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"The Courts and Corporate Executive Compensation in Canada"

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1 Introduction

The rapid rise in the compensation of executives at large corporations has become an issue in many developed countries in recent years. The issue can be framed both as one concerning corporate stakeholders whose interests might not be well served by the trend, or as one concerning society as a whole owing to its relationship with a concurrent rise in income inequality generally. These have raised interest both in the role that institutions have played in shaping this trend and in what role they might play in dealing with it.

This paper looks at the role played by one such institution, the courts, in Canada, a country which has seen both executive compensation and income inequality levels rise substantially since the 1980s. Previous literature on the role of courts in executive compensation disputes have focused almost exclusively on shareholder litigation using the derivative action in the United States.[1] Drawing on a set of cases compiled by the author in which the courts of Canada's common law provinces dealt with a dispute over the compensation of a corporate executive this paper makes two contributions to the literature from a Canadian perspective. The first is that the courts have a more complex role than merely being a forum that hears shareholder suits challenging pay. Executives themselves often turn to the courts seeking to enforce contractual claims to pay, and disputes also appear in bankruptcy/arrangement proceedings in which multiple stakeholder interests are in play. Additionally, in the Canadian context despite a robust volume of shareholder litigation none of it has used the derivative action so commonly referred to in the American literature. Rather such cases overwhelmingly proceed using Canadian corporate law's oppression remedy, a significantly different mechanism that gives shareholder lawsuits a much different character. An over riding feature with litigation generally however is that while most stakeholder groups – shareholders, executives and to a lesser extent creditors – regularly feature in disputes, corporate employees are the one stakeholder group whose interests are not generally represented.

The second contribution relates to the fact that previous studies have examined the role of the courts mainly from the perspective of the corporate law agency problem.[2] This paper instead views it from the perspective of both the agency and inequality problems that executive pay currently poses. Taking into consideration the broader institutional setting it explores the argument that an expanded role for the courts might better allow for the balancing of these two concerns. In the Canadian context the paper raises an exploratory argument that this could be

[1] Randall S. Thomas and Kenneth J. Martin, *Litigating Challenges to Executive Pay: An Exercise in Futility?*, 79 Washington University Law Review (2001) 569; Randall S. Thomas, and Harwell Wells, *Executive Compensation in the Courts: Board Capture, Optimal Contracting and Officer's Fiduciary Duties* 95 Minnesota Law Review (2011) 846; Lisa M. Fairfax, *Sue on Pay: Say on Pay's Impact on Director's Fiduciary Duties* 55 Arizona Law Review (2013) 1.

[2] While most papers acknowledge popular perceptions that executive pay is out of control, they generally focus their analysis on the distinction between optimal contracting and managerial power perspectives, both of which are based on agency concerns: see for example Thomas and Wells, *supra* note 2.

accomplished through expanding the scope of the oppression remedy mechanism to allow employees to bring claims against executive compensation.

The paper proceeds as follows. Section two defines executive compensation as a problem and outlines the institutions – markets, norms and law – which control it. Section three then describes the relationship between the rise in executive compensation and income inequality in Canada. In section four the various legal avenues by which disputes over executive pay can wind their way to courts in Canada – through corporate law, contract law, employment law and bankruptcy/arrangement law – are laid out. Section five then provides a quantitative overview of the set of cases, from 1876 to 2018, which allows for an understanding of how executive compensation disputes have found their way to court, who has brought them, how courts have responded and how trends have evolved over time. Section six then explores what role the courts might play, laying out a basic argument in favor of an expanded role based on the oppression remedy. Conclusions follow.

2 Institutions and the Executive Compensation Problem

2.1 Defining the Problem

Executive compensation can be viewed as a problem in two ways. On the one hand it has long been viewed by the corporate law literature as part of the agency problem endemic to the corporate form.[3] Executives are one class of stakeholder in the corporation and their compensation is what they receive for their contribution in the same way that shareholders receive dividends, regular employees receive salary and creditors receive interest payments. Since unlike these other stakeholders executives are uniquely vested with a great deal of decision making power over how proceeds are distributed, including decisions related to their own pay, the risk exists that they will abuse this position to pay themselves in excess of what they are worth, to the detriment of the other stakeholders and the corporation itself. Some means of limiting their ability to do so is thus seen as an important element in corporate governance generally. Additionally, even in the absence of such abuse lies the concern that the personal interests of executives can diverge from those of the corporation. Monitoring this conflict is itself an agency cost and structuring pay contracts to more closely align the two through the use of various incentive based forms of pay has long been advocated as a way of accomplishing this.[4]

On the other hand, executive compensation is also increasingly being addressed as part of a broader debate on income inequality generally.[5] The incomes of executives at large corporations

[3] Lucien Bebchuk and Jesse Fried, *Pay Without Performance: The Unfilled Promise of Executive Compensation* (Cambridge: Harvard University Press, 2004).

[4] This latter concern, the "reward strategy", is often the primary way in which executive compensation is addressed in corporate law texts. See Reinier Kraakman, John Armour, Paul Davies, Luca Enriques, Henry Hansmann, Gerard Hertig, Klaus Hopt, Hideki Kanda and Edward Rock, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (Oxford: Oxford University Press, 2009) at 75-78.

[5] Bryan C. Tingle, *How Good are Our "Best Practices" When it Comes to Executive Compensation? A Review of Forty Years of Skyrocketing Pay, Regulation and the Forces of Good Governance* 80 Saskatchewan Law Review (2017) 387

in countries like the United States and Canada have increased largely in concert with increases in levels of overall income inequality, and are often cited as one of the driving causes of the latter.[6] To a certain extent, and using a stakeholder model of corporate governance which is not necessarily dominant in Canada, this may be characterized as a form of agency problem as well, since the rise in executive compensation has generally accompanied the stagnation of the incomes of another stakeholder group, employees. To the extent that its effects are impacting society at large, and not merely falling on other corporate stakeholders, however, it cannot be solely viewed as an agency problem in this regard. Rather executive compensation practices, to the extent that they contribute to income inequality generally, are creating an externality the cost of which is absorbed by society at large.

These two views of the problem – the agency and inequality perspectives – imply different normative ends. From an agency perspective the institutions which shape decision making processes should produce executive compensation contracts that are optimal either to the shareholders (in a shareholder primacy model of corporate governance) or to a broader set of corporate stakeholders including shareholders, employees and creditors (in a stakeholder model). From an inequality perspective on the other hand the institutions should produce executive compensation contracts that at a minimum avoid imposing an externality – the negative effects of its contribution to income inequality – on society as a whole. Theoretically these two ends need not be in conflict if the optimal contracts for corporate stakeholders do not produce such an effect, but the recent aforementioned rise in income inequality associated with rising executive compensation levels suggests the two are not fully in synch.

2.2 Defining Institutional Roles

Executive compensation is in some ways like any other problem society faces in that how it deals with it is to a significant extent determined by the institutions that are available. These may come from a variety of sources, some within the formal legal system and some outside. Previous literature has looked at the role of several of these which operate outside the formal legal system – markets[7] and norms[8] – and those within the legal system – regulation and the courts.[9] The role of each is in some ways determined by which perspective the problem is viewed from – institutions that control the problem from one are not necessarily optimal for the other, and vice versa.

2.2.1 Markets

[6] Thomas Piketty for example devotes some discussion to the contribution of executive compensation, particularly in the US, to broader income inequality. Thomas Piketty, *Capital in the Twenty-First Century* (Cambridge: The Belknap Press of Harvard University Press, 2014) at 333-335.

[7] There is a relatively rich literature in this regard. See generally Alex Edmans and Xavier Gaibax, *Is CEO Pay Really Inefficient? A Survey of New Optimal Contracting Theories* 15 European Financial Management (2009) 486.

[8] Alberto R. Salazar and John Raggiunti, *Why Does Executive Greed Prevail in the United States and Canada but not Japan? The Pattern of Low CEO Pay and High Worker Welfare in Japanese Corporations* 64 American Journal of Comparative Law (2016) 721.

[9] Thomas and Martin, *supra* note 2.

From the agency perspective markets are one of the main institutions which can discipline executive compensation levels. Corporations have to operate in numerous markets and in each of these they risk punishment for poor decisions on what to pay their executives. Equity and credit markets[10] may raise the cost to the company of raising capital if they believe its executives are paid too much, paid in a way that does not properly incentivize them, or are given contractual terms that may create significant future liabilities for the corporation. The product or services market that constitute the corporation's main business may also provide disciplines[11] since money paid to executives in excess of what they are worth, or which does not adequately incentivize them may hurt them competitively. Labor markets may work two ways. If they fail to pay their executives as generously as those at similarly situated companies are they may have difficulty in hiring or retaining talented executives. On the other hand paying their executives too much may have negative effects on lower tier employees, since as with investment in products and services it may leave less to invest in salaries for regular employees. Likewise extreme disparities may have an adverse effect on employee morale and corporate performance, particularly where pay decisions seem arbitrary.[12]

Market forces do have limits, however. They require the existence of rational decision makers basing market decisions – whether to invest in a company, or buy its products, or work for it – on perfect information, something which never happens in actual practice. Informational asymmetry and rational apathy play into the hands of executives who have both the ability and a high incentive to invest in information related to their own pay. Shareholders, creditors, customers or regular employees of the corporation on the other hand almost never have adequate information, the means of evaluating it, nor the incentive to invest their time in doing so. On perspective, the managerial power theory,[13] also suggests that defects in the negotiating process between executives and boards result in contractual terms that may constitute little more than rent extraction from the company. Despite the use of compensation committees stocked with independent directors who ostensibly should be able to represent shareholder interests, CEOs under this view are said to have extensive power over boards. In part this is because of the CEOs influence in determining who will become a director and in part it is because directors themselves are incentivized to negotiate overly generous packages in the expectation of its effects on their own pay. Most independent directors are full time executives at other companies where industry comparisons are important factors in the setting of pay, thus the effects of approving higher pay in their role as director will, through its effects on the executive labor market, indirectly benefit themselves. No countervailing motivation encourages them to push pay levels down, and thus the entire system for negotiating and approving executive pay has an inflationary impulse built into it.

