaining for severance payments. They conclude that they are either rarely present or subject to the same risk of opportunistic behaviour that they are supposed to protect against.

**(i) Risk Premiums in Wages**

Trebilcock and Howse point out that, employers typically do not front load compensation to employees, but rather, pay below employees' marginal product in the early years of the relationship and gradually increase compensation towards the end of employment. This compensation structure leaves employees vulnerable to opportunism by the employer who will save the cost of paying older workers more than their marginal product by

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<sup>15</sup> *Loc. cit.* referring to the work of Jonathan Macey as one example, at note 4..

terminating them. As well, even if a risk premium was part of the bargain employees would have to be able to assess and price the risk *ex ante*. Since that risk is related to the economic health of the firm and management strategies, the co-authors suggest that rules concerning disclosure of this information to employees would have to be substantially reformed in order to provide sufficient information to price the risk premium.<sup>16</sup> However, even with adequate pre-contractual disclosure, employees are still vulnerable to post-contractual increases to the risk by shareholders and managers. Increasing the risk increases the shareholders potential maximum payout without compensation fixed claimants such as bondholders or employees for the increased risk they will not receive full payment.<sup>17</sup>

Other contracting parties exposed to this “moral hazard” typically impose constraints on management’s ability to substantially alter the risk or a mechanism to readjust the bargain where the risk has been increased. The moral hazard risk is exacerbated in corporate takeover situations because shareholders who are about to “cash out” do not have to be concerned about the market reputation affects of opportunism on the corporation’s future access to debt or labour markets.<sup>18</sup> However, provisions constraining management or providing for renegotiation are not typically part of employment contracts. Overall, the co-authors suggest that compensation structures do not reflect a risk premium approach to protection and even if such an approach were adopted, employees would have to be able

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<sup>16</sup> Robert Howse & Michael Trebilcock, “Protecting the Employment Bargain” *supra*, note 1 at 755-56.

<sup>17</sup> *Ibid.* at 756-57.

<sup>18</sup> This is the same moral hazard discussed in the context of the insurance provided by creditors under limited liability in Halpern, Trebilcock & Turnbull, “Limited Liability”, *supra* note 1 at 40.

to constrain post-contractual risk alteration for that approach to offer sufficient protection.

**(ii) Contractual Severance Payment Obligations**

Another option to protect employees' investments assessed by Howse and Trebilcock would be to require payment of an amount to compensate for early termination of the employment relationship. While these payments do offer some compensation, the co-authors note that one study found no correlation between the presence of the severance payment requirements in collective agreements and the likelihood of plant closures or job losses. They found this indicative of significant information failures in the bargaining process and potentially of the conflicts of interest between younger and older workers in setting bargaining goals.<sup>19</sup>

One other factor that is not mentioned by the co-authors is that, unlike risk premia included in wages, payment of severance is dependent on the solvency of the corporation. In some situations, shareholders' post-contractual increase of risks may lead to bankruptcy, where severance payments may not be made or be severely reduced. In such circumstances severance payments would be entirely ineffective in protecting employees' investments in the firm.

**b. Analogies Between Collective Bargaining and Bond Covenants**

After noting that similarities in the moral hazard problems that face bond holders and employees as long-term investors in the firm would raise the issue of why collective agreements do not contain the same constraints on management risk-alteration as do bond

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<sup>19</sup> Robert Howse & Michael Trebilcock, "Protecting the Employment Bargain" *supra*, note 1 at 758 – 59.

covenants, Trebilcock and Howse look at the explanation offered by Oliver Williamson, who suggests that unions can renegotiate collective agreement terms with relative frequency and can exact compensation for risk-alteration.<sup>20</sup> Williamson argues that the constraints provided by reputational effects in the marketplace and the fact that the employer and employees have mutual hostages because they both have large sunk costs in the firm offer adequate constraints on the moral hazard for shareholders and managers.

