



INVESTOR RIGHTS AFTER THE CRISIS

—Indira Anita Anand*

“The most advanced justice system in the world is a failure if it does not provide justice to the people it is meant to serve. Access to justice is therefore critical. Unfortunately, many Canadian men and women find themselves unable, mainly for financial reasons, to access the Canadian justice system. ... Their options are grim: use up the family assets in litigation; become their own lawyers; or give up.”

—Chief Justice Beverley McLachlin, Supreme Court of Canada¹

I. INTRODUCTION

Investors are consumers. They purchase a good called ‘security’ in a market. Although the security carries value, or potential value, it is intangible. The consumer may never see evidence of the security itself, especially if he or she executes the purchase through a dealer or other intermediary. Nevertheless, this consumer has at least one purpose in mind: to turn a purchase into a profitable investment. When numerous consumers purchase and sell such securities, a capital market is born.

In Canada, investing is a widespread phenomenon. Approximately 50 per cent of all working Canadians are directly or indirectly invested in the securities market (IIAC, 2007)² and 55 per cent of Canadians own securities outside a retirement savings plan (such as a company-managed pension plan, RRSP or RRIF

* This is an updated and revised version of a chapter entitled The relationship between investors and corporations after the financial crisis in Research Handbook on Directors’ Fiduciary Duties (Adolfo Paolini, ed. London, 2014)). The author extends her appreciation to Edward Elgar for allowing the revised version to appear here. Deep thanks also to Grant Bishop, Vlad Calina, Duncan Melville and Parsa Pezeshki for very helpful research assistance.

¹ Beverley McLachlin, The Challenges We Face: Remarks of the Right Honourable Beverley McLachlin, P.C., presented at the Empire Club of Canada (Toronto, Canada, March 8, 2007) available at <http://www.scc-csc.gc.ca/court-cour/judges-juges/spe-dis/bm-2007-03-08-eng.aspx> (Last visited on August 16, 2014).

² The Investment Industry Association of Canada (IIAC) is a national self-regulatory body of the Canadian securities industry. See Investment Industry Association of Canada, Representing Canada’s Investment Professionals, available at <http://www.iiac.ca/welcome-to-iiac/about-us/who-we-are/> (Last visited on August 16, 2014).

[CSA, 2012]).³ In the United States (US), about 49.9 per cent of all family-owned securities in 2010 are invested in similar retirement savings plans.⁴ In continental Europe, the proportion of households estimated to be investing in the stock market ranges from 15 to 20 per cent.⁵ Similar proportions of stock market participation exist across other developed market economies.⁶

The scale of investment participation and its attendant risks compels us to consider the legal remedies available to investors. What remedies should investors have when a public corporation violates the law – be it securities law, corporate law or criminal law? Currently, the scheme of remedies available to investors is broader on the private than on the public side. Wronged investors have more options for initiating private actions than even the securities regulator. This imbalance has the effect of favouring plaintiffs with ‘deep pockets’ and those who are able to undertake the lengthy process involved in private litigation. Investors who rely on public remedies are unlikely to see their investment returned; public remedies usually have no provision for restitution for injured investors and regulators may not exercise powers of restitution even when they have them.

This article argues in favour of a remedy that ensures that investors are paid back a percentage of any amounts obtained by the regulator as a result of disgorgement of funds from the defendant. The argument counters the views of traditional law and economics scholars⁷ who argue that investors should not be compensated for securities fraud. They contend that active investors with diversified portfolios will have losses arising from fraud netted out against legitimate gains. This argument is flawed since the lost amount from fraud does not easily (or always) correlate with legitimate gains resulting from an investment. Perhaps, as argued here, a third party regulator that deters wrongful conduct and sets monetary penalties at an amount that allows investors to receive restitution is a necessary aspect of the analysis.

³ In May 2012, the Canadian Securities Administrations (CSA) engaged Innovative Research Group to conduct an in-depth national survey to gauge Canadians’ investment knowledge and behaviour, finding that 55% manage their investment portfolios, where 21%, or 38% of the 55%, are active investors while 34%, or 62% of the 55%, are passive. See Innovative Research Group, 2012 CSA Investor Index, 11 (October 16, 2012), available at http://www.securities-administrators.ca/uploadedFiles/General/pdfs/2012%20CSA%20investor%20Index%20-%20Public%20Report%20FINAL_EN.pdf (Last visited on January 10, 2013).

⁴ The SCF Chartbook published by the Federal Reserve describes the trajectory of US family stock holdings. See Federal Reserve, SCF Chartbook, 506, available at http://www.federalreserve.gov/econresdata/scf/files/2010_SCF_Chartbook.pdf (Last visited on January 10, 2013).

⁵ Guiso L et al, Household Stockholding in Europe: Where Do We Stand and Where Do We Go? 18(36) Economic Policy, 123 (2003), available at <http://www.ecb.int/events/pdf/conferences/haliasos.pdf> (January 11, 2013).

