PEOPLES DEPARTMENT STORES V. WISE AND THE “BEST INTERESTS OF THE CORPORATION”

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I. INTRODUCTION

“For whom are corporate managers trustees?”1 Berle and Dodd’s famous debate about this question more than seventy years ago in the Harvard Law Review ended, as is well known, with Berle conceding that Dodd’s view – that corporate managers’ duties should be seen as owed to the corporation as an institution, rather than to the shareholders alone – had prevailed.2 In truth, however, Berle’s concession did not end the debate among academics. With the rise to dominance in the last several decades of the economic analysis of corporate law, shareholder primacy – Berle’s view that shareholders’ interests alone should be the focus of managers’ duties – has attained the status of orthodoxy among corporate law academics in the United States.3

Indeed, so confident are the proponents of shareholder primacy of its intrinsic superiority that two prominent academics, Henry Hansmann and Reinier Kraakman,

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1 E.M. Dodd, “For Whom Are Corporate Managers Trustees?” (1932), 45 Harv. L. Rev. 1049; A.A. Berle, “For Whom Corporate Managers Are Trustees” (1933), 45 Harv. L. Rev. 1365.
2 A.A. Berle, The Twentieth Century Capitalist Revolution (New York, Harcourt, 1954), at p. 169 (“Twenty years ago, the writer had a controversy with the late Professor E. Merrick Dodd, of Harvard Law School, the writer holding that corporate powers were powers in trust for shareholders while Professor Dodd argued that these powers were held in trust for the entire community. The argument has been settled (at least for the time being) squarely in favor of Professor Dodd’s contention”).
3 This is not to say that shareholder primacy does not have its detractors in the U.S. corporate law academy. See, for example, L.E. Mitchell, ed., Progressive Corporate Law (Boulder, Co., Westview Press, 1985); M. Blair and L. Stout, “A Team Production Theory of Corporate Law” (1999), 85 Va. L. Rev. 247.
recently proclaimed the “end of history for corporate law,” by which they mean a “broad normative consensus” around shareholder primacy, among elites in “leading jurisdictions,” and a process of convergence toward shareholder primacy in national corporate laws themselves.⁴ Even critics of the normative position seem to acknowledge the dominance of the position they oppose.⁵

In this context, the Supreme Court of Canada’s ruling in *Peoples Department Stores v. Wise*⁶ is striking for its rejection of shareholder primacy. The Supreme Court’s opinion was, on this point, unequivocal:

> [I]t is clear that the phrase the “best interests of the corporation” should be read not simply as the “best interests of the shareholders” […] [I]n determining whether they are acting with a view to the best interests of the corporation it may be legitimate, given all the circumstances of a given case, for the board of directors to consider, *inter alia*, the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment.⁷

This Comment is concerned with understanding and evaluating the Court’s rejection of shareholder primacy. In particular, I want to evaluate the reasons given by the Court for its choice, and to articulate and analyze the competing normative arguments, some of which appear to have been overlooked or inadequately dealt with by the Court. Despite being sympathetic to the Court’s rejection of shareholder primacy, I argue that the Court’s justification of its decision does not do justice to the issue.

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⁵ See, e.g., P. Ireland, “Shareholder Primacy and the Distribution of Wealth” (2005), 68 Mod. L.Rev. 49, at p. 49 (acknowledging that there is a “growing consensus in favour of the shareholder-oriented corporation”).
II. LEGAL POSITION PRIOR TO PEOPLES

For practical purposes, the question whether the “interests of the corporation” are reducible to the interests of the shareholders was not the subject of authoritative case law in Canada prior to Peoples. There were, in essence, two relevant cases.