Trebilcock and Howse point out that during corporate restructurings, where there is the greatest potential for moral hazards, neither the threat of demands for compensation at the next round of bargaining nor concerns about reputational loss will constrain shareholders. Assuming the union survives the changes accompanying the restructuring, the shareholders at the next round of bargaining will be completely different. As well, since shareholders only have a “transitory and impersonal identity” as parties to a collective agreement, concern about reputational effects does not constrain shareholders. Finally, the co-authors point out that reputational effects are present in the case of bondholders, yet they still require significant constraints on the acts of managers and shareholders. In fact they suggest that reputational effects should be more effective in the case of bondholders because they face less opportunity costs in withholding capital than do employees with industry-specific skills.<sup>21</sup>

Howse and Trebilcock point out that the mutual hostage analysis has limits because while employees’ firm-specific investments increase over time, those of the shareholders are depreciating over the same time period. Thus, when a merger or acquisition that requires

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<sup>20</sup> Oliver Williamson, *Economic Institutions of Capitalism* (1986); “Corporate Governance” 93 *Yale Law Journal* 1197, 1200 – 3.

<sup>21</sup> Robert Howse & Michael Trebilcock, “Protecting the Employment Bargain” *supra*, note 1 at 760 - 63

a plant shutdown is under consideration, employees usually have much more to lose than shareholders.<sup>22</sup>

**c. Alternative to Contract – Participation in Firm Management**

Having reviewed the shortcomings of *ex ante* contractual terms to protect employees' interests, Trebilcock and Howse investigate alternatives such as permitting post-contractual constraints similar to bond covenants, employee participation on boards of directors, and mandatory consultation on significant events.

**(i) Covenants constraining management**

Employers could agree to terms in collective agreements that prohibited plant closures, required union consent or consultation where worker interests are threatened or potentially threatened by a merger or takeover bid, or promised to make investments in training or physical plant. While such provisions would clearly offer similar protection against moral hazards as some bondholder covenants, Trebilcock and Howse see two potential problems with such terms. First, they might be seen as a breach of fiduciary duty to the shareholders, where that duty is seen as maximizing shareholder wealth. Secondly, they might provide additional protection to a lackluster management from hostile takeover bids.<sup>23</sup>

**(ii) Employee board membership**

Other countries have a practice of having employees on their board of directors. Trebilcock and Howse see this practice as potentially beneficial both as a source of

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<sup>22</sup> *Ibid.* at 763-64.

<sup>23</sup> *Ibid.* at 767-68.

information about the economic condition of the firm and its strategic direction, but also as a control over corporate opportunism, either by whistle-blowing or as a deterrent to the proposal of the more egregiously opportunistic proposals.<sup>24</sup> In answer to concerns that the practice would institutionalize conflicts of interest on the board, the co-authors suggest that board decisions might be better able to avoid “foolhardy, reckless or ill-considered strategic decisions” through the enhanced scrutiny and debate that multiple perspectives would offer.<sup>25</sup> They ask why conflict should be avoided in the boardroom when theorists who adopt the nexus of contracts model do so in recognition of the conflicts amongst stakeholders, suggesting that if the model has any value then it must be because “the value of joint economic activity amongst diverse stakeholders outweighs the constraints on pursuing shareholder wealth that are required to vindicate the interests of other constituencies”.<sup>26</sup>

**(iii) Consultation without Co-Determination**

An alternative to providing workers with a voice in strategy would be to provide them with a voice regarding the effects of such strategies. Trebilcock and Howse see a potential in such arrangements for orderly and humane arrangements for plant closings at the least, and a vehicle to allow employees to respond to changes in the marketplace that may lessen the chances of major terminations of employment.

**3. The Analytical Approach**

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<sup>24</sup> *Ibid.* at 768.

<sup>25</sup> *Ibid.* at 769.

<sup>26</sup> *Ibid.* at 770.

One thing that is conspicuous in the analytical stance adopted in these two articles is the lack of deference to the status quo and consensus about the “efficiency” of current arrangements. Instead, the logical implications of a theory or model are explored and discussed with the stated goal clearly in focus and without concern that these implications would disturb those interests presently enjoying advantages in commercial relationships. Rather, Trebilcock and his co-authors required a compelling justification for those who enjoyed advantages to continue to do so. Marketplace transactions did not automatically meet the standards of efficiency because they occurred in the market. Instead the market was required to demonstrate that it provided opportunities to all participants to accurately price risks and its contracts did not create moral hazards and permit opportunistic behaviour by some participants.