⁶ Norway has 0.93 million (21%) households investing in the stock market, Denmark 1.2 million (23%), Japan 36.8 million (29%), UK 17.7 million (30%) and Australia 7.75 million (41%).

⁷ Easterbrook FH & Fischel R, Limited Liability and the Corporation, 52(89) University of Chicago Law Review (1985).

To be clear, this article does not deny the importance of ‘buyer beware’ and it does not relate only to cases of fraud. Rather, it addresses the following question: when an investor is wronged for breach of fiduciary duty or other violations of corporate or securities law, what remedies should he or she have? Part 2 analyzes the law relating to private remedies, focusing on remedies for breach of fiduciary duty, before turning to examine public remedies. Part 3 then focuses on the relative efficacy of private versus public remedies and the importance of the latter in the overall remedial regime available to investors. Part 4 concludes.

Any discussion regarding remedies for corporate malfeasance should be placed in the context of the ‘nexus of contracts’ conception of the corporation as an entity comprising of many contracts with various stakeholders.⁸ The nexus of contracts idea, however, is not determinative with respect to remedies. That is, the remedies to which stakeholders are entitled tend to be found in common law or in statutes rather than in their individual contracts with the corporation. The strange fact is that a mere violation of one’s fiduciary duty does not automatically entitle those who bear the consequence of this violation to a remedy. In many cases, the remedies are difficult, not to mention expensive, to pursue, as will be discussed below.

II. BOARD DUTIES AND SHAREHOLDER REMEDIES

Shareholders have certain remedies available when corporations or their boards of directors violate the law. ‘Private remedies’ refer to the ability of individual litigants to bring a suit on their own against the corporation or its members, such as its directors and officers. ‘Public remedies’ involve a third party, usually a governmental body or regulator, bringing a suit in public interest for the alleged wrong.⁹ Thus, private remedies are personal whereas public remedies have a societal element. These two types of remedies will be discussed in turn, using Canadian, UK and Indian law as the basis for the discussion.

A. Duties

Private remedies for investors span various areas of law, particularly securities regulation and corporate law. The main securities law remedy is civil liability for misrepresentation in a prospectus or continuous disclosure document. In Canada, this remedy exists in statute and is less onerous to prove than the similar right that exists in tort at common law; the plaintiff does not need to prove reliance because the statute contains a ‘deemed reliance’ provision.¹⁰ The civil remedy in

⁸ Jensen MC & Meckling WH, *Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure*, 3 *Journal of Financial Economics* 305 (1976).

⁹ ‘Public interest’ is not a well-defined term. See Section 127 of the Securities Act (Ontario), RSO 1990 c S5 [“OSA”].

¹⁰ See Section 130, OSA. See also Section 12, Securities Act of 1933, 15 USC § 77a for the American provision.

securities law is rarely used, perhaps because of the associated litigation expenses involved as well as extensive defenses available to boards of directors and other parties.¹¹

By contrast, a host of corporate law remedies exist for breach of ‘fiduciary duty’, which differ by jurisdiction. The US operates under a shareholder primacy doctrine (also referred to as a ‘norm’), which, at its core, holds that directors must act in the best interests of shareholders of the corporation over which they preside. The doctrine is reflected in various shareholder rights, including the right to elect directors, approve the financial statements, appoint auditors and approve fundamental changes.¹² Boards of directors are required to make decisions in the best interests of shareholders and they have an explicit responsibility to maximize shareholder value.¹³ In reviewing whether directors’ decisions conform to these rules, courts will apply the business judgement rule, presuming that directors are motivated by a bona fide regard for the corporation’s interests.

In the UK, directors’ duties have been codified since 2006.¹⁴ While it is still necessary to consider the duties of directors under common law and equity¹⁵, many duties are codified as being owed to the company. Under the UK Companies Act, 2006, a director’s fiduciary duty is to run the company “*for the benefit of its members as a whole, and in doing so have regard*” to other interests including the environment and the employees of the company.¹⁶ Directors must act within powers granted by the company’s constitution for the purposes conferred¹⁷; to promote the success of the company¹⁸; to exercise independent judgment¹⁹; to exercise reasonable care, skill and diligence²⁰; to avoid conflicts of interests²¹; to refuse benefits from third parties²²; and to declare interests in proposed transactions.²³ The director’s duty to promote the success of the company includes considering a ‘long-term increase in value’ of the company.²⁴

¹¹ Section 130, OSA.

¹² Smith DG, *The Shareholder Primacy Norm*, 23(2) *Journal of Corporation Law* 277 (1998).

¹³ See the succession of cases beginning with *Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd.*, 1964 AC 465 : (1963) 3 WLR 101 : (1963) 2 All ER 575 (HL); *R. v. Cognos Inc.*, (1993) 1 SCR 87.

¹⁴ Section 170, UK Companies Act 2006 (Chapter 46) [“UKCA”].

¹⁵ Section 170, UKCA.

¹⁶ Section 172, UKCA.

¹⁷ Sections 171(a)-(b), UKCA.