The first of these, Teck Corp. Ltd. v. Millar, involved a decision by the board of directors of Afton Mines Ltd. to conclude an agreement involving the issuance of shares to a friendly third party, thus thwarting another party’s attempt to acquire control of Afton. In suing the directors for breach of their fiduciary duties, the spurned suitor invoked Hogg v. Cramphorn, in which an English court ruled that directors violated their duties by issuing shares to defeat a hostile takeover which they believed in good faith would be disadvantageous “to the shareholders, the company’s staff and its customers.” In declining to follow Hogg, Justice Berger of the B.C. Supreme Court rejected the view he believed was implicit in Hogg, namely that it would be inconsistent with the directors’ duties for them to consider the interests of other constituencies in addition to the shareholders:

A classical theory that once was unchallengeable must yield to the facts of modern life. In fact, of course, it has. If today the directors of a company were to consider the interests of its employees no one would argue that in doing so they were not acting bona fide in the interests of the company itself. Similarly, if the directors were to consider the consequences to the community of any policy that the company intended to pursue, and were deflected in their commitment to that policy as a result, it could not be said that they had not considered bona fide the interests of the shareholders.

I appreciate that it would be a breach of their duty for directors to disregard entirely the interests of a company's shareholders in order to confer a benefit on its employees: Parke v. Daily News Ltd. But if they

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10 Ibid., at [1967] Ch. 256.
observe a decent respect for other interests lying beyond those of the company's shareholders in the strict sense, that will not, in my view, leave directors open to the charge that they have failed in their fiduciary duty to the company.\textsuperscript{11}

Although Berger J.'s rejection of shareholder primacy is expressed unambiguously, some commentators have argued that Berger J.'s remarks were obiter.\textsuperscript{12} Indeed, it does not appear that the facts in \textit{Teck} involved any conflict between the interests of the shareholders as a group and the interests of any other constituency. Moreover, although \textit{Teck} has been cited in several subsequent judicial decisions, these references have not been to Berger J.'s conception of the best interests of the corporation,\textsuperscript{13} but to other parts of his reasons more central to the outcome of the case.\textsuperscript{14}

The other significant case is the English decision mentioned by Berger J.: \textit{Parke v. Daily News Ltd.}\textsuperscript{15} In that case, upon selling the corporation’s newspaper business, the board of directors decided that the net proceeds from the sale should be applied for the benefit of the staff and pensioners of the business and it submitted a resolution to the shareholders for their approval of this plan. A shareholder sued for a declaration that the proposed resolution was illegal, and Plowman J.'s ruling for the plaintiff leaves little

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\item \textsuperscript{11} \textit{Teck}, supra, footnote 8, at p. 314, citations omitted.
\item \textsuperscript{13} One exception is \textit{Gainers Inc. v. Pocklington} (1992), 132 A.R. 35 (Q.B.), in which the court quoted Berger J.'s expansive conception of the best interests of the corporation in its ruling on a motion to strike out a statement of claim. However, the court’s comment on the invocation of \textit{Teck} was lukewarm at best: “[w]hile I am sceptical about the chances of the plaintiffs’ being successful, I cannot say that the case is hopeless” (at p. 60).
\item \textsuperscript{14} For instance, courts have cited \textit{Teck} for the propositions that management is not bound to accede to instructions given to it by a majority shareholder and that its duties do not impose a rule of managerial passivity in the face of a takeover bid. See, e.g., \textit{Rio Tinto Canadian Investments Ltd. v. Labrador Iron Ore Royalty Income Fund (Trustee of)} [2001] O.J. No. 2440 (Sup. Ct. J.); \textit{Pente Investment Management Ltd. v. Schneider Corp.} (1998), 42 O.R. (3d) 177, 1998 CarswellOnt 4035 (C.A.); \textit{First City Financial Corp. Ltd. v. Genstar Corp. et al.} 33 O.R. (2d) 631 (H.C.J.).\textsuperscript{14}
\item \textsuperscript{15} [1962] 1 Ch. 927 (Ch.D.) (\textit{Parke}).
\end{itemize}
doubt as to his opinion that the interests of the corporation are to be understood as meaning the interests of the shareholders:

The view that directors, in having regard to the question what is in the best interests of their company, are entitled to take into account the interests of the employees, irrespective of any consequential benefit to the company, is one which may be widely held. … But no authority to support that proposition as a proposition of law was cited to me; I know of none, and in my judgment such is not the law. In Greenhalgh v. Arderne Cinemas Ltd. Lord Evershed M.R. said, in a different context, that the benefit of the company meant the benefit of the shareholders as a general body, and in my opinion that is equally true in a case such as the present.16

Parke has been mentioned a few times by Canadian courts,17 but it has been applied only once in Canada in a case involving directors’ duties, and even that case involved a cooperative, not a business corporation.18

Some commentators have nonetheless been willing to take a position on the question of whether the interests of the corporation are legally synonymous with those of the shareholders as a group. Typically, however, authors have relied on either Teck or Parke and ignored or dismissed the other.19 In addition, defenders of shareholder primacy have pointed out that various courts, including the Supreme Court of Canada, have sometimes referred to shareholders as the “owners” of the corporation.20 More significantly, courts have occasionally seemed to equate the interests of the corporation

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16 Ibid., at p. 948. The Court quotes at length from Hutton v. West Cork Rwy [1883] 23 Ch. D. 654 (C.A.), which is famous for Lord Bowen’s statement that “the law does not state that there are to be no cakes and ale, but that there are to be no cakes and ale except such as are required for the benefit of the company”, Ibid., at p. 672.
19 See, e.g., Gray, supra, footnote 12, at pp. 242-243, notes. 2 and 3 (relying on Parke and describing Teck as obiter); Macintosh, supra, footnote 12 (same); R. Yalden, “Competing Theories of the Firm and Their Role in Canadian Business Law” (2002), The Corporation in the 21st Century: Ninth Queen’s Annual Business Law Symposium, at pp. 25-26 (relying on Teck, ignoring Parke).
with those of “all of the shareholders.” Thus, for example, in *Palmer v. Carling O’Keefe*, the Ontario Divisional Court stated:

Mr. Heintzman explained that the “company as a whole” means […] “all of the shareholders, taking no one sectional interest to prevail over the others”. In my opinion, that is an accurate statement of the law.\(^{21}\)

However, these cases involved conflicts among shareholders as opposed to conflicts between shareholders’ interests and the interests of non-shareholder constituencies.\(^{22}\) The proposition that the directors may not give preference to the sectional interest of one group of shareholders at the expense of the others does not entail the proposition that *only* the interests of the shareholders are relevant.

### III. THE SUPREME COURT’S REJECTION OF SHAREHOLDER PRIMACY

The Supreme Court of Canada’s rejection of shareholder primacy is couched as an endorsement of a doctrine already well-established in Canada. The following is the relevant part of the opinion:

[I]t is clear that the phrase the “best interests of the corporation” should be read not simply as the “best interests of the shareholders.” From an economic perspective, the “best interests of the corporation” means the maximization of the value of the corporation. However, the courts have long recognized that various other factors may be relevant in determining what directors should consider in soundly managing with a view to the best interests of the corporation. [Here, the Court cites *Teck*, quoting Berger J.’s *dictum*.]

The case of *Re Olympia & York Enterprises Ltd. v Hiram Walker Resources Ltd.* approved the decision in *Teck*. We accept as an accurate statement of law that in determining whether they are acting with a view to the best interests of the corporation it may be legitimate, given all the

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\(^{24}\) *Peoples, supra*, footnote 6, at para. 42.
circumstances of a given case, for the board of directors to consider, *inter alia*, the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment.\textsuperscript{24}

In light of the legal position prior to *Peoples*, the Court’s legal analysis is unsatisfying. *Teck* is not, contrary to the Court’s suggestion, exemplary of a position “long recognized” by the courts. It is a solitary judicial endorsement, likely *obiter*, of a controversial legal proposition.