### **III. Application of the Approach**

#### **1. Pension Governance**

One area where the insurance standpoint adopted by Trebilcock and his co-authors offers an opportunity to analyze the operations of the marketplace is the defined benefit workplace pension plans that grew rapidly following the Second World War and are now a central feature of many large industrial enterprises. Pension plans contain a number of the problematic elements that were identified by Trebilcock and his co-authors in the two articles analyzed earlier.

First, such arrangements are implicit insurance contracts offered to employees by the employer, but as will be pointed out below the employees may actually be self-insured to some extent when the employer is a limited liability entity. Second, the pension plan is part of the employment contract and exhibits the same characteristics of lower

compensation in relation to production in the early years followed by a reversal of that relationship near the end of employment. Third, the moral hazards and agency problems created by a defined benefit pension plan are complex and are as difficult to control as those created by the corporate form. Thus, just as in the case of limited liability for smaller corporations, there is no marketplace-provided insurance for pension plan members.

#### **a. The Insurance Risk-Bearer**

The defined benefit pension promise is very close to an annuity contract in its terms, though not in its funding arrangements. The promise is that, on reaching a certain age, a certain sum of money will be paid at regular intervals for the rest of the pension plan member's life. In return, the employee must work for the employer for until the age of retirement. In an annuity, the capital amount calculated to be sufficient to pay the promised amounts is turned over to the insurance company, which then invests the funds to earn sufficient income to pay the annuity as well as its profits. The remaining risk, which is that the insurance company will be unable to pay the promised benefits because it is insolvent, is borne by the plan members and any self-insurance funds created by the insurance industry.

##### **(i) Pricing Insolvency Risk in Long-Term Contracts**

In a defined benefit pension promise, the insurance contract is written on the employer's assets. However, those assets are not being invested in order to provide for pensions, but rather utilized in the firm's business operations and investments to be used to provide profits to the shareholders. Absent regulation or additional contractual terms, such an arrangement creates an enormous pricing and moral hazard problem in a long-term

relationship in which all of the consideration is delivered over decades by one party and the other party is not obliged to make any payments until there is no more consideration to be received. In such circumstances, the price agreed on at the commencement of the employee's employment is unlikely to capture all of the solvency risk of the enterprise over the decades until retirement.<sup>27</sup> Instead of providing a means to diversify the risks of termination following the employer's insolvency, this type of funding arrangement exacerbates the adverse effects of that loss by adding another non-diversifiable investment by the employee.<sup>28</sup> In addition, such an arrangement permits current shareholders to transfer the payment for currently accruing pension obligations to future shareholders unless that obligation is reflected in the prices of the shares sold by the current shareholders.<sup>29</sup> As that obligation grows over time, the "insurance" provided by the employer's assets becomes much less valuable, given that the claims of the employer's secured creditors will always be able to trump the "insurance" in the pension promise.

However, current defined benefit pension plan arrangements provide employees with a more valuable insurance in the form of an obligation on the employer to pre-fund benefits as they accrue and segregate the pre-funding contributions from the employer's other

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<sup>27</sup> A more expansive review of this point can be found in Ronald Davis, "Restructuring Proceedings and Pension Fund Deficits: A Question of Risk and Reward", *Annual Review of Insolvency Law* – 2003, 29 – 65; Janis Sarra and Ronald Davis, *Director and Officer Liability in Corporate Insolvency*, (Markham & Vancouver: Butterworths Canada Inc., 2002); and, Ronald Davis, "Protecting the Fund" – Report on Research Project # 10 Commissioned by the Ontario Expert Commission on Pensions, (Toronto: Queen's Printer for Ontario, 2007) (available through <http://www.pensionreview.on.ca/english/summaries/>).

<sup>28</sup> See discussion by Trebilcock and Howse, "Protecting the Employment Bargain", *supra* note 1 at 781-82 about the risks accompanying employee buy-outs as another example of such exacerbation of risk by not diversifying investments by employees.

