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**CORPORATE LAW, PENSION LAW AND THE TRANSFORMATIVE POTENTIAL
OF PENSION FUND INVESTMENT ACTIVISM**

FREYA KODAR

**A thesis submitted to the Faculty of Graduate Studies
in partial fulfilment of the requirements
for the degree of**

Master of Laws

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York University
Toronto, Ontario**

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by **Freya Kodar**

a thesis submitted to the Faculty of Graduate Studies of York
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Abstract

Pension funds, the funds held in trust to support occupational pension plans, represent significant funds of capital. Together with other institutional investors such as mutual funds and hedge funds they have become important actors in financial markets – nationally and internationally. They have significant holdings in national and transnational corporations. They are also deeply implicated in the financial instability of global financial markets, and free market globalization.

In the past decade some members of the labour movement have sought to have more active involvement in pension fund investment decision-making. They have seen this involvement as a strategy for influencing corporate management and practice, and for encouraging productivity, local and regional development and long-term growth and sustainability. More radically, they have seen it as a means to create new conceptions of “value” that include factors other than monetary return, and to transform capital by gaining greater social and democratic control over it. They have pursued strategies such as advocating for greater representation on pension plan boards of trustees or investment advisory committees, shareholder activism including proxy voting, investment screening and economically targeted or community investing.

This thesis assesses these strategies within the Canadian context and looks at their transformative potential in light of pension law and corporate law principles and practice. It argues that the current strategies of pension fund activists, even if extended to other types of investors – individuals and institutional – are not likely to lead to more democratic and social systems of corporate regulation. It also suggests that pension fund activists have not fully explored the possibilities created by the fact that pension funds have many “owners” and “beneficiaries” – legal or otherwise. Nor have their strategies adequately considered the suggestion that the uncertainties of corporate law make completing the separation of the corporation from the shareholder, and creating democratic and social systems of corporate regulation, a more appropriate and meaningful political project. In short, they have not challenged the limitations of pension law and corporate law with strategies that recognize the corporation and markets as social institutions that should be democratically and socially regulated. One avenue for doing this appears to be through utilizing the public pension system, particularly by expanding a funded public pension system, and democratizing the fund investment decision-making process.

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INTRODUCTION

Ensuring adequate levels of retirement savings for an ageing population and for ourselves in retirement has become a significant public issue in recent years. In Canada, most people rely on a combination of public and private pensions and/or income from their retirement savings plans to support themselves in retirement. Recent government and media attention on the public pension system has focused on a pending “crisis” in the ability of the Canada/Quebec Pension Plan, the public pension system,¹ to support the ageing population.² In response, many have advocated various forms of privatization of the Canada Pension Plan (CPP), from allowing individuals to opt out, to replacing it with individual savings plans.³ Although the reforms that were ultimately implemented in 1997 did not privatize the CPP, one of the reforms was the establishment of an investment fund managed by private financial institutions which can be invested in the stock market, and “it could be argued that the ... move to partial funding of the CPP is the first step along the road to privatization.”⁴

¹ The Canada/Quebec Pension Plan is funded by the contributions of employers and employees. If an individual’s CPP/QPP benefit falls below a minimum level, it is supplemented by the federal government’s Old Age Security program which includes the Guaranteed Income Supplement and the Allowance for spouses and partners, and is funded from general revenue.

² See e.g. Association of Canadian Pension Management, *Dependence or Self-reliance: Which way for Canada’s Retirement Income System?* (Toronto: Association of Canadian Pension Management, 2000); Government of Canada, *An Information Paper for Consultations on the Canada Pension Plan* (Ottawa: Department of Finance, 1996).

³ For a review and critique of these proposals see generally M. Condon, “Gendering the Pension Promise in Canada: Risk, Financial Markets and Neoliberalism” (2001) 10 *Social & Legal Studies* 83; M. Townson, *Pensions Under Attack: What’s behind the push to privatize public pensions* (Ottawa: Canadian Centre for Policy Alternatives & James Lorimer, 2001) [hereinafter *Pensions Under Attack*].

⁴ *Pensions Under Attack*, *ibid.* at 32.

In the private system, attention has focused on the cost and the risk to employers of providing occupational pension plans.⁵ Occupational pension plans are either defined contribution or defined benefit plans. Defined benefit plans guarantee a level of pension benefit based on a formula set out in the plan. Employer contributions must be such that, together with any employee contribution and the plan's investment returns, the promised pension can be provided. Defined contribution plans on the other hand, do not guarantee a specific level of pension benefit. The pension benefit is instead provided from the accumulated contributions of the employer, and in some cases the employee. Increasingly, new occupational pension plans are defined contribution plans.⁶ These plans, in addition to reducing the financial risk to the employer while increasing individual employees' market risk, also eliminate the income redistribution that occurs within a defined benefit pension plan system.

In addition to the shift from defined benefit to defined contribution as the favoured type of plan, many employers simply do not offer pension plans for their employees, or they contribute to an employee's individual registered retirement savings plan (RRSP). Individual plans and contributions to them are on the increase. The federal government's 2001 tax expenditure estimates for example, show the tax expenditures for

⁵ These are also referred to as employer-sponsored or employer-based pension plans and include registered pension plans, deferred profit sharing plans and group registered retirement savings plans.

⁶ "Survey of Pensions" *The Economist* 362:8260 (16 February 2002) 3 at 4-5, 15-21; M. Townson, *Reducing Poverty among Older Women: The Potential of Retirement Income Policies* (Ottawa: Status of Women Canada, 2000) at 33; Statistics Canada, *Pension Plans in Canada, January 1, 2000*, Catalogue no. 74-401-XPB (Ottawa: Ministry of Industry, 2001) at 6 & 37-38 [hereinafter *Pension Plans in Canada*].

individual RRSP contributions at \$9,035 million in 1996 with a projected increase to \$12,005 million in 2002.⁷

Commentators have noted that the changes to the private and public pension systems as well as the reform proposals are reflective of a political and economic environment characterized by increased globalization, economic restructuring, rapid technological change and the increasing influence of a neoliberal political agenda.⁸ This agenda emphasizes limited state intervention in the market, economic liberalization, particularly the removal of barriers to trade and investment, and reductions in state-provided social benefits and services in favour of increased reliance on the market to provide for human needs.