Equally questionable is the Court’s reliance on *Olympia & York*.\textsuperscript{25} Contrary to what the Supreme Court’s reference to the case might lead one to believe, *Olympia & York* contains no reference at all to Berger J.’s *dictum* or to his expansive conception of the best interests of the corporation. To be sure, the Divisional Court in *Olympia & York* does cite *Teck*, but it quotes from a different part of Berger J.’s opinion, and it relies on *Teck* in connection with a finding that directors had not violated their duties by resisting a hostile takeover they believed was contrary to the shareholders’ interests.\textsuperscript{26} *Olympia & York* cannot, therefore, plausibly be interpreted as an endorsement of Berger J.’s broad conception of the interests of the corporation.

In short, the Supreme Court’s ostensible reason for rejecting shareholder primacy – that the permissibility of taking into account non-shareholder interests had “long [been] recognized” judicially – is unpersuasive.

\textsuperscript{25} *Re Olympia & York Enterprises Ltd. v. Hiram Walker Resources Ltd.* (1986), 59 O.R. (2d) 254 (*Olympia & York*).

\textsuperscript{26} *Ibid.*, at p. 272 (the Court concluded that the directors had “[taken] all reasonable steps to maximize value for all shareholders”).
IV. A DEBATE IGNORED

In portraying its choice as merely confirming a “long recognized” principle, the Court perhaps hoped to avoid having to deal with the normative aspect of the legal question.

The normative debate about shareholder primacy has taken place on two planes, the conceptual and the pragmatic. On the conceptual plane, proponents of shareholder primacy argue that the shareholders, as owners of the corporation, are entitled to expect that their assets would be deployed in furtherance of their interests alone. Most commentators now regard as inconclusive, and even unhelpful, arguments for shareholder primacy based on the concept of ownership. In the first place, the ownership metaphor does not reflect the legal relationship of shareholders to the corporation. In legal terms, shareholders are not the owners of the corporation, but instead own choses in action (shares) giving them certain rights determined by corporate law and the corporate charter with respect to corporate governance and the assets of the corporation. More fundamentally, the argument from ownership is unhelpful because it takes for granted that shareholders are analogous to owners, while obscuring the more pertinent inquiry into what grounds of analogy, if any, there are, between shareholders and property.

27 Milton Friedman is a well-known defender of this view, which he first articulated in 1962, in arguing that the only “social responsibility” of business is “to make as much money for their stockholders as possible”, for reasons that include the fact that “[the] corporation is an instrument of the stockholders who own it.” See M. Friedman, “Monopoly and the Social Responsibility of Business and Labor” in Capitalism and Freedom (Chicago, U. Chi. Press, 1962), at p. 133.

owners, and whether those grounds justify imposing a duty on the part of the management to maximize the shareholders’ profits. As William Allen put it, “the premise of ‘ownership’ simply assumes but does not justify an answer.”

And so, the debate about shareholder primacy also takes place on a more pragmatic level, where the basic question is: is the power wielded by those who manage corporations better channelled by imposing legal duties to serve only the interests of shareholders or by requiring or permitting them also to consider the broader impact of their activity? In support of a broader duty, one can cite the harm to non-shareholder interests that may be caused by the single-minded pursuit of shareholder interests. For instance, in the context of Peoples, the plaintiff’s argument was that the directors had harmed the creditors’ interests by adopting a risky strategy that, in the event of success, would benefit Peoples’ shareholder but, in the event of failure, would leave creditors unpaid. If the negative expected value of the decision for the creditors is greater in absolute value than the positive expected value of the decision for the shareholders, the adoption of the strategy, although beneficial to the shareholders, is destructive of overall enterprise value. This is the logic that underlies the influential argument that, at least in the “vicinity of insolvency,” the directors’ duties should not be confined to the exclusive pursuit of the shareholders’ interests.