<sup>29</sup> Jean-Jacques Gollier, "Private Pension Systems", in (OECD Working Party on Private Pensions ed) *Private Pension Systems and Policy Issues* 223 (2000) [hereinafter Jean-Jacques Gollier, *Private Pension Systems*] at 232-36.

assets. This provides three advantages over the unregulated regime. First, it more closely approximates the insurance annuity product, in that a capital contribution is made that is solely dedicated to the provision of pension benefits. Second, the fund must be separated from the employer's assets so that it is not vulnerable to the claims of the employer's creditors. Finally, this segregated fund can offer employees an opportunity to diversify their risks arising from employment by investing it in sectors of the market that are not highly correlated with those of the employer.<sup>30</sup>

The current funding arrangements do not, however, eliminate the risks to employee's pension benefits that can arise from an employer's insolvency, nor do they eliminate the implicit self-insurance provided by the employee for the pension promise in the presence of limited liability. That risk has been summarized as follows:

Once pension funds have been insulated from the employer's creditors through their transfer to a third party, the remaining risk that the fund will be inadequate to pay the promised pension benefits arise from the funding policies of the sponsor and the investment policies of the pension fund. The funding policy of the sponsor must provide for contributions to the pension fund that are sufficient, when increases from investments are taken into account, to fund the expected benefit. The investment policy of the fund must be able to consistently meet or exceed the assumed rate of return for investments used in establishing the employer's funding policy. Implicit in both policies is an assumption of a certain degree of risk arising from the necessarily imprecise calculation of future events affecting the cost of benefits and from the choice of investments that will earn higher rates of return than risk-free investments.<sup>31</sup>

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<sup>30</sup> Although that opportunity has not always been taken by pension plans where the bulk of the assets are invested in the employer's securities see e.g. Ronald Davis, "The Enron Pension Jigsaw: Assembling Accountable Corporate Governance by Fiduciaries" (2003) 36 *UBC Law Review* 541; Susan Stabile, "Freedom to Choose Unwisely: Congress' Misguided Decision to Leave 401(k) Participants to Their Own Devices", (2002) 11 *Cornell Journal of Law and Public Policy* 361.

<sup>31</sup> Ronald Davis, "Protecting the Fund", *supra* note 27 at 16 – 17.

Thus, as far as the pricing of the self-insurance provided by the employee for the employer's defined benefit pension promise, the exercise is no longer one of estimating the likelihood of the employer's insolvency at some future date without any information about the priority ranking of other creditors at that time. Instead, it involves estimating the relationship between the plan's obligations and assets at some future date when the plan is terminated by the employer's insolvency. If the pension fund cannot meet all of its obligations then the employer's assets are there to ensure full payment, but only outside of the employer's insolvency. With an insolvent employer, the same priority contest for the assets will ensue as would occur without pre-funding. Thus, pricing of the insurance will be basically the same process of assessing the insolvency risk to the employer, with the only difference being a reduction in the proportion of benefits which are unfunded.

**(ii) Risk Bearing Outside of Insolvency**

One factor that is often used to justify much of current pension funding policy is the assertion that employers bear the risk of funding and investment policies through the explicit insurance of promised benefits, at least outside of insolvency. Some questions about this issue still remain, however. This insurance is a result of the regulatory requirement that employers must fund any deficiency in the plan's ability to pay all benefits in full by making special payments sufficient to liquidate the deficiency over the course of the next five years. These special payments are in addition to the payments necessary to fund the cost of currently accruing benefits. This raises the issue of whether the employer is the ultimate risk bearer outside of insolvency.

The arguments are whether or not the employer is able to transfer the cost of special payments to the employees by lowering their future compensation. James Pesando

suggests that the evidence of initial incidence is clear, but the evidence of the ultimate incidence is not so clear. In his view a labour market in which the firm unambiguously bore the ultimate incidence of the special payments would be one in which employees received the full value of their marginal production every period. In such a market, an employer faced with special payments could not extract the value of those payments from the next period's workforce because they are paid the full value of their marginal production for that period.<sup>32</sup> However, as noted by Trebilcock and Howse, the actual labour market is one in which employees are paid less than the value of their marginal product in their early years with the implicit promise that their compensation will increase beyond the value of the marginal product in their final years of employment.<sup>33</sup> Pesando suggests that there is nothing in this implicit long-term contract to preclude an employer from transferring the ultimate incidence of special payments to employees and that the existence and degree of any transfer is a matter for empirical investigation.<sup>34</sup>

Thus, employees attempting to price either the insolvency risk to their pension benefits or the degree to which they will bear the ultimate incidence of the costs of periodic funding shortfalls face similar problems to those attempting to price their creditor-provided insurance during long-term contracts in cases of limited liability. It is comparable to the problems employees face in pricing risk premiums for wage loss and human capital investment on insolvency. The defined benefit pension plan can add a diversified portfolio of investments to the assets available to address the consequences of

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<sup>32</sup> James E. Pesando, "Risky Assumptions: A Closer Look at the Bearing of Investment Risk in Defined-Benefit Pension Plans", (2008) C.D. Howe Institute Commentary No. 266 at [http://cdhowe.org/pdf/commentary\\_266.pdf](http://cdhowe.org/pdf/commentary_266.pdf) (last viewed August 10, 2009)

<sup>33</sup> Robert Howse & Michael Trebilcock, "Protecting the Employment Bargain", *supra* note 1 at 755-56.