It offers a vision of society in which individuals provide for themselves through the market, rather than one of social citizenship whereby individuals provide for one another through state redistributive mechanisms.⁹ In the context of Canadian pension

⁷ This represents the tax expenditures for both the tax deductions for RRSP contributions and the non-taxation of RRSP investment income. When the taxation of RRSP withdrawals is factored in, the net tax expenditures are estimated at \$6,845 million in 1996 and projected to be \$8,530 million in 2002. Government of Canada, "Table One – Personal Income Tax Expenditures" in *Tax Expenditures and Evaluations 2001* (Ottawa: Department of Finance, 2001) [hereinafter *Tax Expenditures and Evaluations 2001*]. It is also interesting to note that RPP assets grew 138% between 1988 and 1998, while RRSP assets increased by 200% during the same period. Statistics Canada, *Trusteed Pension Funds: Financial Statistics 1998*, Catalogue no. 74-201-XPB (Ottawa: Minister of Industry, 2000) at 5 [hereinafter *Trusteed Pension Funds*].

⁸ See generally Condon, *supra* note 3; *Pensions Under Attack*, *supra* note 3; B. Waine, "Workers as Owners: The Ideology and Practice of Personal Pensions" (1992) 21(1) *Economy & Society* 27.

⁹ For example, Anthony Giddens, one of the architects of "New Labour" in the United Kingdom, argues that "social democrats have to shift the relationship between *risk* and *security* involved in the welfare state, to develop a society of 'responsible risk takers' in the sphere of government, business enterprise and labour markets." *The Third Way: The Renewal of Social Democracy* (Malden: Polity Press, 1998) at 100. For commentary about this shift see J. Fudge & B. Cossman, "Introduction: Privatization, Law and the Challenge to Feminism" (Paper prepared for the Conference: Feminist Political Economy: Revitalizing the Debate, Institute for Feminist Legal Studies, Osgoode Hall Law School, 24 March 2001) online: <<http://www.yorku.ca/ifls/privateconf/1intro7.htm>> at 11-14, 18-20; *Pensions Under Attack*, *ibid.* at 40.

policy, Monica Townson argues that “the direction ... is clearly to transfer more of the risk and responsibility for providing for retirement onto individuals. Reducing the role of public pensions in the retirement income system is part of that trend.”¹⁰

The rapid globalization of the last three decades has seen significant increases in both the number of transnational corporations (TNCs) and in the international movement of capital, and has resulted in a decline in state regulation and monitoring of corporate activity in a number of spheres including labour, human rights and the environment. Widespread exploitation of labour, the abuse of labour and human rights, and the degradation of the environment have been linked to pressures from globalization and the effects of neoliberal policies.

While globalization and the pervasiveness of neoliberal ideology have clearly influenced recent changes to pension policy in Canada and many other countries,¹¹ pension funds, the funds held in trust to support occupational pension plans,¹² are not merely passive actors on the global scene. Pensions and other institutional investors such as mutual funds and hedge funds hold and invest increasingly large pools of capital. In Canada, trustee pension funds represent a significant pool of investment capital. They are the second largest pool of investment capital in Canada, after financial institutions.¹³ They are also relatively recent arrivals to the institutional investment arena, having

¹⁰ *Pensions Under Attack*, *ibid* at 32.

¹¹ See generally *Ibid.*; R. Blackburn, “The New Collectivism: Pension Reform, Grey Capitalism and Complex Socialism” (1999) 233 *New Left Rev.* 3 [hereinafter “New Collectivism”]; R. Minns, “The Social Ownership of Capital” (1996) 219 *New Left Rev.* 42.

¹² These funds would be made up of a combination of employer contributions, and/or employee contributions and investment income, although the actual percentages of each would depend on the individual plan.

experienced phenomenal growth since the mid-1960s.¹⁴ This makes pension funds very powerful investors with “increasingly deep roots in many private and public capital markets, and a vital force in Canada’s ability to convert national savings into productive investment.”¹⁵

The exponential growth of pension funds and their effect on capital markets has not been limited to Canada. By 1994 the value of pension funds globally was \$10 trillion.¹⁶ As Robin Blackburn comments, pension funds have assets “equivalent to the total value of shares on the world’s three leading exchanges.”¹⁷ As a result, pension funds have become increasingly important actors in financial markets, and have significant effects on local, national and global economies. It would appear that they also have significant influence, or the potential to influence corporate governance and policy.

Pension funds also provide retirement income to workers who are generally unionized members of the labour movement, a movement that has a history of working to limit many of the excesses of capitalist accumulation through both collective bargaining with individual employers, and participation in the political process to promote a broad range of state regulatory programs including worker health and safety, unemployment insurance, tax reform, and universal public pension and childcare programs. Indeed the labour movement has been an active force in the emerging global political society

¹³ *Trusted Pension Funds*, *supra* note 7 at 1.

¹⁴ Pension funds are approximately seventy-five times larger than they were in the mid-1960s. K. Falconer, *Prudence, Patience and Jobs: Pension Investment in a Changing Canadian Economy: Summary Report* (Ottawa: Canadian Labour Market and Productivity Centre, 1999) at 3.

¹⁵ *Ibid.*

¹⁶ “New Collectivism”, *supra* note 11 at 5.

¹⁷ *Ibid.*

composed of a variety of actors – state and private – who are working in coalition to re-orient or temper the effects of global capitalism and neoliberalism.¹⁸

The significance of the size of the funds that provide their retirement pensions and their implication in some of the problems associated with global financial markets and neoliberalism has not gone unnoticed by the labour movement. Members have watched as these funds have been invested in corporations that use non-union labour, or have poor labour-management relations, violate environmental, labour or human rights, lay off unionized labour, or move production to another region or country. At the same time they found they had little or no ability to affect these decisions, or to advocate for investment decisions with collateral benefits such as job creation or the provision of social services or other economic benefits.