¹⁸ Section 172(1), UKCA. Note that Section 171(3) says that the duty “imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company.” The explanatory note states that this provision should be taken to mean that bankruptcy law governs this context.

¹⁹ Sections 173(1)-(2), UKCA.

²⁰ Section 174, UKCA. It is worth noting in passing that the codification of this rule and its traditional common law form are not substantively different.

²¹ Section 175, UKCA.

²² Section 176, UKCA.

²³ Section 177, UKCA.

²⁴ Goldsmith PH, *Lords Grand Committee*, at column 254 (February 6, 2006).

The statutory provisions in the UK render it clear that the duty of a UK-based board is not solely to maximize shareholder value. In making their decisions, directors are to take into account a series of factors, including the likely consequences of any decision in the long term, the interests of the company's employees, the need to foster the company's business relationships with suppliers, customers and others, the impact of the company's operations on the community and the environment; the desirability of the company maintaining a reputation for high standards of business conduct, and the need to act fairly as between members of the company.²⁵ Thus, directors must consider the competing interests of all stakeholders in the corporation, though it is entirely within their discretion to determine a particular course of action, considering the interests of investors beyond shareholders alone.

Canada stands closer to the UK than the US in terms of fiduciary duties owed by boards of directors. Directors' basic statutory duty is as follows: "*Every director and officer of a corporation in exercising their powers and discharging their duties shall (a) act honestly and in good faith with a view to the best interests of the corporation; and (b) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.*"²⁶ In *BCE Inc. v. 1976 Debentureholders*, the Supreme Court of Canada explained that the duty is not owed to any one stakeholder group in the corporation, not even the shareholders. Rather, "*the directors owe a fiduciary duty to the corporation, and only to the corporation... [I]t is important to be clear that the directors owe their duty to the corporation, not to stakeholders*"²⁷ Thus, unlike in the US, shareholder value maximization is not the law in Canada.

India's corporate law is contained primarily in the Companies Act, 2013.²⁸ The statutory provisions provide that, "*[a] director shall act in good faith in order to promote the objects of the company for the benefit of its members as a whole, and in the best interests of the company, its employees, the shareholders, the community and for the protection of environment.*"²⁹ Thus, unlike Canadian corporate law, India's statute specifically refers to particular stakeholders to whom the board of directors owes its fiduciary duties. Furthermore, directors must

²⁵ Sections 172(1)(a)-(f), UKCA.

There is no guidance given as to the relative weight of these factors. The governing principle is suggested by the UK legislature as one of maximizing 'enlightened shareholder value' (i.e. value for a shareholder who takes into account the considerations of other stakeholders when making decisions). The Explanatory Note Commentary accompanying the legislation is useless for guidance, as it only says that: "The duty requires a director to act in the way he or she considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole and, in doing so, have regard to the factors listed." See Explanatory note to Section 172, UKCA.

²⁶ Section 122, Canadian Business Corporations Act, R.S.C., 1985, c. C-44 ["CBCA"].

²⁷ *BCE Inc v. 1976 Debentureholders*, 2008 SCC 69 ("BCE").

²⁸ Companies Act, 2013 (No. 18 of 2013), available at http://egazette.nic.in/WriteReadData/2013/E_27_2013_425.pdf.

²⁹ Sections 166(1)-(2), Companies Act, 2013.

act with “reasonable care, skill and diligence and shall exercise independent judgment.”³⁰

Thus directors’ duties in the jurisdictions discussed here tend to contain both a fiduciary duty and a duty of care. The question remains, however, whether the complement of available remedies is similar across jurisdictions. It is to this question that we now turn.

B. Remedies

In terms of remedies, in the US, a plaintiff does not have an automatic remedy for breach of fiduciary duty.³¹ The remedies available depend, in part, on state law. A plaintiff can seek an injunction against the impugned conduct or damages.³² In many states, the plaintiff can also seek and recover punitive damages, particularly if the plaintiff proves that the defendant’s breach was due to fraud.³³ As a remedy to be claimed, damages are most common, particularly where transactions are approved by non-interested directors. This remedial approach may result from the reluctance of US courts to intervene in transactions that have been approved by the board³⁴, because of the business judgement rule. Thus, plaintiffs may turn to other remedies to recover against conduct that they perceive to be wrong, including a derivative action for damages.

In the UK, shareholders are entitled to bring a derivative action against the directors on behalf of the company in certain circumstances.³⁵ While the statute does not seek to replace the common law rules, it attempts to create “a new derivative procedure with more modern, flexible and accessible criteria for determining whether a shareholder can pursue an action.”³⁶ (Under the UKCA, a court must refuse permission where a person acting in accordance with the duty to promote the success of the company would not seek to continue the claim.³⁷ Further, before granting permission to continue, the court must evaluate the importance that a person acting in good faith would ascribe to continuing the action, whether an individual shareholder would have a personal action available

³⁰ Section 166(3), Companies Act, 2013.

³¹ Rothschild KR, Breach of fiduciary duty claims don’t automatically create individual remedies” (2013), available at <http://www.lexology.com/library/detail.aspx?g=4e8924ed-lefe-4312-8654-0ce38d937560> (Last visited on February 19, 2013).