<sup>34</sup> James Pesando, "Risky Assumptions", *supra* note 32 at 6 – 7.

employment termination, however, its long-term nature makes the price of employee self-insurance difficult to price.

**b. Moral Hazard and Agency Problems**

Most employers have control over two important pension plan functions that are key elements in the moral hazards and agency problems of pension plans. Employers control the funding policy of the plan as well as its investment policy.

**(i) Moral Hazards in Funding Assumptions**

Regulatory provisions usually set funding obligations based on actuarial valuations of the plan. In conducting these valuations actuarial standards for pension actuarial services provide enormous scope for the exercise of discretion.<sup>35</sup> One protection afforded by this requirement is that an actuary concerned with his or her professional reputation will not risk their status in order to please a particular client. Similar reasoning applied with respect to the use of professional auditors as checks on the more aggressive management accounting practices in corporate law. However, the actuarial profession has undergone changes similar to those that have affected the public company accounting profession. These changes may render much of its ability to act as an independent check on management debatable, much as they have raised similar questions about the role of accountants in Enron and other corporate reporting scandals.<sup>36</sup> In a recent court case it is

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<sup>35</sup> Canadian Institute of Actuaries Task Force on Pension Plan Funding, 'Final Report of the Task Force on Pension Plan Funding' (2003) <<http://www.actuaries.ca/publications/2003/203012e.pdf>> (accessed 2 November 2003), at 6 provided a rationale for developing a revised standard based on the ambiguity of the current standard's wording and the lack of any guidance about appropriate economic assumptions to be used in estimating future events.

<sup>36</sup> William W. Bratton, "Enron and the Dark Side of Shareholder Value" (2002) 76 *Tulane Law Review* 1275, at 1349 noting that Andersen received \$5.7 million in consulting fees from Enron with respect to the Chewco and LJM related transactions and notes that regulators were not blind to the dangers from these

alleged that the plan's actuary misstated the solvency position of the pension fund. The Ontario Court of Appeal has permitted the plan's actuary to pursue a third-party claim against the directors who acted as the pension plan administrators based on the actuary's allegations that they gave instructions to pursue an aggressive asset valuation methodology in order to avoid the employer becoming obligated under applicable legislation to make special payments to make-up a funding deficiency.<sup>37</sup> If nothing else, these allegations by the actuary, who was a partner in a large actuarial consulting firm, might reflect a seemingly diminished capacity to act as an independent professional.

**(ii) Agency Costs in Investment Policy**

One might expect that both employers' and plan members' interests might coincide, rather than conflict, with respect to the sufficiency of initial contributions and the need to ensure the assets matched the nature of the pension liabilities. Where there is a defined benefit plan, a problem in either area will lead to either increased funding obligations for an employer or in some cases to employer insolvency, both of which will adversely affect an employer's shareholders. However, this view does not consider the conflicts of interest between managers and shareholders of the employer over the desirability of incorporating

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situations, just unable to overcome the political lobby that opposed their regulatory initiatives, *Ibid.* at 1351:

“The dangers posed to audit quality by the conflict of interest bound up in ancillary consulting arrangements have been widely discussed. The Big Five firms marketed their advisory services very aggressively. They sold tax products having a record of going over the line of legality. They also marketed SPE arrangements. Significantly, the more aggressive the accounting implicated in the products, the more important it has been that the seller firm also be the auditor. The sales relationship imports a favorable audit. Alternatively, aggressive transactional "products" have been sold by investment bankers complete with opinion letters from Big Five firms opining conformity to GAAP. The letter serves to constrain later objections from an auditor.”