Perhaps not surprisingly, the last decade has also seen a renewed interest on the part of the labour movement in participation in occupation pension fund investment management and decision-making as a strategy for influencing corporate management and practice, and encouraging productivity, local and regional development and long-term growth and sustainability, and more radically as a means to transform capital by gaining greater social control over it. One strategy that labour movement pension fund activists have advocated is for greater representation on pension plan boards of trustees through either joint or sole trusteeship, or they have worked to create advisory bodies to these

¹⁸ See generally R. O'Brien, "NGOs, Global Civil Society and Global Economic Regulation" in S. Picciotto & R. Mayne, eds., *Regulating International Business: Beyond Liberalization* (London: Macmillan in association with Oxfam, 1999) 257.

boards.¹⁹ In terms of investment practices, pension fund activists have focused on three in particular: shareholder activism including proxy voting, investment screening and economically targeted or community investing.

Pension fund activists have sought to use these practices to influence individual corporate decisions, to encourage particular corporate practices such as adherence to labour or social standards, and to encourage investments that are sustainable, create jobs, or address social or economic needs that are not being adequately addressed by regular market allocations. Although not always stated, some pension fund activists have hoped to create new conceptions of “value” through this work. These conceptions of value would include factors other than monetary return, such as for example job creation, and social and environmental benefits.

This thesis assesses these strategies within the Canadian context and looks at the limitations existing regulatory systems place on the effectiveness of these strategies and their transformative potential. The first chapter provides the background for this inquiry and examines the role that pension funds play in supporting global capitalism and neoliberalism, with a particular focus on the distinction between investment practices that create productive return and those that do not: “financial investments in paper” versus

¹⁹ Most pension funds are held in pension trusts of which many are exclusively controlled and managed by employers. A minority are controlled by unions. Others are jointly-trusted, with input from both labour and management into the plan’s administration, often including pension fund investment decisions. In Canada, approximately one-third of total pension assets are managed under “some version of jointly-trusted administration.” Falconer, *supra* note 14 at 7. It is mainly the pension plans of public sector unions that are jointly-trusted.

“real investments” that create jobs.²⁰ Pension funds and their investment practices have been linked to a number of problems associated with global capitalism and financial markets: an emphasis by institutional investors on maximizing share returns over the short-term; the “herd mentality” of investment managers associated with the concentration of pension funds management; and the failure of market investment activities to generate productive activities in terms of job creation and capital investment.

The second chapter traces the development of pension plans and the politicization of the labour movement regarding pension funds. It provides an overview of some of the current work being undertaken by the labour movement in Canada with respect to pension fund management and investment, and outlines the main investment strategies that labour movement pension fund activists have pursued: shareholder activism including proxy voting, screening and economically targeted or community investing.

The third and fourth chapters apply pension law and corporate law to some of the assumptions that underpin the strategies pursued by pension fund activists. They look at the theoretical and practical limitations that these legal regimes create for the transformative potential of these investment strategies. Chapter three applies pension law to two arguments put forward by pension fund activists: first, that pension funds are workers’ deferred wages which belong to them, and they should therefore have more control over how their pension funds are invested; and second, that if workers’ or their representatives had more say about how “their” funds were invested, they would and

²⁰ J. Stanford, *Paper Boom: Why Real Prosperity Requires a New Approach to Canada’s Economy* (Ottawa: Canadian Centre for Policy Alternatives and James Lorimer, 1999) [hereinafter *Paper Boom*].

could consider criteria other than or in addition to monetary rate of return in making investment decisions.

The fourth chapter looks at the uncertainty in corporate law about the legal nature of the share, which mediates the relationship between the shareholder and the corporation, and the contradictions that exist within modern corporate law between separate corporate personality doctrine on the one hand and shareholder ownership “rights” on the other. It examines the implications of these uncertainties for pension fund activists’ strategies and suggests that the more appropriate project for pension fund activists may be to focus on creating more democratic and social systems for regulating corporations and capital accumulation and investment.

The final chapter considers whether these pension fund activist strategies, taken together and in the absence of government regulatory changes, result in anything more than moderate reforms. Is pension fund activism the most effective strategy to create real productivity, long-term sustainability and transform corporate management and practice? It also considers the directions that government regulatory reform should take in this area.

It appears that the current strategies of pension fund activists, even if extended to other types of investors – individuals and institutional – are not likely to lead to more democratic and social systems of corporate regulation. The final section of the last chapter considers some reform proposals that attempt to do this. Of particular importance to the labour movement is the emphasis that many of these strategies place on expanding or utilizing public pension systems, one of the original focuses of labour movement pension activism in Canada.

CHAPTER ONE: PENSION FUND INVESTMENT PRACTICES AND THEIR EFFECTS ON FINANCIAL MARKETS

Introduction

Many analysts blame the increasing influence of international organizations such as the World Trade Organization and the International Monetary Fund (IMF), which regulate international trade and finance, or the failure of nation-states to intervene in the market through measures to increase employment or provide an adequate social safety net, for the increasing exploitation of workers around the globe, the abuse of labour rights, and the decline of state-provided social benefits and services.²¹ Others argue that these actors are not the only or primary ones responsible for the current state of the global economy because institutional investors have also helped shape it through their tremendous influence on both international and state level activities.²²

This chapter examines the role that pension funds play in supporting global capitalism and neoliberalism. The first part looks at capital investment generally, with a

²¹ See e.g. H.W. Arthurs, "The Collective Labour Law of a Global Economy" in C. Engles & M. Weiss, eds., *Labour Law and Industrial Relations at the Turn of the Century: Liber Amicorum in Honour of Roger Blanpain* (The Hague: Kluwer, 1998) 143; S. Gill, "Globalization, market civilization, and disciplinary neoliberalism" (1995) 24:3 *Millenium* 399; R. Mayne, "Regulating TNCs: the Role of Voluntary and Governmental Approaches" in Picciotto & Mayne, eds, *supra* note 18, 235; United Nations, Press Release SG/SM/6881/Rev.1, "Secretary-General Proposes Global Compact on Human Rights, Labour, Environment, in Address to World Economic Forum in Davos" (1 February 1999); International Labour Organization, *World Employment Report 1998-99* (Geneva: International Labour Organization, 1998).