In support of a narrower duty, it is argued that replacing shareholder primacy with a more amorphous goal effectively liberates management to pursue its own interests

29 Allen, ibid., at p. 269.
under the guise of balancing competing interests, at the expense of shareholders and non-shareholders alike.\textsuperscript{31}

The Supreme Court appears to have been aware of these arguments, but it made no effort to evaluate them, let alone answer those that militated for positions the Supreme Court rejected. For instance, the Court mentions that “shareholders are commonly said to own the corporation”\textsuperscript{32} but does not discuss whether this metaphor has any implications for the meaning of the “best interests of the corporation.” The Court mentions that “from an economic perspective, the ‘best interests of the corporation’ means the maximization of the value of the corporation,” but it does not draw any conclusions from this statement and, in the next sentence, it rejects shareholder primacy on the basis of “long recognized” principle.\textsuperscript{33} Before rejecting the view that a special duty to take into account the interests of creditors arises in a financially distressed corporation, the Court acknowledges that financial distress can bring the interests of shareholders and creditors into conflict,\textsuperscript{34} but overlooks what is most pertinent about the financial distress context, namely that shareholder primacy could, in such circumstances, lead to uneconomic directorial decisions.

One could understand the Court’s decision not to engage with the underlying normative issues if the legal position were as clear as the Court implies. However, in light of the sparseness and inconclusiveness of the prior case law, and the Court’s

\textsuperscript{31} See, e.g., F. Easterbrook and D. Fischel, \textit{The Economic Structure of Corporate Law} (Cambridge, Mass., Harvard U.P., 1991), at p. 38 (“[A] manager told to serve two masters (a little for the equity holders, a little for the community) has been freed of both and is answerable to neither. Faced with a demand from either group, the manager can appeal to the interests of the other.”)

\textsuperscript{32}\textit{Peoples, supra}, footnote 6, at para. 31.

\textsuperscript{33} \textit{Ibid.}, at para. 42.

\textsuperscript{34} \textit{Ibid.}, at paras. 44-45.
unconvincing analysis of that case law, the Court’s omission to take seriously the
normative aspect of the question is to be regretted.

V. PEOPLES AND THE “END OF HISTORY”

How should we understand, in light of the end-of-history thesis, the Supreme
Court’s rejection of shareholder primacy?

Adherents of the end-of-history thesis will likely view Peoples as a futile attempt
by the Supreme Court to swim against the tide of history. On this interpretation, Peoples,
like other pockets of resistance to shareholder primacy, is destined to be overwhelmed by
the forces of convergence. I suspect that many readers of the Court’s opinion in Peoples
will be drawn to this interpretation, in part because of the style of analysis adopted by the
Court. In particular, the Court’s evasion of the underlying normative issues and its
unconvincing doctrinal analysis, culminating in an awkward reformulation of the “best
interests of the corporation” standard as a duty to “make the corporation a ‘better
corporation,’” are reminiscent of the “bad old days” of formalist jurisprudence.

We would, however, be mistaken to conclude from the Court’s failure to provide
a convincing justification for its rejection of shareholder primacy that the normative case
for shareholder primacy is unanswerable. In my view, there are at least two reasons for

35 See, supra, footnote 3.
36 See Hansmann and Kraakman, supra, footnote 4, at p. 459 (expressing doubt that national obstacles to
convergence “will be able to stave off for long the reforms called for by the growing ideological consensus
focused on the standard model.”)
37 Peoples, supra, footnote 6, at paras. 41, 47 (describing the directors’ duty as a duty to make the
corporation a “better corporation”). In repeating the “better corporation” formulation three times, the Court
appears to be presenting it as a further elaboration or specification of the statutory standard when in fact it
is, at best, a reassembly of the same words in a different order.
38 I do not mean to disparage formalist analysis per se. My point is that the Court’s approach obscures the
choice actually faced by the Court and the normative considerations relevant to that choice. In this way, it
is an example of the kind of reasoning that realist scholars persuasively criticized in the last century. See,
*e.g.*, F. Cohen, “Transcendental Nonsense and the Functional Approach” (1935), 35 Colum. L. Rev. 809.
questioning the normative aspect of the end-of-history thesis, and thus for defending the Supreme Court’s choice.