³² Black BS, The Principal Fiduciary Duties of Boards of Directors, presented at the Third Asian Roundtable on Corporate Governance (2001), available at <http://www.oecd.org/daf/ca/corporate-governanceprinciples/1872746.pdf> (Last visited on February 19, 2013).

³³ A Breach of Fiduciary Duty, Lawinfo (2009), available at <http://resources.lawinfo.com/business-law/a-breach-of-fiduciary-duty.html> (Last visited on February 19, 2013).

³⁴ Black, *supra* note 32.

³⁵ Sections 178 and 260, UKCA.

³⁶ UK Law Commission No. 246, Cm 3769, Shareholder Remedies: Report on a Reference under 3(1)(e) of the Law Commissions Act 1965, at para 6.15 (1997).

³⁷ Section 263(2)(a), UKCA. For an application of the same, see *Franbar Holdings Ltd. v. Patel*, 2008 EWHC 1534 (Ch).

and whether the act or omission complained of is likely to be or has been authorized before or ratified after occurring.³⁸

Legal remedies for oppressive conduct exist under UK common law and statute. In particular, conduct that is ‘unfairly prejudicial to the interests’ of members or shareholders³⁹ permits a broad range of remedies, including any orders fit for providing relief, regulation of company affairs, injunctive relief and compulsory buy-backs of shareholders’ stocks, among others. This ability of plaintiffs to recover for being treated oppressively derives from the common law⁴⁰ and a remedy of corporate dissolution is available under the UK Insolvency Act, 1986.⁴¹

As in India, the UK and the US, the derivative action in Canada is a representative action brought in the name and on behalf of the corporation. Thus, any remedy granted accrues directly to the corporation rather than the litigants who brought the action on the corporation’s behalf. An individual plaintiff requires leave of the court to proceed and so must satisfy the court that he or she has given notice and is acting in good faith. The court must also be satisfied that it is in the interests of the corporation that the action be brought.⁴² Once leave is granted and the action proceeds, the plaintiff can reasonably expect that his or her costs will be recovered on a solicitor-client or substantial indemnity basis.⁴³

The second statutory action is called the ‘oppression remedy’, a remedy existing in Australia, Canada, India and the UK.⁴⁴ Unlike the derivative action, under the oppression remedy, a plaintiff can bring an action because of a wrong suffered by him or her personally. In granting a remedy, the court must be satisfied that the powers of the directors of the corporation or any of its affiliates are or have been exercised in a manner that is “*oppressive or unfairly prejudicial to or that unfairly disregards the interests of any security holder, creditor, director or officer*”.⁴⁵ If a court finds that this provision has been violated, it can make an interim or final order as it thinks fit.⁴⁶ In interpreting the wording of the statute,

³⁸ The only case to have moved forward beyond the second stage was recognized by the court to be a ‘classic case’ of a derivative action at common law: *Parry v. Bartlett*, 2011 EWHC 3146 (Ch).

³⁹ Section 172(1), UKCA.

⁴⁰ *Westbourne Galleries Ltd.*, In re, 1973 AC 360 : (1972) 2 WLR 1289 : (1972) 2 All ER 492.

⁴¹ Section 122(1), UK Insolvency Act, 1986. See Sandrak Miller, *How Should U.S. and U.K. Minority Shareholder Remedies for Unfairly or Oppressive Conduct be Reformed?*, 36(4) *American Business Law Journal* 579, 580-582 (1999).

⁴² Section 239(2), CBCA. The Indian law on the point is contained in Section 241 of the Companies Act, 2013.

⁴³ *Primex Investments Ltd. v. Northwest Sports Enterprises Ltd.*, (1995) 2383 (BCCA), cited in Cohen et al. 2011.

⁴⁴ The Australian law on this point is contained in the Corporations Act, 2001 (Section 234).

⁴⁵ Section 241, CBCA.

⁴⁶ Section 241, CBCA. As suggested above, the oppression remedies of the Corporations Acts of Alberta (Section 242), Saskatchewan (Section 234), Manitoba (Section 234), New Brunswick (Section 166), Nova Scotia (Third Schedule, Section 5) and Newfoundland (Section 371) are substantially similar to that of the CBCA.

the courts require that directors consider the reasonable expectations of other parties when making decisions.⁴⁷

Where does the concept of fiduciary duty fit in interpreting and awarding a remedy under the derivative action or oppression remedy? Historically, the courts have shied away from characterizing the substantive duties created by the oppression remedy as fiduciary in nature. In Canada, it was not until *BCE* that it became clear that an oppression claim exists for breaches of fiduciary duty and that constituents other than shareholders can bring the action (in this case, creditors).⁴⁸ In this case, the Supreme Court of Canada reiterated the statutory obligation of boards of directors to act in the corporation's best interests.⁴⁹ The result of *BCE* is vague⁵⁰ and indeterminate⁵¹; what does it mean to say that directors owe their duty to the 'corporation'? The *BCE* decision does not provide directors with clarity regarding how and to whom specifically their duties are owed. The concept that a duty is owed to 'the corporation' when in fact the corporation is a legal fiction is highly ambiguous.⁵²