[10] Zhigong Chen, Yuan Hang and K.C. John Wei, *Executive Pay Disparity and the Cost of Capital*, 48 Journal of Financial and Quantitative Analysis (2013) 849.
[11] Vincente Cuñat and Maria Guadalupe, *Executive Compensation and Product Market Competition*, LSE Research Online Documents on Economics 19985 (2004).
[12] Ethan Rouen, *Rethinking Measurement of Pay Disparity and its Relation to Firm Performance* 95 The Accounting Review (2020) 343.
[13]Bebchuk and Fried, *supra* note 4.

From the inequality perspective, markets are also problematic as an institution for controlling executive compensation. Theoretically the markets will only discipline pay decisions for their impacts on the competitiveness or value of the firm on that market. The minor contribution of an individual company's pay decision to overall levels of inequality is not a piece of information that any market is likely to take into consideration. Moreover as just noted the logic of some markets, particularly the labor market for executives, has worked to inflate rather than control pay levels thus putting them into direct conflict with inequality concerns.

2.2.2 Social Norms

Another institution which can potentially constrain executive compensation is cultural. The strength of social norms against greed have been cited as an explanatory factor for executive pay differentials across jurisdictions for example. In the comparative law literature the relatively lower levels of Japanese executive pay compared to those in Canada and the United States has thus been explained in cultural terms. "A business culture that does not tolerate excess nor encourage greed is likely to both favor lower executive compensation practices and harness the corporate governance system to control executive excess" according to Salazar and Raggiunti.[14] Similar observations have been made in comparisons of German and American corporate governance.[15]

From an agency perspective, a strong social norm against greed may be beneficial to the extent that it discourages opportunism, but may be problematic if it also discourages pay packages that which align interests in an optimal way. From an inequality perspective such a norm has obvious benefits, with the equally obvious caveat that it needs to actually exist. If a norm against greed explains lower executive pay in a country like Japan, this invites the conclusion that a set of norms which encourages (or at least tolerates) greed at least partly explains higher levels in countries like Canada. It is indeed hard to ignore the fact that norms within the Canadian business community – commonly held by all components of the corporate governance industry who are meant to control pay[16] – at the very least can be said to be quite comfortable with allowing extreme disparities between what executives at large corporations and regular workers are paid

A further issue is that social norms don't usually provide a viable path to reform since such informally recognized conventions are both difficult to define and harder to change. They are relevant, however, to the extent that where such norms are inflexible and easy to defend, they may frustrate legal reforms which run afoul of them. Here though, the implied cultural norm in Canada is one that is permissive of extremely high pay, but not necessarily one that requires it.

2.2.3 Regulation and the Courts

[14] *Supra* note 9 at 29.
[15] Franklin A Gevurtz, *Disney in a Comparative Light*, 55 American Journal of Comparative Law (2007) 453 at 478.
[16] Bryce C. Tingle, *Framed! The Failure of Traditional Agency Cost Explanations for Executive Pay Practices* 54 Alberta Law Review (2017) 899.

When institutions outside the formal legal system fail to provide adequate controls on a problem, the next recourse is often the legal system itself. Law and economics scholars like Richard Posner have placed some emphasis on the distinction between regulatory and litigation based strategies.[17] Regulatory approaches generally involve ex ante rules enforced by a public agency, while litigation takes place ex post and relies on enforcement by private parties bringing cases to the courts.

In the context of executive compensation, securities regulation is of particular relevance to the former. In Canada provincial securities regulators require publicly traded companies[18] to disclose the process by which the board determines the compensation of all directors and officers. They must also disclose whether they have a compensation committee composed entirely of independent directors and describe its responsibilities, powers and operation. If they do not have an independent compensation committee, they must explain what steps they take to ensure an objective process is used for determining compensation.[19] These mandatory rules are supported by voluntary guidelines that recommend the use of compensation committees comprised of independent directors for setting compensation levels and detail their responsibilities.[20] To these we can add "soft" forms of regulation by private entities rather than public agencies. The Toronto Stock Exchange has specific rules for securities based compensation arrangements[21] that must be followed by listed companies. And proxy advisory services like Institutional Shareholder Services also publish voting guidelines related to compensation which may influence compensation decisions.[22]

These rules are largely based on the agency perspective – by providing information to shareholders they can use the mechanisms at their disposal (such as exit) to discipline those charged with forming the executive pay contracts and thus assure that they are optimal from their perspective. In recent years some jurisdictions have however begun to also use securities regulation to address inequality concerns, notably the United States' Securities and Exchange Commission's adoption of a rule requiring the disclosure of the ration of CEO to median worker pay at public companies[23] though no similar rule yet exists in Canada.

The courts also act as a means of enforcing rules, only they do so ex post when a factual dispute has erupted between two private parties and they can do so in areas which securities regulators cannot, such as contract and corporate law. While both securities regulators and the courts enforce sets of rules that influence the process by which a contractual entitlement to an executive's pay is formed, it is only the courts that have the actual power to enforce (or refuse to

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[17] Richard A. Posner, "Regulation (Agencies) versus Litigation (Courts)" in Daniel P. Kessler (ed), *Regulation vs. Litigation: Perspectives from Economics and Law* (Chicago: University of Chicago Press, 2011) 11-26.
[18] National Instrument 58-101 Disclosure of Corporate Governance Practices S. 2.1
[19] Form 58-101F1 Corporate Governance Disclosure.
[20] National Policy 58-201 Corporate Governance Guidelines ss. 3.15-3.17
[21] Toronto Stock Exchange, *TSX Company Manual* S. 613.
[22] Institutional Shareholder Services, *Canada Proxy Voting Guidelines for TSX-Listed Companies Benchmark Policy Recommendations* available at < https://www.issgovernance.com/file/policy/active/americas/Canada-TSX-Voting-Guidelines.pdf >, accessed 16 September 2020.
[23] United States Securities and Exchange Commission, *SEC Adopts Rule for Pay Ratio Disclosure*, Press Release (5 August, 2015).

enforce) the contract itself should a dispute arise. Despite this, within the framework of the two views on executive compensation – as an agency problem and as an inequality problem – the envisaged role of the courts is either limited (with the former) or ignored altogether (with the latter).

Within the agency perspective, there is some skepticism about the courts as an institution for controlling pay in the US. Among those subscribing to the managerial power perspective this is due to perceived overly deferential approaches taken by the courts, particularly in Delaware.[24] More recent works in the American context however have given closer consideration to the use of litigation as a means of policing pay. These include Thomas and Wells[25], advocating greater supervision of pay by courts using the fiduciary duties of boards to police non-arms length bargaining, Wagner[26] arguing for the introduction of a cause of action against executives based on a breach of a fiduciary duty specifically related to their pay, and Fairfax[27] advocating states courts allow more challenges to pay based on negative say on pay votes. While the Canadian literature has been silent on the role of the courts, it can at least be said that recent years have seen a strong increase in interest in using the courts to police executive compensation in the United States based on agency problem concerns.

From an inequality perspective, the relevance of legal rules governing executive pay has been given some consideration by McGaughey[28], finding that the historical shift from corporate law rules putting decisions on director pay in the hands of shareholders to one putting it in the hands of the directors themselves in the 20th century in the UK and US[29] (and a different path of legal change in Germany) had an ambiguous relationship with subsequent rises in executive pay. The role of the courts themselves however have not been given much treatment. Instead proposals for reform have generally focused on changes to income tax rules[30], and to a lesser extent corporate law reforms such as the introduction of binding say on pay rules. This apathy to the courts makes some sense. Unlike the agency problem, inequality is a broader problem that doesn't solely relate to executive compensation and thus general policy responses (like income tax rules) make some sense as a focus. Also, as will be discussed below, the limited direct means by which inequality concerns per se can be addressed through private enforcement in the courts may also be a factor.

While this gives us some insight into the theoretical role that might be played by courts – as a monitoring mechanisms that subjects pay to some ex post oversight and might mitigate its level – we are left with the question of what the courts have actually done in practice, which we turn to

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[24] Bebchuk and Freid, *supra* note 4.
[25] Thomas and Wells, *supra* note 2.
[26] Robert E. Wagner, *Mission Impossible: A Legislative Solution for Executive Compensation* 45 Connecticut Law Review (2012) 549
[27] Fairfax, *supra* note 2.
[28] Ewan McGaughey, *Do Corporations Increase Inequality?* Transnational Law Institute Think Paper 32/2016 (2016).
[29] As shall be discussed below in Section 4, a similar historical development occurred in Canada.
[30] Hugh Mackenzie, *Staying Power: CEO Pay in Canada*, Canadian Centre for Policy Alternatives Report (January 2016) at 19

in section 5 below. First though a brief word about the state of executive compensation and income inequality in Canada.

3 Income Inequality and Executive Compensation in Canada

3.1 Income Inequality in Canada

Income inequality in Canada has been the subject of a relatively robust volume of literature over the past decade. The major points which all studies agree on is that it has increased substantially since the mid 1980s and that most of this increase is attributable to growth in incomes at the very top of the distribution. In terms of the overall increase in income inequality, Veall[31] demonstrates that top Canadian earners experienced a surge in their income as a portion of overall income, particularly in the time period between 1985 and 2007, after which the increase tapered off.[32] This resulted in the share of total income going to the top 1% of earners rising from 8% in 1986 to 12.3% in 2009.[33] This result largely conformed that of earlier work[34] showing a rise in market income inequality in Canada during the 1980s and 1990s, a process that was exacerbated by the reversal of progressive tax and transfer policies in the 1990s that until that point had largely mitigated the impact of growing market inequalities.[35]

Explanations for why income inequality in Canada has followed this path – particularly with respect to why it has been so concentrated at the top 1% of the distribution - have generally taken those developed in the American context as starting points. Veall[36] in particular reviews four of these. The first is globalization, which may provide more opportunities for mobile workers at the top end to grow their incomes internationally while those at the bottom face the opposite problem: their jobs being more easily outsourced to low wage countries. A second is technological change, particularly in the field of communications, which allow for "superstars" in a given field to increase their returns by harnessing larger audiences or markets. A third is the elasticity of income in certain brackets to changes in tax. Finally is the question of whether the institutions governing the compensation of corporate executives plays a role.