²² See e.g. M. Aglietta, "Capitalism at the Turn of the Century: Regulation and the Challenge of Social Change" (1998) 232 *New Left Review* 41 [hereinafter "Capitalism at the Turn of the Century"]; A. Harmes, "Institutional investors and the reproduction of neoliberalism" (1998) 5:1 *Rev. of Int'l. Pol'l. Economy* 92 [hereinafter "Institutional investors"]; A. Harmes, *Unseen Power: How Mutual Funds Threaten the Political and Economic Wealth of Nations* (Toronto: Stoddard, 2001) [hereinafter *Unseen Power*]; P. Ireland, "Stakeholding in the Global Casino: A Reply to David Campbell" (1997) 24 *J. L. & Soc.* 276 [hereinafter "Stakeholding in the Global Casino"]; Minns, *supra* note 11; "New Collectivism", *supra* note 11; *Paper Boom*, *supra* note 20.

focus on the distinction between direct investment and investment in the financial or secondary markets. The second part looks at the ways that the investment practices of institutional investors such as mutual funds, pension funds and hedge funds have been linked to a number of problems associated with global capitalism and financial markets, particularly the failure of market investment activities to generate socially productive outcomes such as job creation and capital investment.

Financial Investments and their Relationship to Real Investment

the signals emitted by the stock market are either irrelevant or harmful to real economic activity, and ... the stock market itself counts for little or nothing as a source of finance.²³

In thinking about investment it is helpful to use the distinction that Jim Stanford and others make between the “real” economy and “real” investment and the “financial” economy and “financial” (or paper) investment. The real economy includes “non-financial companies, private households, and government.”²⁴ It includes investments in concrete or tangible capital items such as machinery, computers, construction equipment, factories, offices and other equipment that are used to produce the material products and services bought and sold in the real economy constitute real investments. These products and services include:

... the things that Canadians consume in their homes and communities (such as food, clothing, transportation, entertainment) ... [T]he products and services that Canadian governments or public institutions generate ... (such as health care services and supplies, schools and textbooks, road construction). And ... the raw

²³ D. Henwood, *Wall Street: How It Works and for Whom* (London: Verso, 1997) at 292.

²⁴ *Paper Boom*, *supra* note 20 at 65.

materials, spare parts, and machinery that Canadian companies must purchase in order to maintain and grow their businesses.²⁵

The financial economy, comprised of the financial services sector, creates, buys and sells paper assets - stocks, bonds, derivatives and other securities. A significant portion of pension funds and institutional investment generally is invested in equities (shares) and debt (bonds) that are sold on stock markets. For example approximately 40 percent of the total value of trustee pension funds in Canada is in stocks and 37 percent is in bonds.²⁶

The discussion in this chapter and, in fact in much of this document, focuses on the importance of real investment rather than financial investment to job creation and economic growth. It should not be forgotten however that investments in other forms of capital such as human capital (an individual's education, training and experience)²⁷ and social capital (investments in services which facilitate economic and social activities such as health care and education)²⁸ also have important effects on job creation, economic growth and improved standards of living.²⁹ I am focusing on real investment in contrast to financial investment for two reasons. The first is in order to highlight the effects of the investment practices of institutional investors such as pension funds on the relationship

²⁵ *Ibid.* at 23.

²⁶ Statistics Canada, *Quarterly Estimates of Trusteed Pension Funds, Second Quarter 2001*, Catalogue 74-001-XIB Quarterly (Ottawa: Statistics Canada Income Statistics Division, 2002) at 2 & 7 [hereinafter *Quarterly Estimates*].

²⁷ D. Rutherford, *Routledge Dictionary of Economics*, (London: Routledge, 1995) s.v. "human capital".

²⁸ *Ibid.*, s.v. "infrastructure" and "social capital". The term social capital can also include the real investment in capital items to facilitate these services. In this context I am referring to the service element of social capital.

²⁹ Stanford argues that investments in human and social capital tend to be linked to real investment, and that real investment is the best indicator of job creation and economic growth. *Paper Boom*, *supra* note 20 at 97.

between the financial markets and the real economy. And the second is that as Teresa Ghilarducci points out, “pension funds have two sources: the “real” economy and the “finance” economy.”³⁰ These include: pension contributions on behalf of workers employed in the real economy, coupled with the return on the investment of these contributions in the real economy and the financial economy.

Theoretically at least, financial markets exist to serve an intermediary function by moving “capital from savings to investment”³¹ - linking those with money to invest with those who need the money to develop or expand their businesses or to build the infrastructure to support or encourage economic growth. Investors reward successful, efficient enterprises by buying their shares and driving share prices up. This success in turn makes it easier for the enterprises to raise capital for real investment through the issue of new equity (shares).

Yet for reasons that will be discussed in the remainder of this chapter, investments in the financial sector often have little relationship to, or in fact undermine, real investment. In the 1990s, despite the astronomical growth in the financial services sector,³² there has been no corresponding increase in real savings and real investment that

³⁰ T. Ghilarducci, “Small Benefits, Big Pension Funds, and How Governance Reforms Can Close the Gap” in A. Fung, T. Hebb & J. Rogers, eds., *Working Capital: The Power of Labor’s Pensions* (Ithaca: Cornell University Press, 2001) 158 at 161-62 [hereinafter “Small Benefits”].

³¹ Canada, *Report of the Task Force on the Future of the Canadian Financial Services Sector: Change, Challenge and Opportunity* (Ottawa: Department of Finance, 1998) at 39.