By contrast, on its formulation of the oppression remedy, the Supreme Court was relatively clear. It outlined two related inquiries for an oppression claim to be found. First, the court would determine whether the evidence supports the reasonable expectation asserted by the claimant. Second, the court would determine whether the evidence establishes that the reasonable expectation was violated by conduct falling within the terms 'oppression', 'unfair prejudice' or 'unfair disregard' of a relevant interest contained in the statute.⁵³ In the court's view, the oppression remedy "*focuses on harm to the legal and equitable interests of stakeholders affected by oppressive acts of a corporation or its directors*".⁵⁴

Plaintiffs welcome the *BCE* judgment since it explicitly allows the consequences of breach of fiduciary duty to be characterized as oppressive conduct. This characterization benefits plaintiffs since the oppression remedy offers a broader substantive cause of action – one based on fairness and reasonable

⁴⁷ See *Westfair Foods Ltd v. Watt*, 1991 CanLII 2697 (AB CA); *Westbourne Galleries Ltd., In re*, 1973 AC 360 : (1972) 2 WLR 1289 : (1972) 2 All ER 492; *Naneff v. Con-Crete Holdings Ltd.*, (1995) 959 (ON CA) at 481, 487.

⁴⁸ As the court stated, "the reasonable expectation of stakeholders is simply that the directors act in the best interests of the corporation". *BCE*, at para 66.

⁴⁹ Section 122, CBCA. The basic statutory duty is as follows: "Every director and officer of a corporation in exercising their powers and discharging their duties shall act honestly and in good faith with a view to the best interests of the corporation; and exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances."

⁵⁰ Lupa P, *BCE Blunder: An Argument in Favour of Shareholder Wealth Minimization in the Change of Control Context*, 20 *Dalhousie Journal of Legal Studies* 1 (2011).

⁵¹ Iacobucci E, *Indeterminacy and the Canadian Supreme Court's Approach to Corporate Fiduciary Duties* 48 *Canadian Business Law Journal* 232 (2009).

⁵² Anand A, *Supreme Ambiguity*, *The National Post* (November 18, 2004).

⁵³ *BCE*, at para 68.

⁵⁴ *BCE*, at para 45.

expectations rather than breach of trust and good faith conduct. Furthermore, the remedies available under the oppression remedy are broader than those available in an action for breach of fiduciary duty (historically a restitutionary-type remedy, damages or accounting of profits). There are thus numerous reasons that the *BCE* decision is plaintiff friendly, at least from a remedies' standpoint.

Despite the availability of the oppression remedy when a breach of fiduciary duty occurs, a separate question arises as to the likelihood that plaintiffs will pursue an oppression remedy or other private cause of action when corporate law has been violated. Private law remedies are generally difficult to pursue given the costs involved in the litigation (lawyers' fees and opportunity costs, for example). The plaintiff pays the costs associated with pursuing an oppression claim because, unlike a derivative action, the oppression claim is personal. He or she will only be entitled to recover costs if they are awarded at the end of the proceeding. Even if one is successful in the action, the precise 'remedy' is still at the discretion of the court and certainly may not amount to the monies paid for the investment or the profit lost.

In India, the oppression remedy differs from the Canadian version in three key respects. Firstly, it permits any 'member of the company' to apply to the tribunal⁵⁵, which is defined to include only shareholders of the company.⁵⁶ Under the CBCA, a person with standing to make a complaint includes shareholders, directors and officers of the corporation and 'any other person' a court designates is a proper person to bring an application⁵⁷ Secondly, the Indian oppression remedy permits applications to defend actions, which are 'prejudicial to the public interest'⁵⁸, something the CBCA does not allow. The use of 'public interest' mirrors language in many securities law settings, including Canada, but given the emphasis on improving corporate social responsibility in the reforms to corporate law in India⁵⁹, this likely extends to groups and actions not protected under securities law. Third, applications are made to the National Company Law Tribunal, an administrative tribunal specifically created by the Companies Act, 2013.⁶⁰ In contrast, in Canada applications are made to a provincial or federal court.

C. Public Remedies

A defining feature of private remedies in securities and corporate law is that they accrue to the individual alone, say, if directors have breached their fiduciary

⁵⁵ Section 241(1), Companies Act, 2013.

⁵⁶ Section 244, Companies Act, 2013.

⁵⁷ Section 238, CBCA.

⁵⁸ Section 241(1), Companies Act, 2013.

⁵⁹ Afra Afshaaripour & Shruti Rana, *The Emergence of New Corporate Social Responsibility Regimes in China and India*, 14 *University of California Davis Business Law Journal* 175, 210 (2014).