3.2 Executive Compensation in Canada

[31] Micheal R. Veall, Top Income Shares in Canada: Recent Trends and Policy Implications 45 Canadian Journal of Economics(2012) 1247.
[32] More recent data indicates the growth in incomes at the top end have plateaued following the 2007-2008 financial crisis. Micheal R. Veall, "Income Inequality has Risen in Canada, but not in a Straight Line", Policy Options March 9, 2020.
[33] Veall *supra* note 27.
[34] Mark Frenette, David A. Green and Kevin Milligan, *The Tale of the Tails: Canadian Income Inequality in the 1980s and 1990s* 40 The Canadian Journal of Economics (2007) 734.
[35] Mark Frenette, David A. Green and Kevin Milligan, *Taxes, Transfers and Canadian Income Inequality*, 35 Canadian Public Policy (2009) 389.
[36] Veall *supra* note 27.

The trends in overall income inequality in Canada described above find parallels in the path that executive compensation has followed over roughly the same period.[37] The average income of the CEOs at the top 100 companies on the Toronto Stock Exchange Index was approximately $9.5 million in 2015[38], a ratio of 193:1 to the average Canadian worker which as was widely reported in the press[39] roughly meant that they earned more on the first work day of the year than the average worker would make in the entire year. In addition to quantity, the make up of executive compensation at that top level has also followed American trends, with salary now forming a minority and equity based compensation and variable pay constituting the majority.[40]

Also as in the United States, the current high levels of executive compensation have grown from more modest levels which previously existed. While in 1995 the ratio of the pay of CEOs of the top 50 publicly listed corporations in Canada to the average was 85:1 by 2015 it had reached 290:1.[41] Data availability problems in Canada make it difficult to trace the development of CEO pay levels earlier than the 1990s, though it has been estimated that the ratio of top CEO to worker pay were somewhat lower than seen in the United States in the 1980s.[42]

Not only has executive compensation increased hand in hand with income inequality, the evidence also suggests that the former is a significant driver of the latter. Lemieux and Riddell surveyed the growth in incomes in the top one percent of the spectrum between 1981 and 2006 in Canada across a number of categorizations. Occupationally they found that top executives and those working in the finance industry in Canada "were the two most important contributors to the growth of incomes at the top." This is largely consistent with similar findings in the United States.[43] In addition to its specific effects on the top end of the income spectrum Cobb[44] also suggests that in developed countries where a significant portion of the labor force is employed by large corporations, intra corporate decisions on how to reward executives and regular employees has a direct effect on income inequality in general.

4 The Law: How can Executive Pay Disputes end up in Canadian Courts?

The previous section has laid the ground work for the proposition that the increase in executive compensation and its contribution to income inequality generally suggest that existing institutions – markets, norms and the legal system – are not balancing the concerns of the

[37] Thomas Lemieux and W. Craig Riddell, *Top Incomes in Canada: Evidence from the Census*, NBER Working Paper No. 21347 (2015) at 128.
[38] Hugh Mackenzie, *Throwing Money at the Problem: 10 Years of Executive Compensation*, Canadian Centre for Policy Alternatives Report (January 2017).
[39] Sophia Harris, *Canada's Top CEOs Earn 200 Times an Average Workers Salary: Report*. CBC News (2 January, 2018).
[40] Mackenzie, *supra* note 39.
[41] *Ibid.*
[42] *Ibid* at 9.
[43] Jerry W. Kim, Bruge Kogut and Jae-Suk Yang, *Executive Compensation, Fat Cats and Best Athletes* 80 American Sociological Review (2015) 299.
[44] Adam Cobb, *How Firms Shape Income Inequality: Stakeholder Power, Executive Decision Making and the Structuring of Employment Relationships*, 41 Academy of Management Review (2016) 324.

agency and inequality perspectives in Canada. Market mechanisms are operating to increase rather than moderate compensation levels and countervailing social norms are either weak or nonexistent. Regulatory measures in turn are largely based on the agency perspective and do little to account for inequality concerns. This leaves us with the question of the role of the courts, which has thus far gone unexplored in the Canadian context. This section lays out the various means by which disputes over executive pay wind up in court – through corporate, contract, employment and bankruptcy/arrangement law. First though it addresses the question of who constitutes an "executive".

4.1 Who are the Executives?

The term "executive" here encompasses two types of person whose legal positions with regard to compensation are radically different: directors and officers. Directors are not employees of the corporation (at least in their role as directors) and rather are elected to the office by the shareholders. Historically at common law their position was viewed as different from employees who fell under the law of master and servant[45] and it was assumed that they had no claim to remuneration of any sort absent an explicit agreement to the contrary. Early corporate law statutes, notably Section 54 of the 1862 Companies Act in the UK,[46] thus required that director pay, where it was to be provided, was to be set by the general shareholders meeting an early iteration of the say on pay rules adopted in some jurisdictions around the world in recent years. Canadian jurisdictions, notably Ontario, would follow this model in their 19th century corporate laws as well, requiring that any compensation paid to directors and the president be set out in by-laws that required approval by the general meeting.[47] In 1975 corporate law at the Federal level was significantly reformed with the introduction of the Canada Business Corporations Act ("CBCA").[48] This led to significant copycat reforms at the provincial level in subsequent years, resulting in a significant convergence of provincial corporate law on the CBCA model.[49] As part of this trend, Canadian corporate law moved away from this rule and the directors now may set their own compensation without shareholder approval.[50]

Officers on the other hand are in an employment relationship with the corporation, albeit one which is differentiated from that of regular employees in that they are appointed directly by the board to perform delegated functions in the running of the corporation and they fall under the same duties to the corporation (fiduciary and care) as directors. Their remuneration is set by the board of directors as part of the contract of employment.

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[45] *Re Bolt and Iron Company Livingstone's Case* [1887] O.J. No. 153
[46] 25 & 26 Vict. c.89.
[47] S. 48 Ontario Companies Act of 1897 RSO 1897, c.191.
[48] R.S.C., 1985, c. C-44.
[49] By 1986 all of Canada's provinces had enacted corporate law reforms inspired by the CBCA model. For an overview of this see R.J. Daniels *Should Provinces Compete? The Case for a Competitive Corporate Law Market* 36 *McGill Law Journal* 130 (1991).
[50] S. 125 R.S.C., 1985, c. C-44. All provincial statutes likewise no longer require approval from the general shareholders meeting.

Historically the fact that the same person could simultaneously hold different positions – director, officer and even regular employee – subject to different rules on how their pay was to be authorized (particularly the fact that director pay had to be set in by-laws approved by the shareholders which was not required for officers or employees) created a great deal of confusion for the courts.

Today this distinction is less of a legal problem, but other changes have led to some divergence in the pay of directors and officers, particularly at large corporations. One of the most important has been the shift from a board made up of directors who also held other roles in the company[51] to a supervisory model in which most are independent directors.[52] Directors at most large companies thus do not receive a salary, and rather are compensated either through fees for meeting attendance or retainers, with additional remuneration for specific functions like chairing committees or serving as the chair.[53] Though boards can set their own compensation, the amounts they receive are relatively modest compared to what officers are paid and thus not the subject of much commentary or public controversy.

Officers, however, are full time employees whose contracts, particularly for Chief Executive Officers (CEOs) are sometimes quite controversial and are the main contributors to the widening divide between top executive and average worker compensation. This is often attributed to a shift in the makeup of officer compensation.[54] Whereas directors receive retainers and fees, officers receive base salary, bonuses and various forms of stock based incentive pay such as options or grants. The proportion of taken up by the latter has increased significantly in recent decades.

This distinction between the compensation of directors and officers, it should be noted, is primarily relevant to large corporations. At smaller, and particularly privately held ones, the lines between them are blurred as the roles of directors and officers are more often held by the same person whose overall compensation may fail to draw a distinction between the two.

4.2 Corporate Law

Corporate law – referring to the CBCA and its provincial counterparts – is an area where the law has evolved significantly in terms of rules relevant to executive pay over the years. Corporate law based executive pay disputes before the courts today look nothing like they did one hundred years ago in terms of the rules being litigated. It is also an area where Canadian law, with its oppression remedy, significantly diverges from that in the United States.

In terms of its temporal evolution, prior to the above mentioned introduction of the CBCA and the subsequent convergence of Canadian corporate law, there was some divergence between the provinces over how executive pay was regulated. Most notably some provinces like Ontario and

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[51] Evidenced in many cases from the early 20th century in which directors serving as officers or regular employees were a constant feature, see for example *Re Matthew Guy Carriage and Automobile Co*. [1912] O.J. No. 136.
[52] In 2016, independent directors were the majority in 94% of large corporations in Canada. Korn Ferry Canada, *Corporate Board Governance and Director Compensation in Canada: A Review of 2016* (January, 2017) at 27.
[53] *Ibid* at 66-99.
[54] Mackenzie, 2017 *supra* note 36.

Manitoba required that all compensation paid to the corporate directors or president be set out in the by-laws and approved by the shareholders meeting for any legal claim to that pay to materialize.

While this rule did not apply to all officers, in the 19th and early 20th century the distinction between directors and officers was not as fine as it is today and most executives who held a position as an officer also served as a director.[55] The distinction was further undermined by court rulings which favored interpreting the provision as requiring all pay the director received from the corporation in executive roles (which tended to be included as a responsibility of a director) to be approved by the shareholders.[56]

This procedural requirement created a wide range of grounds on which disputes over executive pay could find their way to court. At a time before the introduction of statutory derivative actions or oppression remedies, it could be used alongside the common law doctrine of breach of trust by minority shareholders to challenge pay to directors/officers that failed to comply with it. In *Waddell v. Ontario Canning Co*.[57] for example two directors, who also served as president and secretary treasurer of the corporation, had paid to themselves salaries for their services out of corporate funds without a by law approving them being approved by the general meeting. When a group of minority shareholders later objected they, holding a majority of the shares, attempted to ratify the compensation they had taken by passing by-laws retroactively approving it. The Court held that they had committed a breach of trust which constituted "harsh treatment" by the majority against the minority they could not later ratify, and the proper remedy was for them to refund the moneys paid.

Many cases involving the SOP rule however did not involve minority shareholders but were often bankruptcy proceedings in which the claims of directors to pay had to be weighed against that of creditors of the company.[58] In these cases the rule had the potential to cause serious hardship for directors who would potentially lose remuneration for services they had duly rendered simply owing to a defect in the formalities of obtaining approval.

By the 1980s SOP provisions requiring shareholder approval of director pay had been removed from the books in all jurisdictions, Ontario's notably being replaced in 1982.[59] This round of reform also introduced to Canadian corporate law statutes codified versions of the derivative action and the oppression remedy, the latter of which would play a major role in litigation in the years since. We might first, however, say a word about the derivative action and its odd place in Canadian corporate law.