³² For example, Stanford points out that by 1998 there were more than 2,000 Canadian mutual funds. In contrast, there were a little over 1,300 companies listed in the Toronto Stock Exchange (TSE). *Paper Boom*, *supra* note 20 at 53.

would be expected if these financial institutions were properly performing their intermediary function.³³

Before turning to a discussion of the investment practices of institutional investors, it is important to note that most purchases on the stock market, particularly in equities, do not provide new capital for real investment for the company since the vast majority of stocks bought and sold on stock exchanges around the world are not newly issued stock. Instead, existing stocks are bought and sold between investors, and the corporations themselves do not receive any additional capital to invest from these exchanges. For example, between 1990 and 1998, new stock issues by TSE-traded companies “accounted for just 5% of the value of all shares bought and sold on the TSE.”³⁴

Moreover new equity issues do not always create capital for new real investment. Private companies going public often use the capital raised by a share issue to buy out the company’s original owner. In Canada during the 1990s, the creation of new financial instruments such as “income trusts,” which provide shares in future income produced by an existing asset such as a pipeline or mine, accounted for a significant proportion of new equity issues. In addition, many finance and holding companies (mutual funds, hedge funds, etc.) issued their own equity, thus raising new capital for financial intermediaries rather than for real investment. Privatization of many Crown corporations and other non-profit companies was another significant cause of new equity issues. The capital raised

³³ See generally *Ibid.* at c. 2 & 3.

by these issues generally goes to the government vendor, rather than to real investment by the firm itself.³⁵ Thus Stanford calculates that between 1995 and 1997 for example, “just over one-half of the gross funds raised through new issues was collected by private companies active in the real economy.”³⁶ This in turn amounted to less than 10 percent of real investment spending by Canadian companies.³⁷

In fact, companies fund the majority of their investment projects from the income they generate.³⁸ In Canada, this accounts for approximately 95 percent of business gross fixed investment expenditure.³⁹ Ironically, this also means that when there is insufficient internal income to permit companies to purchase equipment that would allow production expansion and increased jobs, for example, it is difficult for them to raise funds from the financial sector: “once a company turns to the external market for money the value of the firm is discounted because lenders suspect that a firm wants to borrow because it is in trouble, despite the financial statements or actual condition of the firm.”⁴⁰ This difficulty is exacerbated when coupled with the competing pressures on the company to increase shareholder value through layoffs and downsizing.

The next section looks at the ways that the investment practices of institutional investors such as pension funds have helped exacerbate pressures on corporations to

³⁴ *Ibid.* at 46-47; See also R.M. Unger, *Democracy Realized: The Progressive Alternative* (London: Verso, 1998) at 153-54.

³⁵ *Paper Boom*, *ibid.* at 47-49.

³⁶ *Ibid.* at 51. Calculations based on Financial Post Datagroup, *Record of New Issues*.

³⁷ *Ibid.*

³⁸ Unger, *supra* note 34 at 153.

³⁹ *Paper Boom*, *supra* note 20 at 51.

⁴⁰ T. Ghilarducci, *Labor's Capital: The Economics and Politics of Private Pensions* (Cambridge: The MIT Press, 1992) at 92 [hereinafter *Labor's Capital*].

downsize, layoff workers and reduce capital expenditures. In addition to concerns that investment activities are increasingly focused on the financial sector rather than on promoting real or productive investment (the difference between paper and real investment), there is also concern that the increasing influence of large institutional investors such as pension funds has contributed to some of the problems associated with global capitalism and financial markets, particularly the failure of market investment activities to generate productive outcomes such as job creation and capital investment.

Pension Funds' Implication in Global Capitalism

... it has been the rapid development of capital markets in recent years that has been principally responsible for the tightening of the constraints under which corporations now operate. The increasing mobility of capital, and of money capital in particular, has installed capital markets, financiers, and fund managers as major agents of corporate (and other) discipline.⁴¹

... pension funds help to constitute a new pattern of political economy which is deeply implicated in current economic woes. The doctrines and policies of neoliberalism certainly bear heavy responsibility for market turmoil, but the roots of the latter lie in the innermost structures of the financial complex to which the funds belong.⁴²

Until recently, banks and individual investors comprised the main parties who owned and allocated capital.⁴³ Today, corporate ownership has shifted from individual to institutional investors, and it is these institutional investors who increasingly dominate capital allocation.⁴⁴ In Canada for example, the size of pension funds in Canada alone has grown seventy-five times since the 1960s. The market value of trustee pension funds in

⁴¹ "Stakeholding in the Global Casino", *supra* note 22 at 279.

⁴² "New Collectivism", *supra* note 11 at 4.

⁴³ "Institutional investors", *supra* note 22 at 115.

Canada was \$568.6 billion at the end of the second quarter of 2001.⁴⁵ Robin Blackburn argues that we are currently experiencing a new form of capitalism, one which he cleverly terms 'grey capitalism': "a new financial regime of accumulation based on the salience of pension funds in Britain and the United States, a model now spreading to many other countries."⁴⁶

Blackburn and others argue that the rise of institutional investors such as pension and mutual funds has created three significant problems associated with grey capitalism.⁴⁷ These problems are: the concentration of pension fund management; an inappropriate investment focus on short-term growth; and a regulatory framework that is unable to deal with the changes to the capitalist system that institutional investors have helped create.

a. *Concentration of Management and the Collective Allocation of Capital*

Clearly pension funds have become major, if not dominant, players in the Canadian economy. And while the media and government focus on the celebrity corporate elite, ... the nondescript pension fund managers are probably the most powerful arbiters of business.⁴⁸

Despite the growing value and number of pension funds, pension fund investment management is highly concentrated. Globally, the vast majority of pension funds are managed by a small group of American, British and Swiss banks and insurance

⁴⁴ *Ibid.*; R. Deaton, *The Political Economy of Pensions: Power, Politics and Social Change in Canada, Britain and the United States* (Vancouver: University of British Columbia Press, 1989) at 191; *Unseen Power*, *supra* note 22 at 31-32.

⁴⁵ *Quarterly Estimates*, *supra* note 26 at 1 & 4.

⁴⁶ "New Collectivism", *supra* note 11 at 5.

⁴⁷ See e.g. *Ibid.*; "Capitalism at the Turn of the Century", *supra* note 22; T. Ghilarducci, "U.S. Pension Investment Policy and Perfect Capital Market Theory" *Challenge* (July-August 1994) 4 [hereinafter "U.S. Pension Investment Policy"]; "Institutional investors", *supra* note 22.