⁶⁰ Section 408, Companies Act, 2013.

duty to act in the best interests of the corporation. But corporate law generally does not contain public remedies, unlike securities legislation where, depending on the jurisdiction, the action is brought by a third party (Crown, regulator or prosecutor) on behalf of the public at large. The third party is typically a securities commission that has jurisdiction under securities legislation to act in the public interest⁶¹ in fulfilling the mandate of securities legislation to protect investors and to maintain fair and efficient capital markets.⁶² Thus the remedy by and large seeks to benefit the public at large by deterring future conduct from occurring again.⁶³

The term ‘public interest’ is undefined in the statute. The OSA states: “*The Commission may make one or more of the following orders if in its opinion it is in the public interest to make the order or orders.*”⁶⁴ These include orders that a person cease trading in any securities, a person or company be reprimanded, a director or officer resign or a person be prohibited from acting as a director or officer, a person or company pay an administrative penalty of not more than \$1 million for each failure to comply, and a person disgorge to the commission any amount obtained as a result of non-compliance with the law. But the concept of ‘public interest’ is within the discretion of the Commission to define in any given situation.

The securities commission will not pursue cases of breach of fiduciary duty on investors’ collective or individual behalves. The commission will refrain from adjudicating fiduciary duty questions because fiduciary duty falls under corporate law and is outside the commission’s purview. Case law specifies that the purpose of such public interest remedies in securities law is to protect the public interest by removing from the capital markets those individuals whose conduct is so abusive as to warrant apprehension of future conduct detrimental to the integrity of the capital markets.⁶⁵ Further case law holds that the public interest jurisdiction is not compensatory or punitive but should be applied as necessary to prevent harm to the capital markets. Prevention may include considerations of deterrence, both general and specific (*Cartaway*). The former refers to deterrence aimed at society to prevent wrongdoing from taking place; the latter refers to deterrence aimed at the individual wrongdoer to prevent her from repeating the wrong.⁶⁶

A further public remedy that exists in some jurisdictions, particularly in Canada, is for the securities commission to bring quasi-criminal actions against defendants for violations of securities law. The actions are brought in courts

⁶¹ See Section 127, OSA: “The Commission may make one or more of the following orders if in its opinion it is in the public interest to make the order or orders”.

⁶² Section 1.1, OSA.

⁶³ *Cartaway Resources Corp., In re*, (2004) 1 SCR 672 (“*Cartaway*”).

⁶⁴ Section 127, OSA

⁶⁵ *Committee for the Equal Treatment of Asbestos Minority Shareholders v. Ontario (Securities Commission)*, (2001) 2 SCR 132 at para 43 (“*Asbestos*”).

⁶⁶ *Cartaway*, at para 52.

rather than in administrative bodies (i.e. securities commissions). The explicit purpose of this type of action is to punish the defendant. The penalties in this type of action are accordingly more severe and can range from fines to five years less a day in prison.⁶⁷ A court can also order the defendant to provide restitution to investors.⁶⁸

In a majority of cases brought within securities commissions in Canada, investors do not receive restitution or compensation for lost funds. The relevant statutes contain no explicit right to restitution for investors in cases where the securities regulator brings an action in the public interest via an administrative proceeding. Admittedly, where commission staff members choose to pursue disgorgement of profits as a sanction, they may, if successful, disperse funds to investors. But this regulatory distribution of disgorged funds occurs at the regulators' discretion rather than by any right of recovery that accrues directly to the investor per se.

By contrast, under the 'Fair Funds' provision in the Sarbanes-Oxley Act of 2002, the US Securities and Exchange Commission (SEC) has the ability to place moneys received from defendants under a court order or settlement in a fund which can be used to compensate injured investors.⁶⁹ The SEC has no obligation to compensate victims but the ability and discretion to do so exists by virtue of the fund. The creation of this fund is unprecedented among Western jurisdictions including Australia, Canada and the UK.

III. REBALANCING REMEDIAL RIGHTS?

La Porta *et al* have studied private and public remedies extensively.⁷⁰ They analyzed the securities laws of 49 countries and found that financial markets do not prosper when left to market forces alone. Both disclosure rights and liability standards were positively correlated with larger stock markets, whereas public enforcement, such as having an independent securities regulator, played a modest role in the development of stock markets. Although their research has been criticized⁷¹, their findings at least suggest that securities laws have the greatest

⁶⁷ Note that in Canada, certain constitutional issues can arise in relation to the size of administrative monetary penalties in the securities commission. *Rowan v. Ontario Securities Commission*, 2012 ONCA 208 ("Rowan").

⁶⁸ See Section 122(1), OSA: "If a person or company is convicted of an offence under this Act, the court may, in addition to any penalty, order the convicted person or company to make restitution or pay compensation in relation to the offence to an aggrieved person or company."

⁶⁹ Section 308, Public Company Accounting Reform and Corporate Responsibility Act (Sarbanes-Oxley), 15 USC §7264 (2011).

⁷⁰ La Porta R et al, What Works in Securities Laws?, 61(1) *Journal of Finance* 1(2006). Note that this has been criticized on a variety of fronts.