The statutory derivative action found in Canadian corporate laws is based on an American model, though a similar procedure existed at common law in Canada prior to its introduction and

[55] This is evidenced in many of the early cases, in which directors also serving as officers were litigants. See for example *Waddell v. Ontario Canning Co.* [1889] O.J. No. 63

[56] *Birney v.The Toronto Milk Co., Ltd* [1902] O.J. No. 2

[57] [1889] O.J. No. 63

[58] See for example Northern Trust Co. v. Butchart, [1917] M.J. No. 37.

[59] *Business Corporations Act, 1982,* SO 1982, c 4

was sometimes used in executive pay cases prior to the 1970s.[60] Interestingly while the derivative action has dominated American executive pay related litigation and academic interest[61], it has lain completely dormant in Canada in such disputes since its introduction: not a single decision rendered by a court has involved the use of a statutory derivative action in an executive pay dispute.

The co-existence of the derivative action with the oppression remedy in the Canadian environment is the likely explanation for the former's irrelevance. As demonstrated by the American experience, and also in Canada in its use outside the executive pay context[62], the derivative action possesses a number of features that make it relatively unattractive to plaintiffs compared to the oppression remedy. First of these is that the derivative action presents procedural hurdles like the demand requirement and the requirement to obtain leave of the court to bring an action. These requirements, which doom many executive pay actions in the United States before they even get to a trial on the merits[63], do not exist with respect to oppression remedy applications. A second reason is that, while the CBCA defines "complainants" who can bring both derivative actions and oppression remedy applications in the same way, in practice derivative actions have been limited by courts to shareholders, while oppression remedy applications have been successfully brought by a wider range of actors including creditors and others.[64] In a derivative action plaintiffs must prove the violation of some sort of legal duty in order to succeed, while in an oppression remedy application they must merely show that the act complained of was "oppressive or unfairly prejudicial" or that it "unfairly disregards the interests of any security holder, creditor, director or officer."[65] Finally the courts in oppression remedy applications are empowered to provide a much wider range of remedies than are available in a derivative action.[66]

The similarities that nonetheless exist between the derivative action and oppression remedy application have raised the question of what claims are properly brought under which. Courts have acknowledged that there may be some overlap, but generally view derivative actions as being the proper mechanism for wrongs done to the company as a whole, while oppression remedy applications are intended for independent wrongs done to the applicant as distinct from the corporation.[67] This raises the question of whether the oppression remedy application might be limited to pay decisions that adversely affect, say, a minority shareholder in a closely held corporation while excluding those in publicly traded corporations that, no matter how egregious the pay decision, negatively affected all shareholders equally.

[60] See for example *D'Amore v. McDonald et al.* [1973] O.J. No. 1860, [1973] 1 O.R. 845, 32 D.L.R. (3d) 543.
[61] Thomas and Martin, *supra* note 1.
[62] Difficulties with the derivative action are discussed in William Kaplan and Bruce Elwood, *Derivative Action: A Shareholder's Bleak House* 36 University of British Columbia Law Review (2003) 443.
[63] Thomas and Martin, *supra* note 2.
[64] J. Anthony VanDuzer, *The Law of Partnerships & Corporations* (Toronto: Irwin Law, 2009) at 412.
[65] S. 241(2) *Canada Business Corporations Act* R.S.C., 1985, c. C-44.
[66] S. 241(3) *Canada Business Corporations Act* R.S.C., 1985, c. C-44.
[67] *Radford v. MacMillan* 2017 BCSC 1168.

In cases where the question of whether the case should have proceeded as a derivative action has not been brought up, however, the courts have been accommodating to oppression remedy applications involving allegations of a broad range of oppressive pay decisions. In the Ontario case *UPM-Kymmene v. UPM Miramichi*[68] for example the Court upheld an oppression remedy application against the former chairman of the board of a large publicly traded company who had been awarded an egregiously generous contract which negatively affected all shareholders equally. In other cases where the defence has raised the argument that the claim should have properly been brought as a derivative action the courts have often been able to find some form of oppressive conduct against the plaintiff that would allow it to proceed as an oppression remedy application.[69]

In the executive compensation context another key feature of the oppression remedy is that it allows the Court to review the reasonableness and fairness of the actual amount of pay rather than just focusing on whether any duties were violated in the process of its approval (though these may also be examined). In numerous cases[70] the courts have ruled against executives on the grounds that their pay was in excess of what was reasonable and fair. Courts have generally held[71] that fair and reasonable compensation is to be determined in light of the fair market value.

Another corporate law issue that is sometimes litigated in executive pay disputes are conflict of interest provisions. Similar to the oppression remedy these provisions provide a "reasonable and fair"[72] test for contracts with the corporation in which a director has a material interest (such as an employment contract). Provided that their interest is disclosed (which it obviously is in the case of employment contracts) such contracts are not void or voidable, nor is the director liable to the corporation for any profit therefrom, but only provided that the terms of the contract are reasonable and fair.[73]

4.3 Contract and Employment Law

A significant part of the remuneration an executive earns over the course of their career may come at the very end, when they either resign, retire or are terminated. In such instances the principles of contract law and employment law come into play. These can generally be divided into two categories of claim, usually initiated by the executive: claims to entitlements in a contract based on general principles of contract law, or claims for compensation (notice) based on an action for wrongful dismissal. In many cases both may be brought simultaneously.

4.3.1 Contractual Claims

[68] 2002 Canlii 49507.
[69] In none of the cases in this study was an oppression remedy application dismissed on the grounds that it should have proceeded as a derivative action, despite that defence being raised in several.
[70] See for example *Radtke v. Machel*, [2000] O.J. No. 3019.
[71] See for example *Konig v. Hobza* 2013 ONSC 1060.
[72] S. 120(7) *Canada Business Corporations Act* R.S.C., 1985, c. C-44 provides that any contract which an officer has an interest is not voidable provided that it was disclosed, it was approved by the directors, and it was reasonable and fair to the corporation at the time of approval.
[73] *Rooney v. Cree Lake Resources Corp*. [1998] O.J. No. 3077, 70 O.T.C. 241.

Executive pay disputes involving pure questions of contract law make their way to court with some frequency. Most of these are brought by the executives themselves following a change of control transaction which results in their ouster.[74] Since the contracts for executives at large corporations often contain "golden parachute" provisions that give them much more than they would be entitled to under a wrongful dismissal claim when their employment is terminated without cause, litigation over such dismissals usually centers on how much they are entitled to under such provisions rather than on issues such as notice periods.

The contractual cases are interesting since unlike corporate law claims mostly between shareholders and executives, they instead involve disputes between new executives (via the corporation) and former ones. At issue is invariably the question of whether or not a contractual claim to a particular piece of a golden parachute is available to the old executive within a particular fact situation. Sometimes for example the granting of certain elements might be subject to the discretion of the board[75], contingent on certain events whose occurrence is disputed[76] or a dispute might exist with respect to whether the corporation's internal procedures for approving them had been met in order for a contractual commitment to have been formed (particularly when oral promises or alterations to a contract are involved). [77]

A subset of the cases based on contractual claims involve breaches of corporate law fiduciary duties by the officer. In *Southern Pacific Resources Corp. v. Gulka*[78], a case brought by a corporation against the former CEO of a corporation it had amalgamated with, at issue was whether the defendant was required to pay back to the company an "advance on severance" he had taken without anything in his contract entitling him to it, though the board had later approved a retroactive employment agreement that would have provided him with severance on, inter alia, termination without cause. The Court characterized the defendant's actions as a "flagrant" breach of his fiduciary duties and found that he was not entitled to severance under the retroactive contract since they gave the board just cause to demand his resignation. In *969625 Ontario Ltd. v. Goldstone Resources Inc*.[79] the plaintiff was a former CEO and director of the defendant suing for compensation under a Management Services Agreement for work in his position. The Court found that the Agreement, which provided him with extremely generous remuneration, had been "rubber stamped by a Compensation Committee and board of directors that was friendly to him rather than mindful of the responsibilities the law imposes."[80] The Court, examining both the procedure followed by the compensation committee in approving the contract and the reasonableness of the terms of the compensation, held that they fell outside the protection of the business judgment rule and, owing to the breach of fiduciary duties in approving the contract, set aside the terms regarding compensation.

[74] See for example *Hannan v. Methanex Corporation* 26 CCEL (2d) 103.
[75] *Weedon v. Sherrit*, 2002 ABQB 217 (CanLII)
[76] *Joyer v. Creditloans Canada Financing Inc*., 2017 BCSC 2341
[77] *Cardiff v. Fincentric Corporation*, 2005 BCSC 173
[78] 2012 ABQB 676
[79] [2017] O.J. No. 519
[80] *Ibid,* at para 98.

4.3.2 Employment Law

The relationship of directors in their role as directors with the corporation is not governed by employment law, but that of officers is. The latter may therefore sue for wrongful dismissal when they are terminated without cause, and the quantum of their notice period and other elements of severance (a substantial amount of their overall compensation in many cases) is often at issue.[81] As noted earlier in many cases the existence of generous golden parachute provisions in the employment contracts of top executives which far exceed what they would be entitled to in a wrongful dismissal claim has had the tendency to remove many cases in which an executive was terminated without cause from the realm of wrongful dismissal actions.

In addition to wrongful dismissal claims, a small number of cases have tested whether executives are able to claim remuneration based on various pieces of employment standards regulations. These types of claims, which haven't appeared since 1981 and involve small claims against small companies, have been rejected by courts on the grounds that the executives in question were not "employees" covered by the respective Acts at issue.[82]

4.4 Bankruptcy/Arrangement Law

In the early 20th century executive pay cases would often come to court during a bankruptcy proceeding which pitted the executive against other corporate creditors. At issue in most of these early cases was whether the executive's pay had been properly approved under the corporate law SOP provisions in effect in Ontario in particular[83], with courts generally upholding or dismissing executive claims to pay based on whether the formal requirements had been complied with.