<sup>37</sup> *Morneau Sobeco Limited Partnership v. Aon Consulting Inc.* (2008), 65 C.C.P.B. 293, 291 D.L.R. (4<sup>th</sup>) 314 (Ont. C.A.) leave to appeal application dismissed September 4, 2008 (SCC).

certain risks and valuation practices in the employer's pension plan. These conflicts mirror those between the managers and the plan members regarding these same issues. The core of the conflict involves two interrelated issues. The first issue is how to determine the cost of benefits as they accrue. The second issue is whether or not to incur significant asset/liability mismatch risk. These issues are interrelated because the potential benefits of asset/liability mismatch risk for managers are created by actuarial practice concerning the determination of costs of accruing benefit. The conflict arises because current actuarial practice permits managers to include future earnings in the calculation of the cost before the earnings are realized. Where the assets generating those earnings are "risk-free", then the practice may not be controversial, but where the assets are risky with volatile returns, then conflict arises because the risk is shared by the shareholders and plan members without being reflected in the pricing of the benefits.

The means by which the contribution obligations in a defined benefit plan are required to be calculated by the actuary require the use of "accepted actuarial practice" in making the calculation.<sup>38</sup> However, it is precisely in this area that the actuarial profession has run into issues that have provoked a vigorous debate in the profession. A crucial element in these calculations is whether or not the assumed rate of earnings ought to include an "equity investment premium" that would increase the assumed long-term earnings on the plan's assets over the rate that would be estimated if risk-free debt investments were used. This equity premium thus decreases the employer's annual contribution obligations by allowing the actuary to assume the plan is earning an increased rate on its investments.<sup>39</sup>

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<sup>38</sup> PBA Reg. (Ont.), s. 2.

<sup>39</sup> James G. Paterson FCIA FSA, 'Selection of Valuation Interest Rates for Funding Valuations of Pension Plans - Traditional Pension Plan Approach Versus Financial Economics Approach', Member's Paper (2003)

However, these premiums are based on the beliefs that, over the long-term, equity investments are good matches for the liabilities of a pension plan. Zvi Bodie has been very critical of this belief. In his view, it misinterprets a small probability of a loss as meaning the magnitude of any loss will also be small. However, he points out where in any year there is a potential that the value of an equity investment will be +20% or -20% then in a worst case over 20 years, 99% of the value of the original investment can be lost.<sup>40</sup>

Thus, while the probability of risk is low, the effect of its realization is potentially enormous on a pension benefit where the size of the liabilities steadily increases over time and then matures on retirement.<sup>41</sup> Bodie's concern is that policy makers appear to be under the misapprehension that "equity securities provide a long-run hedge against defined-benefit pension liabilities".<sup>42</sup> Keith Ambachtsheer has suggested that the belief in a consistent premium lacks a factual basis, as research has shown it is a variable and suggests that the practice is a "dubiously speculative proposition even today".<sup>43</sup> A proposal was made by the Canadian Institute of Actuaries Task Force on Pension Plan

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in Publications <<http://www.actuaries.ca/publications/2003/203044.pdf>> (accessed 5 November 2003), at 5 provides a sample calculation with the equity premium at 3.7% over the first 15 years and 3.5% over the post 15 year period.

<sup>40</sup> Zvi Bodie, 'What the Pension Benefits Guarantee Corporation Can Learn from the Federal Savings and Loan Insurance Corporation', Copy Downloaded from Social Science Research Network (1996) 10 *Journal of Financial Services Research* 83-100 <[http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=271328](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=271328)> (accessed 10 November 2003), at 12

<sup>41</sup> Henry T.C. Hu, "Faith and Magic: Investor Beliefs and Government Neutrality" (2000) 78 *Texas Law Review* 777, raises the concern that inaction by securities regulators is allowing the securities industry to promulgate the same misunderstanding amongst investors. Hu suggests that the absence of a financial product that provides a guarantee based upon the myth about equities is conclusive evidence of the fallacy of the belief.

<sup>42</sup> Bodie, 10 *Journal of Financial Services Research*, *supra* note 42 at 2 (SSRN ms).

<sup>43</sup> Keith Ambachtsheer, 'Cleaning up the Pension Mess: Why It Will Take More Than Money' (2004) 78 *C.D. Howe Institute Backgrounder* <[http://www.cdhowe.org/pdf/backgrounder\\_78.pdf](http://www.cdhowe.org/pdf/backgrounder_78.pdf)> (accessed 28 March 2004), at 3.