⁴⁸ B. Tielman, "Labour and the pension fund giant" *National Post* (15 March 1999) at C5.

companies.⁴⁹ Added to this is the fact that other pension fund trustees rely on the investment advice of a small group of consultants. For example, a study in the United Kingdom found that 65 percent of pension fund transfers were undertaken on the advice of four consultants.⁵⁰ A 1995 IMF report concluded that: “the investor base in securities markets in industrialized countries, and increasingly in developing countries is dominated by a relatively small number of large institutional investors.”⁵¹

Subject to the legal requirement that pension funds be invested in the best interests of the policyholders, generally interpreted to mean their best *financial* interest, pension fund managers have significant discretion regarding the investments. Thus it is they, rather than individual pension policyholders, who control pension fund investments. This concentration of management also means that it is managers rather than individual investors who are the “arbiters of company take-overs, privatization flotations, corporate policies, as well as, internationally, the purchase of government debt with ... effects for national exchange rate and interest rate policies.”⁵²

Adam Harnes argues that the centralization of investment decision-making created by the concentration of fund management means that “capital is now being allocated collectively in an extremely direct fashion.”⁵³ In addition to the concentration of management, institutional investors tend to use similar investment criteria and to follow

⁴⁹ Minns, *supra* note 11 at 48.

⁵⁰ “New Collectivism”, *supra* note 11 at 6.

⁵¹ International Monetary Fund, *International Capital Markets: Developments, Prospects, and Policy Issues* (Washington: International Monetary Fund, 1995) at 165.

⁵² Minns, *supra* note 11 at 48.

⁵³ “Institutional investors”, *supra* note 22 at 102.

the investment behaviour of other institutional investors.⁵⁴ They also tend to focus their investments on large, publicly traded companies because they are better known and it is easier to obtain information about them, than it is to get information about smaller or medium sized businesses.⁵⁵

The concentration of fund management and the increasing size of institutional investment funds have had profound effects on the system of market finance. The tremendous increase in savings in institutional investment funds such as pension and mutual funds has been accompanied by a corresponding decline in savings deposited with banks.⁵⁶ This has led to a shift in the system of market finance from one administered by banking concerns to one dominated by institutional investors. And, as institutional investors have become the dominant shareholders of corporate enterprises, corporate management strategy has had to change to meet their demands.

b. Short-termism

Mutual funds and pension funds have long-term horizons, but the men and women who manage them do not.⁵⁷

[The] dramatic change in corporate ownership from individuals to institutions currently works against the ability of companies to manage for the long term. Where once we had patient investors interested in our long-term growth and development, today we are under constant pressure from institutional investors to

⁵⁴ *Ibid.* at 104.

⁵⁵ "New Collectivism", *supra* note 11 at 9-10.

⁵⁶ "Capitalism at the Turn of the Century", *supra* note 22 at 69. This decline in bank savings also has important implications for real investment activities because the creation of credit through loans to individuals and businesses is "the source of most new money in the economy." *Paper Boom*, *supra* note 20 at 61, 61-65.

⁵⁷ *Unseen Power*, *supra* note 22 at 16.

boost the price of our company's stock and 'provide immediate value to shareholders.'⁵⁸

Under the system of finance dominated by banking concerns, emphasis was placed on the long-term rate of return on the banks' investments and on stability of ownership.⁵⁹ Institutional investors, who have become dominant corporate shareholders, however, tend to emphasize maximizing returns over the short-term. Ghilarducci argues that despite the fact that pension funds are generally thought of as "patient capital" – interested in the long-term value of their investments – they do not actually "invest" in any real sense. Instead, they speculate, and these short-term speculative trading practices create price volatility with no productive return: "trading and investing are not the same activity; investment adds to productive capacity; speculating does not."⁶⁰ In support of their argument that pension funds trade rather than invest, Ghilarducci and Randy Barber point out that in 1960 stocks were held for an average of seven years, while in 1993 they were held for less than two years.⁶¹

Short-termism is word coined in 1986 by then Chancellor of the Exchequer Nigel Lawson, to characterize the thinking of many investors.⁶² Harnes argues that short-term investment criteria are products of the characteristics of institutional investors

⁵⁸ A. Sigler, former Chairman and CEO of Champion International Corporation, Testimony before the Senate Committee on Banking, Housing and Urban Affairs, *The Impact of Institutional Investors on Corporate Governance, Takeovers, and the Capital Markets*, Hearing before the Senate Committee on Banking, Housing, and Urban Affairs, 101st Congress, 1st Session (3 October 1999) cited in *Ibid.* at 179.

⁵⁹ "Capitalism at the Turn of the Century", *supra* note 22 at 69.

⁶⁰ "U.S. Pension Investment Policy", *supra* note 47 at 8. See also T. Hebb, "Introduction: The Challenge of Labor's Capital Strategy" in Fung, Hebb & Rogers, eds., *supra* note 30, 1 at 4.

⁶¹ R. Barber & T. Ghilarducci, "Pension Funds, Capital Markets, and the Economic Future" in G.A. Dymski, G. Epstein & R. Pollin, eds., *Transforming the U.S. Financial System: Equity and Efficiency for the 21st Century*, Economic Policy Institute Series (Armonk: M.E. Sharpe, 1993) 287 at 296.

themselves: their vulnerability to individual investor flight at a “moment’s notice;”⁶³ their bonus and pay structures that emphasize an investment manager’s return rather than real performance (the risk adjusted return), coupled with the fact that evaluations occur on an annual or quarterly basis; their evaluation of investment managers in relation to the performance of their peers rather than “absolute performance; their reliance on computer programs that automatically sell shares when their price drops below a certain price; their extensive use of leveraging with borrowed funds on which they must pay per period fees that can become prohibitive over the long-term; and their membership in a larger investment community in which the culture and investment discourse limits the ability to see beyond the short-term.⁶⁴

Anthropologists William O’Barr and John Conley’s study of those involved in pension fund investment management decision-making highlights the effects of the investment management culture and its values of conformity both socially and in terms of investment practices, and “the extent to which cultural rather than economic factors drive decisions in the financial world.”⁶⁵ In particular, they point out that because investment discourse tends to revolve around the short-term it “may limit the ability of U.S. pension

⁶² At the time Lawson was referring to the attitudes of industrialists and financiers. Rutherford, *supra* note 27, s.v. “short-termism”.