After a lull in the mid-late 20th century, executive pay has re-emerged as an issue in Bankruptcy and Arrangement Proceedings in recent years as courts have been asked to approve Key Employee Retention Plans (KERP) which normally involve special payments to executives to keep them in their positions throughout the process or until some specified objective is achieved. These are significantly different from most other claims for a number of reasons. One is that they are quite controversial since they involve payments to the stakeholder group – management – that is most often blamed for the company having entered into an arrangement proceeding in the first place.[84] A second is that the amounts paid under a KERP are usually above and beyond whatever they were contractually entitled to. And finally it is one of the few court proceedings in which creditors and employees (through their unions) are able to directly challenge a piece of executive compensation since the court in such proceedings is being asked to approve a plan that may affect the prioritization of their claim to corporate assets.

5 Cases Before the Canadian Courts: From 1876 to 2018

[81] *Turner v. Canadian Admiral Corp*. [1980] O.J. No. 3002, 1 C.C.E.L. 130, 3 A.C.W.S. (2d) 162
[82] *Winkler v. High-Test Electrical Manufacturing Ltd*. [1964] O.J. No. 849, [1965] 1 O.R. 386, 48 D.L.R. (2d) 136
[83] *Re Queen City plate Glass Co. Eastmure's Case* [1910] O.J. No. 235, 16 O.W.R. 336
[84] These controversial nature of KERP is discussed in *Warehouse Drug Store Ltd. Warehouse Drug Store Ltd*., Re24 CBR (5th) 275

5.1 Overview

The previous section outlined the legal avenues by which executive compensation disputes might be brought before a court. In order to better understand their relevance it is necessary to get a better understanding of what types of cases are brought, how often they are brought, how courts respond and how trends have evolved over time. In order to provide us with data to answer these questions, the author searched the LexisNexis and Canlii case law databases for all reported cases in the common law provinces of Canada which met the following criteria:

> i) it be a dispute over the entitlement of ii) an officer or director of a corporation to iii) all or part of their remuneration iv) regardless of the grounds for the claim, identify of the plaintiff or form of remuneration at stake (salary, bonus, stock options, retirement bonuses and so on).[85]

The search resulted in 143 decisions. 115 of these are the decisions of trial courts, 24 are from provincial appeal courts, 3 are from the Supreme Court of Canada and 1 is from the Judicial Committee of the Privy Council.[86] It is important to note the caveat that even if complete, the record of judicial decisions is an imperfect proxy for an assessment of the influence of courts since the vast majority of cases filed are settled out of court prior to trial and thus do not leave a record in case law databases. Since the threat of litigation may be as great, or even greater, than actual court outcomes themselves this is not a minor omission. Also since the data set of cases is relatively small, minor fluctuations in the number of certain cases caused by sheer chance may either exaggerate or understate their importance relative to the (unknown) number of cases filed. Nonetheless, the case law databases do have the advantage of existing and thus represent the "least worst" source of evidence by which to try to assess these questions. Moreover even with these caveats in mind certain trends do become apparent in the data set obtained from the databases which seem to reflect more than mere accidents of reporting. These are described below.

5.2 Descriptive Data: When, Where, Who, Why and How

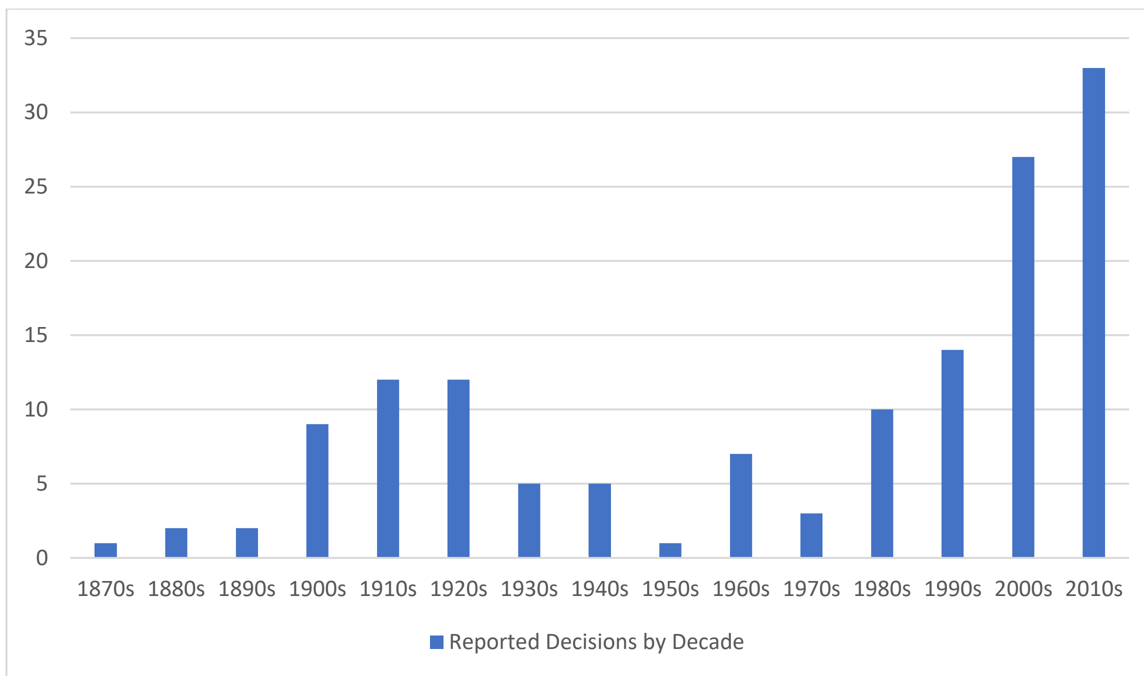
What did the case search turn up? First it is illustrative to address the temporal question: how has the volume of case law developed over time? The earliest case dates to 1876, though executive compensation cases were relatively few and far between for the remainder of the 19th century. For the first three decades of the twentieth century however there was a mini boom in such cases, averaging more than ten per decade. From the 1930s to the 1970s there was an interregnum period with very few cases, reaching a nadir of one for the entire decade of the

[85] The method of search began with simple combined key word searches (such as "compensation" and "executive"), then reading cases found for previous decisions cited and tracing lines of authority and then moving on to another key word search. Owing to the nature of the endeavor it cannot be stated conclusively that the data set contains all cases which meet the above criteria, but it can be stated that the best efforts were expended to keep any from slipping through the cracks.

[86] For a full list of the cases, see Appendix 1. Additional data on how each case was categorized can be obtained from the author on request.

1950s, before an upswing began in the 1980s which has grown to a boom in such cases in the first two decades of the 21st century.

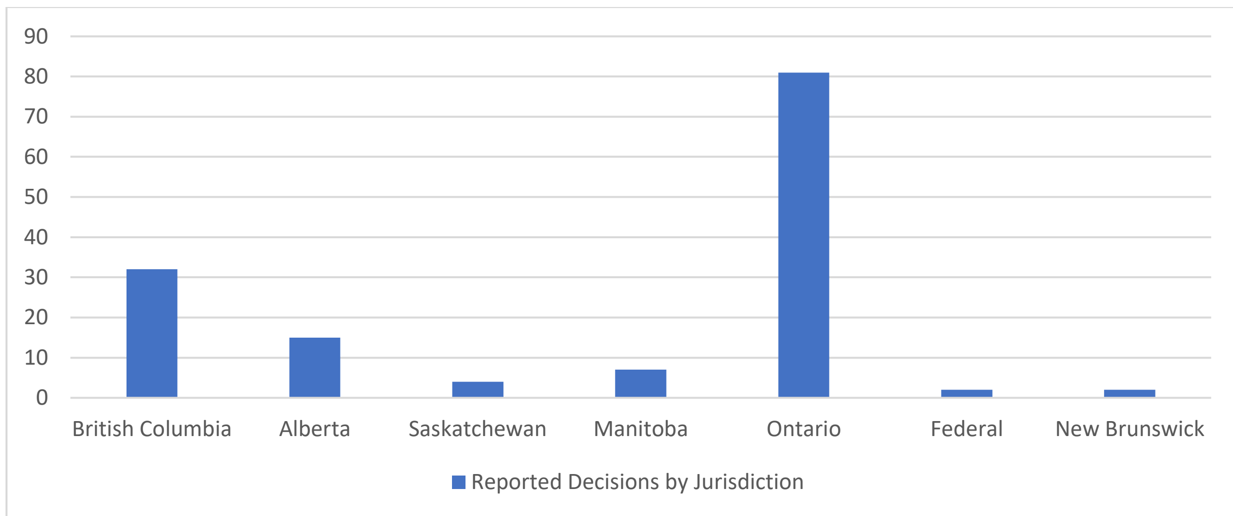
Chart 1: Reported Decisions by Decade[87]



Turning to the geographical question of "where" we find, perhaps unsurprisingly, that Ontario has been the locus of by far the most executive compensation cases as indicated below in Chart 2. This has remained consistent throughout the period from 1876 to the present. British Columbia and Alberta have also emerged as centres of executive pay litigation, the former in particular having produced a great deal of case law in the 21st century. Manitoba emerged as an early Western rival to Ontario in the early 20th century, but largely disappeared thereafter, all but one of its cases being reported in the 1930s or earlier. The Maritimes are represented by two cases from New Brunswick. Two Federal cases appeared in the Exchequer Court of Canada in the early 20th century and dealt with the compensation of directors at companies incorporated under the Railways Act.

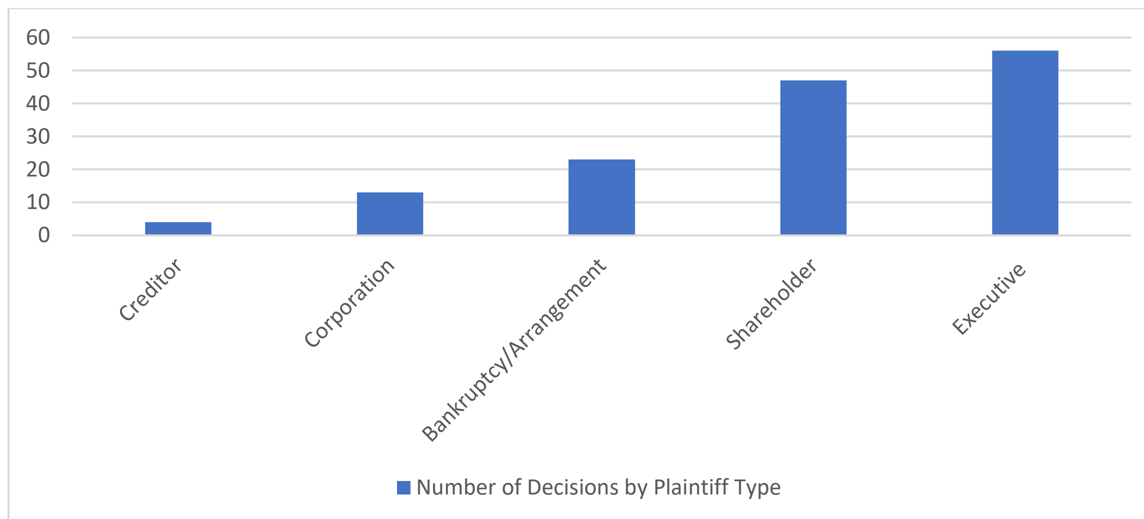
[87] Cases from the 2010s only include cases through to June, 2018.