⁷¹ See Siems MM, What Does Not Work in Comparing Securities Laws: A Critique on La Porta et al's Methodology, *International Company and Commercial Law Review* 300 (2008) and Spamann H, The 'Antidirector Rights Index' Revisited, 23(2) *Review of Financial Studies* 267 (2010).

impact on market efficiency, and thereby on capital market performance, by providing default contract terms, ensuring minimum disclosure and enabling stakeholder participation in corporate governance. But La Porta *et al* also found that extensive disclosure requirements and standards of liability facilitating investor recovery of losses are associated with larger stock markets.

This section builds on the empirical findings of La Porta *et al* and suggests that private contracting as well as public enforcement are integral to a comprehensive remedial regime. In short, public enforcement matters as a means to ensure that investors have confidence in the capital markets. The starting point for the discussion is to recognize that while investors have the ability to seek a private remedy under the oppression remedy or derivative action, they have no analogous ability to be compensated in the public domain except in the quasi-criminal sphere, as described above. The rationale for the absence of compensation for individual investors in the public sphere is that the securities regulator acts on behalf of the investing public, ensuring that capital markets operate with integrity. As case law has explicitly set forth, the regulator's foremost task is to maintain the public interest by deterring prospective misconduct rather than compensating victims or ensuring restitution.⁷²

The absence of a right to restitution in the public sphere, however, presents an incongruity between the private and public spheres that is difficult to comprehend. Why shouldn't investors be entitled to compensation or restitution in the public sphere when a third-party regulator brings an action on their behalf? It stands to reason that investors who have suffered financially because of the defendant's violation of the law should have a right to be compensated or to receive restitution for the defendant's unjust enrichment. Such a right is fundamental to the idea that capital markets operate with integrity; investors will know that if their legal rights are violated, they will have a remedy. They will have greater confidence in the disclosure documents that they review and in placing their money in the capital markets on the basis of this information. Without remedies, investors will question the potential reliability of the disclosure they receive, which undermines the point of the disclosure regime.

The distinction between protecting capital markets on the one hand and ensuring that investors are compensated on the other is outmoded. Securities are goods. Just as consumers who purchase faulty products may be compensated, investors who purchase faulty securities should be able to be repaid funds that have been taken from them illegally. Investors' rights should be no different from consumers who purchase faulty goods. For example, when I inspect and purchase a box of raspberries at the grocery store and find at home that they are rotten,

⁷² One could argue that a deterrence-compensation distinction exists generally between the public-private realms: e.g. absent victim compensation provisions, a tort action for an assault injury is separated from the criminal process. Similarly, in competition law, cartel penalties are not paid to victims (although they may separately sue under a statutory right of action).

I take them back to the store and have the price of the raspberries returned. Similarly, when I purchase a new computer, and bring it home only to find out that it does not function properly, I can return and exchange the good or receive my money back. Indeed, consumer protection legislation typically provides a remedy – rescission or damages – in the face of unfair practices.⁷³ There is seen to be something wrong with the quality of the good that warrants reimbursement.

One could argue that there is a public interest in preventing consumers from purchasing defective goods, including allowing the market for such goods to operate with integrity. Consumers of securities, i.e. investors, should be entitled to a restitutionary remedy, available because they enter into transactions in which ‘buyer beware’ is insufficient to protect their interests. The consumer of raspberries is not, in law, responsible for inspecting each berry to ensure its high quality; there are some things consumers cannot know at the time of purchase. Similarly, an investor in securities may not know at the time of purchase that the corporation in which he or she is investing will violate the law and that the security will then decrease in value.

Ultimately, one must question why securities are treated differently from other, tangible goods especially when the harm arising may be significant. One could argue that there is even a heightened basis on which to allow investors to receive restitution in cases of fraud or other violation of securities law. A key characteristic of securities markets is information asymmetry as between insiders of the corporation and unrelated shareholders. Such information asymmetry has historically augured in favour of the disclosure-based model currently in place in Canada, the US and the UK. Information asymmetries inherent in securities markets justify greater remedies, given that there is inability for consumers to ‘inspect’ their goods. Relative to traditional buyers and sellers of tangible goods, the greater the asymmetry in information between investors and management, the more the restitutionary remedy for violation of the fiduciary obligation or other law is warranted.

This argument counters traditional law and economics scholars who argue that investors holding diversified portfolios are as likely to be on the losing side of transactions as on the winning side.⁷⁴ Their expected losses will therefore match their expected gains so they should not be compensated for securities fraud losses. Other scholars challenge the traditional view, arguing that the undiversified investor suffers uncompensated harm as a result of fraud where there is a lack of disgorgement of wrongful gains from the perpetrators of the fraud (i.e.

⁷³ Ontario’s Consumer Protection Act, SO 2002, chapter 30, Schedule A provides that in the face of unfair practice consumers are entitled to rescind their agreement, under section 18(1), or if rescission is not possible, consumers are entitled, under section 18(2), to recover damages or the difference between their payment and value derived from good or service, or both.