First, the end-of-history thesis may overstate the importance of shareholder-focused legal duties in constraining management. In light of the ease with which consideration of non-shareholder interests can be rationalized in terms of benefits to the shareholders “in the long run,”39 and courts’ reluctance to second-guess management’s business judgment,40 it is not clear that management is significantly constrained even by a legal rule that reduces the “best interests of the corporation” to the interests of the shareholders. Indeed, law-and-economics scholars typically emphasize the greater role of market mechanisms – especially the takeover market – in constraining management in a widely-held corporation.41 The necessity of a shareholder-focused legal duty seems even more doubtful in a case such as Peoples, involving a sole shareholder with the power to replace the board of directors virtually at will and on whose interests, regardless of how the legal duty is specified, the board of directors is therefore likely to be focused.42

Second, the debate about the balance of social benefits and costs associated with shareholder primacy is unresolved – and perhaps unresolvable.43 Even assuming that limiting management’s mandate to the advancement of the shareholders’ interests

39 See Theodora Holding Corp. v. Henderson, 257 A.2d 298 (Del. Ch. 1969) (upholding a charitable contribution because it benefits “those in need of philanthropic or educational support, thus providing justification for large private holdings, thereby benefiting plaintiff [dissenting shareholder] in the long run”).
41 See, e.g., H. Manne, “A Free Market Model of a Large Corporation System” (2003), 52 Emory L.J. 1381, at p. 1392 (arguing that, with an unregulated takeover market, “many arguments about duties of care and duties of loyalty and the like would disappear into the nether world”).
42 Different considerations might apply where a corporation has a controlling shareholder and one or more minority shareholders.
43 See Stout, supra, footnote 27, at p. 1201 (expressing doubt that academics can provide a “definitive answer” to the question whether the benefits of shareholder primacy outweigh its costs).
produces social benefits (enjoyed, in the first instance, by shareholders) by reducing the potential for managerial opportunism, it has not been established that these benefits exceed the costs imposed by shareholder primacy on non-shareholders. In particular, the proponents of shareholder primacy assert, but have not demonstrated, that the interests of non-shareholders may be adequately protected through contractual specification or external regulation.44

VI. CONCLUSION

I have considerable sympathy for the Court’s choice not to reduce the best interests of the corporation to the financial interests of the shareholders or, in a financially distressed corporation, to a combination of the interests of the shareholders and the creditors. It is disappointing, however, that the Supreme Court did not deal with the normative issues underlying the legal debate about shareholder primacy. The Court’s silence on these issues would be unproblematic if, as the Court’s opinion implies, the legal position were clear. But in light of the inconclusiveness of the prior case law, the Court’s invocation of “long-recognized” principle is unpersuasive as a justification of the Court’s choice.

The Court’s evasion of the underlying normative issues is all the more unsatisfying in light of the changes that have occurred in the dominant analytical framework for corporate law since 1974,45 when the Supreme Court handed down its

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44 See, e.g., Hansmann and Kraakman, supra, footnote 4, at p. 442 (“the most efficacious legal mechanisms for protecting the interests of nonshareholder constituencies – or at least all constituencies other than creditors – lie outside of corporate law,” for example in the fields of labour regulation, health and safety law, antitrust law, and consumer protection law).

45 In 1974, Richard Posner’s Economic Analysis of Law was still in its first edition, and the “nexus of contracts” was still two years away from its first appearance in print. See R.A. Posner, Economic Analysis
most recent decision on directors’ duties prior to *Peoples.*\textsuperscript{46} Indeed, for many academics, the style of analysis adopted by the Court in *Peoples* will seem anachronistic. As a result, the decision may, paradoxically, win converts to the end-of-history thesis and its normative defence of shareholder primacy. This would be a shame, for there are good reasons for questioning shareholder primacy.

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