Chart 2: Reported Decisions by Jurisdiction



And now the question of "who". Whereas the prototypical executive compensation dispute is usually said to involve shareholders suing, in fact they come a close second in the data set to executives themselves, usually suing the company for unpaid compensation using a variety of causes of action. Corporations are themselves the plaintiff in a significant number of cases, while creditors are also represented. Executive Compensation also often appears in bankruptcy or corporate arrangement proceedings which, by their nature, do not have a plaintiff and are thus listed separately in Chart 3.

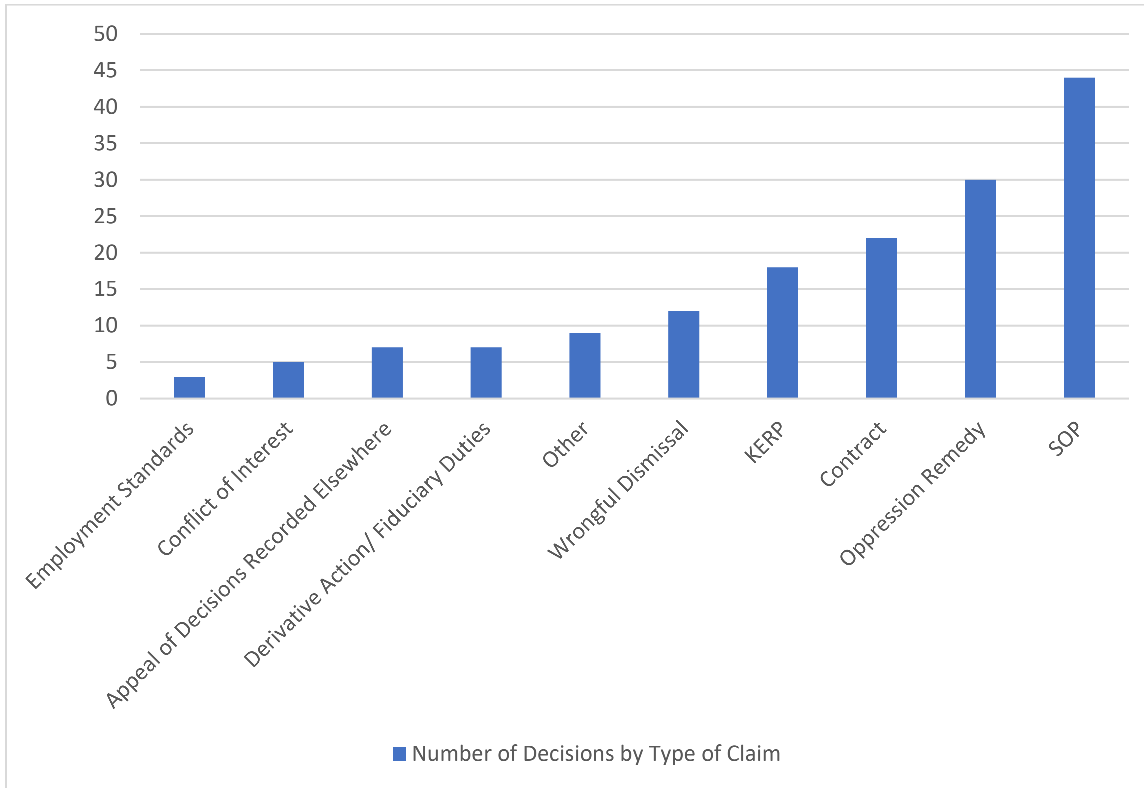
Chart 3: Number of Decisions by Plaintiff Type



And now the question of "how". What causes were the plaintiffs suing for? Here we find some quite interesting trends which give additional meaning to the previous charts. Chart 4 below divides the cases by the types of claims.[88]

Chart 4: Number of Decisions by Type of Claim

[88] There are 157 observations in this chart from only 143 cases since in some cases more than one claim was advanced and these are recorded here separately despite appearing in the same reported decision. For example the case UPM-Kymmene Corp. v. UPM-Kymmene Miramichi Inc., 2002 Canlii 49507 (Ont.) involved oppression remedy, conflict of interest and breach of fiduciary claims being brought simultaneously so these are reported separately in this chart. Also it should be noted that there are seven cases listed as "Appeals of Decisions Recorded Elsewhere" – these are appeals of trial court decisions also included in the data set, listed separately here to avoid duplication of the same dispute. This does not include all of the Appellate level decisions however as those which did not have an accompanying trial court decision (common especially in earlier cases) are simply recorded according to the type of claim in the same way trial court decisions are. The cases listed as "Other" are mostly decisions on various pre or post trial motions.



First it is worth noting that the most common case type is one which hasn't appeared before a Canadian court since 1982 – cases involving the early Say on Pay (SOP) provisions that used to exist in many Canadian corporate laws.[89] The mini boom of the early 20th century is almost entirely made up of cases in which Ontario's version of the rule was at issue. The rule also explains a certain amount of the diversity in plaintiff types outside the prototypical shareholder suit since it could be used by almost any party. In some cases shareholders would challenge pay on the basis that it had not been approved of by the shareholders meeting, while in others an executive suing the company could use the fact that their pay had been properly approved of pursuant to the rule to press a claim. The rule also often appeared in bankruptcy proceedings which pitted the claims of creditors against executives.

A second result worth highlighting is the almost complete lack of derivative actions on the one hand and the high number of oppression claims on the other. Despite having derivative actions in all Canadian corporate law statutes, Canadian shareholders unlike their American counterparts do not use this mechanism to challenge pay. Of the seven cases classified as "Derivative Action/Fiduciary Duties" only four were brought by shareholders (the other three by the corporation) and none used the statutory derivative actions contained in the various provincial or federal corporate law statutes. Rather they were all early cases, the most recent being reported in 1973, in which shareholders brought claims on behalf of the company using common law

[89] S. 48 Ontario Companies Act of 1897 RSO 1897, c.191.

exceptions to the rule in Foss v. Harbottle.[90] In contrast a large number of oppression remedy cases are present and these represent the majority of cases which have appeared since the 1990s.

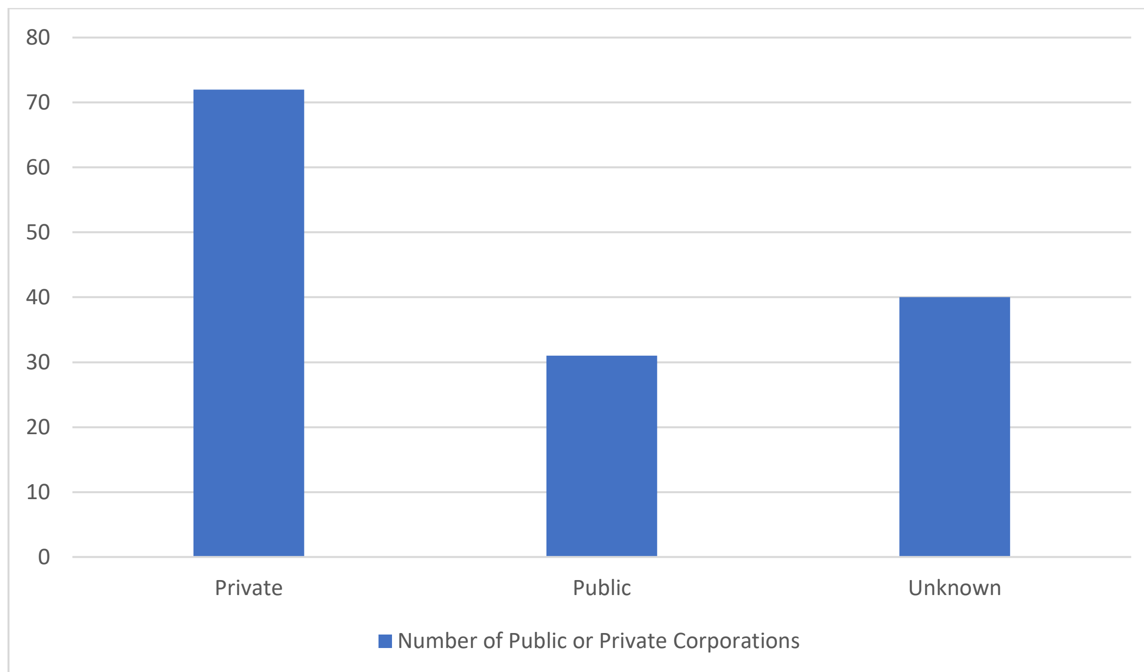
Wrongful dismissal and contractual claims brought by officers against the corporation also form a significant number of cases. In selecting wrongful dismissal cases those in which liability or the length of notice periods were the only issue are excluded since they are indistinguishable from cases involving normal employees (and with liability is unrelated to pay per se). The high number of contractual claims (as distinct from wrongful dismissal claims) is interesting as it reflects the fact that many officers have effectively contracted out of the common law wrongful dismissal system. Most of these cases involve officers who were dismissed without cause after a change of control transaction and were suing based on golden parachute provisions which would have given them much more than they would have been entitled to based on a bare wrongful dismissal claim. It is also worth highlighting that wrongful dismissal claims have become increasingly rare in recent years. Most of them appeared from the late 1970s to early 1990s and only one dates to after 1991.

KERP approvals are cases in which approval for Key Employee Retention Plans in either Company Creditors Arrangement Act[91] (CCAA) or Bankruptcy and Insolvency Act[92] (BIA) proceedings was sought. These cases are relatively new, the first being decided in 2006[93] and have become a regular since.