⁶³ “Institutional investors”, *supra* note 22 at 105. While pension funds as institutional investors are not as vulnerable as mutual funds and hedge funds to individual investor flight, many pension funds invest in mutual funds and hedge funds. In fact, according to a World Bank report, “over 50 percent of pension fund investments are undertaken through the purchase of shares in mutual funds, so the distinction between mutual fund and pension funds is, in practice, more blurred.” World Bank, *Private Capital Flows to Developing Countries: The Road to Financial Integration* (Oxford: Oxford University Press, 1997) at 129, cited in *Unseen Power*, *supra* note 22 at 38.

⁶⁴ “Institutional investors”, *supra* note 22 at 105-106.

⁶⁵ W.M. O’Barr & J.M. Conley, *Fortune and Folly: The Wealth and Power of Institutional Investing* (Homewood: Business One Irwin, 1992) at 9.

executives to invest for the long term ... [as] short-term rhetoric has crowded out alternatives.”⁶⁶

To attract investment in the present system of market finance, corporate management strategies must focus on increasing the equity value of the enterprise, and therefore the share prices, through measures which often include wage cuts and downsizing.⁶⁷ The pressures from institutional investors for short-term profits mean that there is little room for management to focus on the long-term corporate development: “the big funds are notorious for their short-term investment practices, spurring unproductive and costly take-over battles, and prioritizing short-term dividend payments at the expense of broader economic and welfare considerations.”⁶⁸

Indeed, in an August 2001 editorial commenting on findings by various bodies that, despite the fact that Canadian governments have reduced taxes, deficits, interest rates and inflation, Canada ranks low among other Group of Seven countries in measures of business competitiveness, the conservative *Globe and Mail* argued that Canadian corporations bear some responsibility for this state of affairs.⁶⁹ While suggesting that the government can help improve the situation through increased post-secondary education spending with a focus on technology, and management skills needed to compete in the global economy, it also suggested that even with increased government spending, the corporate sector must also “step forward to take responsibility for its own weaknesses.”

⁶⁶ W. O’Barr & J. Conley, “Managing Relationships: The Culture of Institutional Investing” *Financial Analysts Journal* 48:5 (September/October 1992) 21 at 25.

⁶⁷ “Capitalism at the Turn of the Century”, *supra* note 22 at 80; “U.S. Pension Investment Policy”, *supra* note 47 at 7; “Institutional investors”, *supra* note 22 at 107.

⁶⁸ Minns, *supra* note 11 at 43.

Changes suggested included industry education programs, and increased investment in technology and research to increase productivity. Despite the fact that the *Globe and Mail* recognized the need for corporate managers and Boards of Directors to take a long-term focus on their operations, there was no discussion or recognition of the role that short-termism on the part of investors, including institutional investors, has played in limiting the ability of corporations to take just such an approach.⁷⁰

The influence of this short-termism on corporate management is both passive – through the buying and selling of shares – and active. Harmes reviews a number of instances where institutional investors, intent on increasing their short-term share values, have directly intervened to influence corporate behaviour.⁷¹ He argues that it is “no coincidence that the rise of institutional share ownership has corresponded to a drop in Fortune 500 employment rolls from 16 million in 1980 to 12 million in 1990.”⁷²

This influence is not limited to corporate behaviour. Harmes and others argue that institutional investors and their focus on short-term returns have influenced neoliberal restructuring in both developing and advanced industrialized countries by, for example, demanding economic restructuring measures as a condition for investment in developing countries, or lobbying for reduced state-provided benefits, such as retirement benefits, in industrialized nations.⁷³

⁶⁹ “Corporation, fix thyself,” *The Globe and Mail* (6 August 2001) A10.

⁷⁰ *Ibid.*

⁷¹ “Institutional investors”, *supra* note 22 at 107; *Unseen Power*, *supra* note 22 at 191-93.

⁷² “Institutional investors”, *ibid.*

⁷³ *Ibid.* at 108; M. Naim, “Mexico’s Larger Story” in S. Edwards & M. Naim, eds., *Mexico 1994: Anatomy of an Emerging Market Crash*, (Washington: Carnegie Endowment for International Peace, 1997) 305 cited in *Unseen Power*, *supra* note 22 at 103.

In Unseen Power: How Mutual Funds Threaten the Political and Economic Wealth of Nations, Harmes argues that the rise of institutional investors with their concentrated management, herd mentality and focus on the short-term “has increased the potential for market over-reaction and price overshooting”⁷⁴ and that institutional investors, along with capital mobility and policies of fixed exchange rates, played a key role in the 1990s currency crises in Europe, Mexico and Asia. Initially, by investing heavily in the country/regions institutional investors caused asset prices to overshoot their “true” value, in that the prices of the financial assets were not underpinned by real assets,⁷⁵ creating a speculative bubble. With all the investment flowing into the country/regions, individual investors, corporations and governments made real economic decisions based on the paper value of the assets, saving less, and spending and borrowing more, often in foreign currencies.

When markets experienced a negative shock,⁷⁶ and investors began to pull their investments out of the countries, those governments that had fixed exchange rates (or those that sought to defend a floating rate within a certain range) were forced to defend them by raising interest rates. Raising interest rates generally slows down the real

⁷⁴ *Unseen Power, ibid.* at 76.

⁷⁵ The book value of the companies was significantly less than the paper value attached to them in the markets, even after factoring in market premiums that attach to intangible factors such as good management and consumer recognition. Another way to think about this is in terms of inflation i.e. that financial assets increased “from a process of asset price inflation rather than from growth in the inherent value of the ... companies.” *Paper Boom, supra* note 20 at 27, 28-29.