Funding that contributions be calculated with an additional “margin” in order to account for the presence of a very high “degree of mismatch between pension assets and liabilities” such that events occurring after the valuation date may cause “an unacceptable deterioration in the plan’s funded status”.<sup>44</sup>

The controversial issue is whether by giving the appearance of cost savings on the corporation’s balance sheet from the lower actuarial cost calculated using the equity premium, actuaries are requiring plan members to provide insurance for the default risk accompanying the investment of pension funds in equity. A number of actuaries using the insights of financial economics have taken issue with the justifications offered for the practice on the grounds that the alleged cost savings to shareholders are illusory and that the real explanation for the practice is the conflicts of interest of corporate managers and pension plan professional advisors.<sup>45</sup>

According to Lawrence Bader and Jeremy Gold, the financial economics insight into the recognition of an equity premium in cost calculations is that:

***\$1 million of bonds has the same value at \$1 million of equities.*** This is a tautology, of course, and no actuaries would dispute it. Yet the actuarial pension model, by focusing on expected returns while ignoring the market price for risk, implies that higher *expected* future values can be translated into higher present values.<sup>46</sup>

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<sup>44</sup> Canadian Institute of Actuaries Task Force on Pension Plan Funding, 'Final Report of the Task Force on Pension Plan Funding' (2003) <<http://www.actuaries.ca/publications/2003/203012e.pdf>> (accessed 2 November 2003) at 9-10.

<sup>45</sup> John Exley, Shyam Mehta, and Andrew Smith, “Pension Funds – A Company Manager’s View”, in Society of Actuaries, *The Great Controversy: Current Actuarial Practice in Light of Financial Economics* (2003) downloaded from <http://www.soa.org/library/monographs/retirement-systems/the-great-controversy/2004/june/m-rs04-1-01.pdf> .

<sup>46</sup> Lawrence N. Bader and Jeremy Gold, “Reinventing Pension Actuarial Science” (2003) 14 *Pension Forum* 1 at 3.

They go onto to state that pension liabilities do not vary with the assets held by the employer to fund the liabilities any more than the liabilities owed to other creditors will vary based on the assets earmarked to pay the debts. Higher expected returns do not lower liability and expense, they only raise assets and revenue and **only** after the expected gains are realized.<sup>47</sup> Bader and Gold conclude that the practice of recognizing the expected future returns in the cost of financing the liability transfers risk to future shareholders and plan members (in the absence of some form of benefit insurance) from the current shareholders and plan members because instead of investing the \$1,000,000 required to make the pension payments, the actuarial equity premium allows them to only pay \$600,000.<sup>48</sup> While Bader and Gold do not suggest that the practice of investing pension funds in equities be abandoned, leaving that to the capability of the corporation for risk, they do note that actuarial practice does bias management towards such investments. Unlike other forms of investment in which management must wait to actually receive the expected gains from the investment before they are reflected on the corporation's balance sheet, pension actuarial practice permits the expected gains to be realized immediately for risks "not yet weathered".<sup>49</sup> Using actuarial practice, management can increase the corporation's risk without having to disclose the change to the markets, as they would if they did so in other areas of corporate operations. By increasing this risk they can receive immediate increases in management compensation

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<sup>47</sup> *Ibid.* at 4 – 5.

<sup>48</sup> *Ibid.* at 7.

<sup>49</sup> *Ibid.* at 7 – 8.

due to increases in the value of stock option and earnings-linked compensation. In such circumstances, the conflicts of interest for managers are manifest.<sup>50</sup>

All defined benefit pension plans utilize professionals to advise management on the appropriate asset mix and investment policies, as well as professional actuarial services in valuing the liabilities and determining the current cost. However, these professionals have conflicts over the asset mix that biases them towards equity investment. Exley *et al* point out that the actuarial fees generated by equity investment are greater due to the increased likelihood of having to deal with surplus or deficit and there being more opportunity to be consulted by trustees, while equity investment provides fee income to professional advisors in choosing and monitoring investment managers.<sup>51</sup>

#### **IV. Limiting Moral Hazard and the Role of Voice**

Two of the prescriptions suggested by Michael Trebilcock and his co-authors are applicable to the problems in the defined benefit pension plan context. These are improved disclosure and joint decision-making.