Another question that the study gathered some data on is what type of company was the subject of the most executive compensation related litigation. Publicly traded corporations and privately held ones tend to present different profiles in terms of executive compensation. Publicly held ones are, by virtue of their size, more likely to pay their officers more and the more egregious pay packages that are the subject of popular outrage are dominated by officers at publicly traded companies. Conversely, while pay at privately held companies may on average be lower due to most (though not all) of them being quite a bit smaller, small size and lack of public shareholders may also lead to both a lack of formalities and less oversight, which can create opportunities for dominant personalities in the business to pay themselves excessively. From the cases in which it could be determined if the company was private or public the former were found to outnumber the latter at a little over a 2:1 ratio.

Chart 5: Number of Public and Private Corporations

[90] *D'Amore v. McDonald et al*. [1973] O.J. No. 1860, [1973] 1 O.R. 845, 32 D.L.R. (3d) 543
[91] R.S.C., 1985, c. C-36.
[92] R.S.C., 1985, c. B-3.
[93] *Warehouse Drug Store Ltd. Warehouse Drug Store Ltd*., Re24 CBR (5th) 275

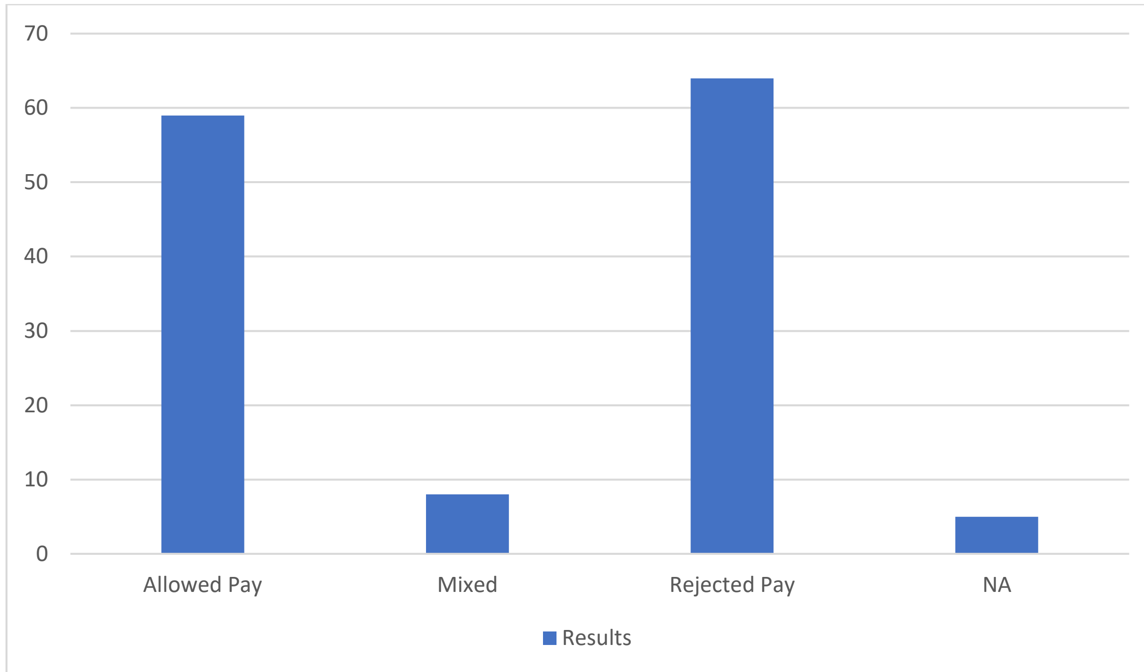


Finally we come to perhaps the most important question, which is how the court reacted to these myriad cases brought before them. The various types of claims brought by parties on opposing sides of the pay issue – executives on one hand seeking to claim pay, shareholders, creditors and the corporation on the other usually seeking to challenge it – means that data on plaintiff success rate per se would be largely meaningless. To simplify things, we instead focus on how the courts dealt with the pay at issue itself, either allowing or rejecting it. Cases in which the courts allowed pay would include such things as successful contractual claims by officers for pay and unsuccessful shareholder oppression claims against pay: in both of these types of case the court upheld the pay at issue. Cases in which the court rejected the pay would be the opposite: unsuccessful contractual claims by officers for pay or successful shareholder oppression claims against pay: in both of these the court refused to uphold the pay at issue. In some cases the parties achieved mixed results with the court both allowing and rejecting discreet parts of the pay in question (perhaps finding that a bonus a CEO received was oppressive but a high salary was not), and these fall into the "mixed" category.

The results recorded in Chart 6 below[94] show that courts have been willing to reject executive pay (64 cases) slightly more often than they have upheld it (59 cases).

Chart 6: Results of Decisions

[94] There are 136 observations out of 143 decisions. In the seven cases where both a trial decision and an appeal decision are in the data, only the results in the appeal decision are recorded. Cases categorized as "NA" are those in which the court did not render a decision on the merits (mostly pre trial motions).

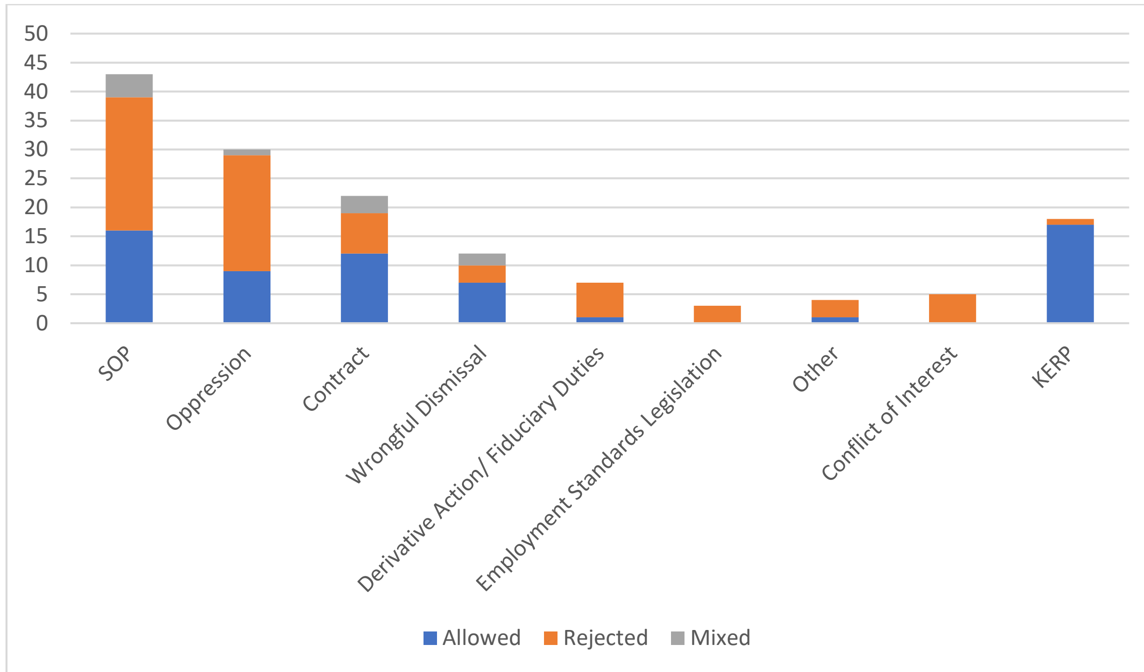


The above Chart however hides a significant amount of variation in terms of how the courts reacted to specific types of claims, which are broken down in Chart 7 below.[95] In terms of deference to pay, the courts have shown a sliding scale. On the one extreme the courts have almost never had a Key Employee Retention Plan brought before them that they couldn't live with, approving them in 17 out of 18 instances. In wrongful dismissal and contractual claims executives achieved success roughly half the time.

On the other end of the scale courts have subjected executive compensation to an extremely high degree of scrutiny in oppression claims, finding that the pay was oppressive in 20 out of 30 instances. In the early 20th century as well courts were routinely willing to strike down claims for executive pay (or uphold claims challenging pay) based on failure to adhere to the requirements of the Say on Pay rule, rejecting the pay in the majority of instances. The small number of derivative actions/ fiduciary duties cases, employment standards legislation based claims and conflict of interest claims were also unkind to executive compensation.

Chart 7: Results of Decisions by Type of Case

[95] Cases where the court did not render a decision on the pay at issue in the case are excluded from this Chart. Mostly these cases (5 in total) were decisions on pre trial motions rather than decisions on the merits. Where both a trial decision and an appeals court decision in the same case exist, only the appeals court decision is included in this Chart.



6 Discussion: What Role for the Courts?

6.1What the Courts Do

The preceding section provides us with a map to understanding the role played by the courts. As an ex post mechanism, this role has evolved over time. In the early twentieth century they were frequently asked to intervene in disputes between shareholders, creditors and directors over the latter's claims to pay, which they often rejected on the basis that the formalities required by the say on pay rule had not been met. In the mid twentieth century such cases disappear and between the 1930s and 1980s the courts were rarely asked to intervene in executive pay disputes. Since the 1990s however the courts have come to again be frequently resorted to, only with a significantly different set of disputes to deal with.

While the literature in the US on the role of the courts has generally viewed them as a venue for shareholder challenges to pay using the derivative action,[96] this study indicates that they play a more complex role (at least in Canada). On the one hand they serve as a venue for shareholders (and sometimes other stakeholders) to challenge pay using the oppression remedy. In such cases the courts often assess the fairness and reasonableness of the actual pay in question, something courts dealing with a derivative action do not need to do. And the courts have shown a willingness to strongly scrutinize pay, rejecting it in a substantial majority of cases. On the other hand the courts also serve as a venue for executives to press their claims for pay, often on contractual grounds, where they have met with more mixed levels of success. In short, recourse

[96] See for example Thomas and Martin, supra note 2.

to the courts today is largely a tool either for shareholders and occasionally creditors to challenge pay, and for executives to demand it.

6.2 What the Courts Might Do

The apparent shortcomings of the institutional framework in dealing with executive compensation as an inequality problem raises the question of whether the courts might play some role in addressing that. Here the paper explores an argument that springs from an observation in the previous section: the courts are used by all the main stakeholders to either challenge or defend executive pay except one: corporate employees.[97] Would allowing them to "join the fray" turn the courts into a more robust mechanism for monitoring executive pay in a way that better incorporates inequality and agency concerns?