⁷⁴ Easterbrook FH & Fischel R, *Limited Liability and the Corporation*, 52 *University of Chicago Law Review* 89 (1985).

the violating company's management or its board).⁷⁵ In particular, Davis Evans⁷⁶ argues that, 'because there is measurable harm from fraud, there is a basis for granting compensation to its victims' because many retail investors do not diversify and some will buy and hold an undiversified portfolio for the long term. She favours providing compensation through an investor compensation fund whereby a portion of the purchase price payable to the selling shareholder on a securities transaction would be placed into an investor compensation fund that will provide victims of the fraud restitution.⁷⁷

The restitutionary remedy advocated here is slightly different. It relates to a regulatory power to award restitution akin to the US Fair Funds provision. The difference between the current proposal and the Fair Funds provision, however, is that under Fair Funds, the SEC has no legal obligation to compensate victims of securities violations. Rather, it has the discretion to do so if it obtains a court order or settlement against a defendant⁷⁸ and it may choose whom to compensate.⁷⁹ The argument put forth here, however, is that, if an explicit statutory right to restitution be absent, individuals should be entitled to a portion of the funds obtained by the securities regulator where it seeks and obtains disgorgement of profits in a regulatory hearing. This would become a legal obligation of the securities regulator that arguably is not contrary to the objectives of securities regulation.

As we know, the securities commission's public interest jurisdiction is aimed at protecting the interests of the investing public on a prospective basis. It is also charged with maintaining investor protection generally.⁸⁰ Unless investors are confident that they will receive restitution in the case of securities fraud or legal wrongs, their interests will remain unprotected and their trust in the capital market will be correspondingly reduced. Less well-off and less sophisticated investors will be discouraged from the capital markets altogether because they do not have the knowledge or the resources to diversify. Investors lose because

⁷⁵ Thakor AV et al, *The Economic Reality of Securities Class Action Litigation*, US Chamber Institute for Legal Reform 1 (2005), available at <http://www.nytimes.com/packages/pdf/business/27suit.pdf> (Last visited on August 16, 2014).

⁷⁶ Davis Evans A, *The Investor Compensation Fund*, 33(1) *Journal of Corporation Law* 101, 103 (2007).

⁷⁷ In addition, a moral hazard problem should be noted: this proposal taxes well-governed corporations in favour of compensating for bad corporations, relieving those who make risky investments and increasing the capital costs for 'good' corporations which could lead to inefficient outcomes.

⁷⁸ Connolly J, *Fair Funds and the Future of Securities Fraud Remedies* (2007), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1004766 (Last visited on February 19, 2013).

⁷⁹ *Official Committee of Unsecured Creditors of WorldCom Inc. v. Securities and Exchange Commission*, 467 F 3d 73 (2nd Cir 2006), available at <http://images.jw.com/com/publications/837.pdf> (Last visited on August, 16 2014). Here, the SEC proposed to distribute the settlement funds only to certain interest holders of WorldCom. Specifically, the SEC's proposal to distribute \$750 million excluded a number of interest holders, including those who recovered 36 cents or more on the dollar under the chapter 11 reorganization plan.

⁸⁰ Section 1.1, OSA.

their wealth will not grow as quickly. Markets lose because fewer individuals will invest their wealth.

Furthermore, egregious conduct will not be efficiently deterred. Capital market participants may suffer a type of fraud discount: if fraud increases, diversified and undiversified investors alike will be harmed⁸¹, not to mention public corporations that operate above the law. With a restitutionary remedy in place, investors will be more confident in making larger investments in individual securities without discounting such purchases by the probability that the stock price is fraudulent.⁸² They will share the risk of fraud with all investors, knowing that if they happen to purchase securities inflated by fraud, they will be placed in the same position as those shareholders who did not.

A restitutionary remedy will better balance private and public remedies, allowing investors who do not have deep pockets to still recover if they are victims of corporate malfeasance. One may argue that 'balance' itself is unimportant, especially because investors have remedial rights that, as La Porta *et al* may argue, are already comprehensive. On the contrary, the addition of a restitutionary remedy tweaks the currently available panoply of investor remedies and it is necessary for both investor protection and efficiency reasons, as described above.

IV. CONCLUSION

This article examined boards of directors' fiduciary duties and remedies that can be available to shareholders upon breach of that duty. When one considers the availability of compensation for breach of fiduciary duty and other wrongs in the private sphere, it seems reasonable to expect that restitution would be available to investors in the public sphere also. The proposal extends beyond the Fair Funds provision in the US to include a mandatory obligation for securities regulators to provide restitution to investors of a corporation of any disgorge obtained from a defendant. Providing such restitution would still deter breaches of fiduciary duties and violations of securities regulations, thereby bolstering investor confidence and enhancing the efficiency of capital markets.

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⁸¹ See Park JJ, Shareholder Compensation as Dividend, 108(3) Michigan Law Review 323, 341 (2009).

⁸² Goshen Z & Parchomovsky G, The Essential Role of Securities Regulation, 55(4) Duke Law Journal 711(2006).

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