One of the problems with defined benefit plans is the lack of disclosure of the actual “bargain” concerning the risk-bearing inherent in the plan’s sponsorship by a limited liability corporation and of the ultimate incidence of the cost of liquidating any shortfall

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<sup>50</sup> *Ibid.* at 8 where the authors note that management may also increase its compensation by merely changing some of the actuarial assumptions, without changing the asset allocation of pension plans; Exley *et al*, “Pension Funds”, *supra* note 45 at section 3 *Insider Considerations*.

<sup>51</sup> ; Exley *et al*, “Pension Funds”, *supra* note 45 at subsection 2.2 *Professional Advice*; see also, Anthony D.F. Coleman, Neil Esho, and Michelle Wong, “The Impact of Agency Costs on the Performance of Australian Pension Funds”, (2005) 5 *Journal of Pension Economics and Finance* 299 at 306 – higher asset management fees in equity investments relative to bonds.

in the assets while the corporation remains solvent.<sup>52</sup> Howse and Trebilcock suggest that better protection of the bargain would occur if collective bargaining rules provided adequate incentives for disclosure of information by management to allow bargaining that takes the risks of dislocation into account.<sup>53</sup> Giving expression to the ultimate risk allocation would allow bargaining over the terms and price of the insurance provided by such a bargain by plan members, shareholders and others who will be affected by the need to fund a plan deficit. The adoption of benefit valuations that do not include future risk premiums in the cost calculation and accounting standards that disallow asset and liability smoothing and expose the stress on pension funding created by differing asset allocations will permit those concerned to assess pension asset and funding policies more clearly.

However, disclosure alone will likely be ineffective in dealing with the moral hazard and conflict of interest issues discussed above. A second prescription involves mandatory joint governance of employer-sponsored pension plans. Mandatory plan member participation in plan governance is required in nearly all of the OECD countries except the U.S., Canada, Mexico and Ireland.<sup>54</sup> Member representation can counteract the moral hazard in the defined benefit pension bargain through inhibiting unjustified risk alterations, enhancing the quality of disclosure to plan members and controlling the

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<sup>52</sup> The need to clarify the risk allocation in the defined pension plan deal is one of the themes explored in Keith Ambachtsheer, book *Pension Revolution: A Solution to the Pensions Crisis* (Hoboken: John Wiley & Sons, Inc., 2007).

<sup>53</sup> Robert Howse & Michael Trebilcock, "Protecting the Employment Bargain", *supra* note 1 at 765.

<sup>54</sup> Fiona Stewart and Juan Yermo (2008), "Pension Fund Governance: Challenges and Potential Solutions", *OECD Working Papers on Insurance and Private Pensions*, No. 18 <http://www.oecd.org/dataoecd/18/29/41013956.pdf> at 15.

conflicts of interest discussed above.<sup>55</sup> Because plan members can represent different generations of plan participants, it may also be possible to control intergenerational risk transfer. Finally, member representation addresses the issue of group-think addressed by Howse and Trebilcock when they suggest that multiple perspectives may increase the potential to avoid bad decisions through enhanced scrutiny and debate about strategy. This insight has certainly been vindicated in the lessons from Enron<sup>56</sup> and offers a standpoint from which to discuss the value added to corporate governance policy decisions by pension funds when plan members participate in the formation of that policy.<sup>57</sup>

As this article has demonstrated, Michael Trebilcock's contributions to scholarship are the fruit of his willingness to confront reality and its inherent untidiness by offering analysis and prescriptions that neither pre-judge the merits nor use assumptions to make difficulties disappear. He provides an example of integrity and rigour to which we can all aspire.

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<sup>55</sup> Ronald Davis, "The Survival of the Trustee Model of Governance in the Era of Financial Engineering" in *A Super Act – 2009*, Proceedings of the 2009 Annual Meeting of the Superannuation Committee of the Law Council of Australia, [CD Format]

<sup>56</sup> Marleen A. O'Connor, "The Enron Board: The Perils of Groupthink", (2003) 71 *University of Cincinnati Law Review* 1233.

<sup>57</sup> Ronald Davis, *Democratizing Pension Funds: Corporate Governance and Accountability* (Vancouver: UBC Press, 2008).