Within the existing legal framework the absence of employees in this area of litigation makes sense – they are not parties to the contract between executives and the corporation, nor are they generally availed any rights under corporate law that shareholders possess. At the same time, however, from an inequality perspective providing employees with a means of challenging executive pay decisions has some obvious merits. In public discourse at least they are often the ones whose interests are portrayed as being, along with shareholders, most ill-served by the rise in executive pay and their own relative pay is usually used as the most effective evidence to bring that point home. Also, as noted earlier, the bifurcation of corporate decisions on pay policies between those affecting executives on the one hand and regular workers on the other is having a spill over effect on inequality levels in general.

From an agency perspective, the benefits are perhaps less clear cut. It is beyond the scope of this paper to go into to great detail, but this ties in to a debate about the function of corporate law itself. Those subscribing to a "nexus of contracts" approach are quite hostile to the idea of giving employees legal rights in corporate law[98], largely on the basis that their rights are already protected by the terms of their contracts and by general rules of employment law. Under this view corporations optimally exist as spaces in which various stakeholders privately arrange their contractual relations with each other. Providing employees with additional rights under corporate law is thus undesirable since this would impose terms on the overall corporate "contract" that the stakeholder parties themselves would not have negotiated.[99]

The general problem with this approach, however, is that it does not do a good job of accounting for the inequality of bargaining power and other hurdles that may prevent optimal contracting, and the externalities that these may create for society as a whole. As noted earlier, these concerns are particularly acute with respect to executive compensation practices due to their impact on broader income inequality. This has prompted some to argue in favor of increasing the role of the employee stakeholder group in corporate decision making processes through a variety

[97] Unions representing employees have been represented, as creditors, in some KERP cases, but outside that narrow context they are completely absent.
[98] Mohamed F. Khimji and Jon Viner, *Oppression – Reducing Canadian Corporate Law to a Muddy Default* 47 Ottawa Law Review (2016) 123 at 172-173.
[99] Ibid.

of means, including changes to corporate law.[100] Employees may be well placed as monitors of corporate decisions which cause negative externalities owing to their access to information, their own vulnerability to such decisions, and the fact that their interests and views are likely to incorporate more information than the mere "bottom line" in comparison to other stakeholders like shareholders.[101]

This paper does not take the position that an increase in employee influence on decision making in corporate governance should come via a greater recourse to litigation (as opposed to other potential methods) per se, but it does here explore the merits of giving employees the ability to challenge executive pay decisions in particular with that end in mind. In the Canadian context the area with the most potential for effecting such a change presents itself in the oppression remedy, which has the benefit of already existing and being the main locus of executive pay litigation today. It also has the advantage of treating pay as a question of whether the compensation at issue was fair and reasonable, which gives it a flexibility that other potential areas like derivative actions lack.

As noted earlier the majority of plaintiffs using the oppression remedy to challenge executive pay are minority shareholders, who were its' main intended beneficiaries when it was introduced to the CBCA.[102] Employees are not, however, specifically precluded from bringing an oppression remedy application since the definition of "complainants" in both the CBCA and its provincial counterparts contains a residual category which courts may recognize at their discretion. Courts have in fact recognized employees as complainants in a number of cases, but only in very limited circumstances. This is due to the fact that while employees may be recognized as complainants, the oppressive conduct complained of must have negatively affected the interests of security holders, creditors, directors or officers[103] rather than the interests of employees themselves. Where an employee brings an application they must thus also fit themselves into one of those categories. In *Downtown Eatery (1993) Ltd. v. Ontario*[104] for example the Ontario Court of Appeal allowed an employee to seek an oppression remedy against the controlling shareholders of a corporation he had worked for. The controlling shareholders had stripped the corporation's assets in order to prevent the complainant from collecting on a wrongful dismissal award, and the court allowed the claim but on the basis the act had been unfairly prejudicial to his interest as a creditor, not as an employee. In contrast in *Joncas v. Spruce Falls Power & Paper Co.*[105] the Court, while recognizing a group of employees in a class action as complainants under the discretionary category of Ontario's rule, granted summary judgment dismissing their claim on the grounds that they could not fit themselves into one of the enumerated categories harmed by the oppressive conduct. There the employees had, as a result

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[100] Brett H. McDonnell, *Strategies for an Employee Role in Corporate Governance* 46 Wake Forest Law Review (2011) 429.
[101] Ibid 106-107. McDonnell discusses these factors in terms of environmental sustainability, but they equally apply in the context of executive compensation decisions.
[102] Robert W. Dickerson, John L. Howard and Leon Getz, *Proposals for a New Business Corporations Law for Canada Volume 1: Commentary* (Ottawa: Information Canada, 1971) at 162.
[103] S. 241(2) R.S.C. 1985, c. C-44.
[104] 54 O.R. (3d) 161; [2001] O.J. No. 1879.
[105] 48 O.R. (3d) 179; [2000] O.J. No. 1721

of being on long term disability, been excluded from a reorganization that had gifted shares in the corporation to employees. Not having actually received any shares they had no interests as security holders (being "potential" security holders was held to be insufficient).

One obvious way of getting around this problem would be to amend the CBCA and provincial corporate laws to include employees specifically as one of the stakeholder groups whose interests are protected from oppression. This would not necessarily be legislatively easy given the need to make changes to both Federal and Provincial laws, but *ad arguendo* we can put that concern to the side. Such a change would have ramifications far beyond the context of executive pay disputes since it would give employees the ability to challenge any decision that was oppressive to their interests. This may raise the problem of a significantly increased litigation risk for corporate managers and controlling shareholders. Though previous concerns in this regard about expanding the field of stakeholders able to bring oppression claims have proven unfounded[106] in order to be effective there would in fact need to be some degree of increased *risk*, if not an increase in actual litigation.

Approaching it from the narrow view of its use in executive pay litigation there are two additional concerns that courts would have to deal with. The first is how to define the relationship between an executive pay decision on the one hand and an outcome oppressive to the interests of employees on the other. There would need to be some sort of causal effect between the two which may be difficult to establish in practice. In minority shareholder claims most successful cases involve either pay that amounts to little more than egregious asset stripping in closely held firms, or pay decisions in publicly held corporations that in both process and result are grossly unfair to the shareholders. In such cases the connection is relatively clear. Potential employee cases may overlap with these since such actions would likely disadvantage them as well, but they may also encompass a wider range of factual situations, such as high executive pay contracts being concluded in a period of restructuring, or with a temporal connection to another decision which adversely affected the interests of employees.

A second issue is the approach of courts to assessing the fairness and reasonableness of executive pay. Their current approach has generally been to use market value as the standard.[107] This is usually determined based on expert advice which in turn relies on industry comparisons, similar to those which compensation committees often use to evaluate pay. In that context they have the advantage of providing a knowable procedure that directors can rely on, thus avoiding uncertainty. This also makes sense when dealing with shareholder litigation, since their interests cannot reasonably be held to be oppressed by transactions consistent with market values. Employee interests on the other hand may not be as well accounted for by this standard. The disadvantages of relying on market value largely mirror the concerns with markets as institutions that control executive compensation noted earlier: they have no mechanisms that allow the costs of inequality to be incorporated into the market value and they also do a poor job of

[106] Stephanie Ben-Ishai and Poonam Puri, *The Canadian Oppression Remedy Judicially Considered:1995-2001* 30 Queens Law Journal (2004) 79 at 108.
[107] For example see *Wonsch (Litigation Guardian of) v. Wonsch*, 76 O.R. (3d) 198; [2005] O.J. No. 3187, *Carlson Family Trust v. MPL Communications Inc*. 2009 ABQB 77

incorporating the agency concerns of employees. Put simply, where markets themselves are oppressive to the interests of employees, they offer a poor benchmark for measuring the existence of oppressive conduct against them. Courts would thus need to take this into account for an employee oppression claim against executive compensation to be effective, such as by evaluating it not solely in terms of market rates but also in relation to the oppressive outcome being complained of. Under such a standard an executive pay contract which might be reasonable by the standards of the executive employment market could nonetheless be deemed oppressive when measured against the pay of regular employees in certain circumstances.

This is not an exhaustive list of the concerns that expanding the oppression remedy to employees would raise, but even assuming for the moment that these persisted to some degree depending on how the courts developed standards for addressing them, the resulting mechanism could provide a moderating influence on executive pay decisions. The threat of litigation would ideally force boards to take such issues as the disparity between executive and regular worker pay into account when making pay decisions and provide a cudgel that would force them to incorporate employee interests into overall pay policies. How the benefits and drawbacks of an approach like this fare in comparison to other policy options, and how feasible it might be in jurisdictions outside Canada, remain areas for further research.

7 Conclusion

The rise of executive pay has created a problem which the existing institutional arrangements in many developed countries are having difficulties dealing with. Canada is no exception to this. Its markets, norms and legal system have struggled to respond in particular to the inequality problems this shift has contributed to, and like many other jurisdictions it finds itself debating what to do about it.

This paper suggests that the courts play a more complex role in executive compensation than previously appreciated. They are resorted to by both shareholders and executives to either challenge or enforce claims to such pay. Over time the nature of claims has shifted markedly in the Canadian context. In the early 20th century the say on pay rules provided a means for both sides to litigate pay. In the mid 20th century executive pay related disputes almost entirely disappeared from the courts, but since the 1980s there has been a renewed boom, in large part (though not exclusively) driven by shareholder litigation. Unlike the United States, in Canada this litigation has not utilized the derivative action but rather the oppression remedy, giving it a very different character since this focuses the inquiry on the fairness of the pay in question rather than on whether or not specific duties have been complied with, and courts have been very sympathetic to such cases.

The paper also suggests however that this growing volume of litigation has itself done little to balance inequality and agency concerns with executive pay. At the same time employees, perhaps the stakeholder group best suited to raising inequality concerns, have been excluded from litigation relating to executive pay. The paper explores the idea of expanding their role through the oppression remedy. While currently impossible, amending the CBCA and provincial

corporate laws to include their interests among the stakeholders protected from oppressive conduct could allow them to use the courts to monitor executive pay using standards that incorporated inequality concerns that are currently lacking. Such a change would create a number of challenges, but should at the least be considered one of the policy options available for dealing with the problem.

Appendix 1

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