⁷⁶ Negative shocks to a market are inevitable, particularly in a global economy where the effect of economic events in one country can influence those in another. For example, if a country raises interest rates, investors may move their money there. Or political events such as protests, assassinations or wars may make investors nervous and they move their funds to a “safer” country. When a country experiences a negative shock, there will be downward pressure on its currency. In the currency crises the negative shocks

economy, increasing unemployment or reducing wages. It also increases government debt. Eventually, government efforts to defend the currency through high interest rates became politically unsustainable for the governments in question because of the negative impact on individual citizens in terms of unemployment and reduced wages, and the exchange rates collapsed along with asset prices.

Institutional investors quickly moved their capital out of the countries/region, causing currencies to drop even further, creating a cycle of further foreign currency debt and more capital outflow and, in the process, doing significant damage to the real economy of the country/regions as businesses collapsed, private and public debt increased, production fell and unemployment rose. Harmes argues that the overreaction of foreign institutional investors when both entering and exiting the markets and the sheer size of their investments in these regions/countries meant that governments were simply unable to defend their currencies or adjust them in a more systematic manner to soften their impact on the real economy.

The concentration of management and the short-term focus of institutional investors, along with their increasing investment power, have significantly influenced both corporate and state behaviour, and the direction of global capitalism generally. At the same time, existing regulatory frameworks are unable to address problems in the global capitalist system, a system and problems that institutional investors helped create.

all resulted in reduced investor confidence in the ability of the country/regions to defend their fixed exchange rate, and they pulled their funds out of them. *Unseen Power, supra* note 22 at 62-63, 80-81.

c. Regulation

Capitalism is engaging entire societies, and the individuals who live in them, in competition without any longer being subject to the constraints that formerly channelled the quest for capital accumulation in the direction of social progress.⁷⁷

In “Capitalism at the Turn of the Century: Regulation and the Challenge of Social Change,”⁷⁸ regulation theorist Michel Aglietta surveys the major changes to the capitalist system in the last twenty years and, like Blackburn, argues that a new capitalist accumulation system has been created, one that emphasizes competition, institutional investor control of corporations, and gives primacy to profit and market value.⁷⁹ He also outlines the current regulatory challenges that the changes have created.

By regulation, Aglietta refers to the process by which various social, political and financial mechanisms mediate the accumulation of capital and ensure that the “distortions”⁸⁰ that capitalist accumulation create are constrained to an extent that ensures continued social cohesion and social progress: “since it is intrinsically a creator and a destroyer, capitalism can only achieve progress for society if sets of mediation mechanisms, forming a mode of regulation, establish coherence among the imbalances inherent in the capitalist system.”⁸¹ For example, in the labour relations field, a “distortion” or “imbalance” is the potential for capitalist management, in its limitless accumulative quest, to abuse its labour force. In response, various regulatory

⁷⁷ “Capitalism at the Turn of the Century”, *supra* note 22 at 67.

⁷⁸ *Ibid.*

⁷⁹ *Ibid.* at 79.

⁸⁰ *Ibid.* at 44.

⁸¹ *Ibid.* at 54.

mechanisms have developed such as unions and collective bargaining, legislation regulating hours of work, and health and safety standards.⁸²

It is also important to understand that these systems of regulation are only legitimate “to the extent that they permit social progress.”⁸³ As Lawrence Tshuma points out “a particular system of accumulation can exist because its schema of reproduction is coherent. The problem is how to bring the behaviours of political and economic agents into some kind of configuration that will keep the regime of accumulation functioning.”⁸⁴

Aglietta argues that the regulatory mechanisms existing under the Fordist regime,⁸⁵ which ensured that productivity increases were linked to real wage growth and equitable income distribution,⁸⁶ have been unable to deal with the significant changes to the capitalist system over the last twenty-five years: “the extension of waged society as capitalism spreads across the world, financial globalization,” the revolution in technology and a renewed social preoccupation with individualism.⁸⁷ This was due in part to the fact that the strength of regulatory mechanisms often lies in their stability or rigidity. This allows little room however, for these regulatory organizations and institutions to adapt to

⁸² *Ibid.* at 44, 49-50.

⁸³ *Ibid.* at 54.

⁸⁴ L. Tshuma, “Hierarchies and Government versus Networks and Governance: Competing Regulatory Paradigms in Global Economic Regulation” (2000) 1 *Law, Social Justice and Global Development*, online: <<http://elj.warwick.ac.uk/global/issue/2000-1/tshuma.html>> at 4.

⁸⁵ A system of capitalist production “founded on mass-production-for-mass-consumption” and a “mode of regulation founded on the Keynesian welfare state.” I. Bruegel, D.M. Figart & E. Mutari, “Whose full employment? A feminist perspective on work redistribution” in J. Wheelock & J. Vail, eds., *Work and Idleness: The Political Economy of Full Employment* (Boston: Kluwer Academic, 1998) 69 at 73. See also Rutherford, *supra* note 27, s.v. “Fordism”.

⁸⁶ “Capitalism at the Turn of the Century”, *supra* note 22 at 57.

⁸⁷ *Ibid.* at 62.

changes in capitalist accumulative systems.⁸⁸ Regulatory mechanisms tend also to develop as a response to changes in the capitalist regime of accumulation rather than in tandem with them, since capitalist accumulation is not self-regulating.⁸⁹ Like Harmes and Blackburn, Aglietta identifies institutional investors as deeply implicated in the new regime of accumulation, supporting the instability of global markets and generally acting as “agents of market discipline.”⁹⁰

In short, the rapid pace of trade liberalization, capital mobility, and global capital market integration that have characterized globalization in the last three decades, and the rise of neoliberalism and its emphasis on limited state intervention in markets that has accompanied and facilitated it, have created financial regulatory systems, both national and global, that are ill-equipped or unwilling to deal with the financial instability created by institutional investors and the short-term investment practices described earlier.⁹¹

Critics of the current systems of financial regulation have targeted a number of areas for reform at the national and international level. The reforms suggested generally aim to encourage longer-term real investment while discouraging short-term speculative investment, and to provide greater transparency and accuracy of information. They include: restricting capital mobility through international and national measures,

⁸⁸ *Ibid.*

⁸⁹ *Ibid.* at 64.

⁹⁰ *Ibid.* at 80.

⁹¹ See generally *Ibid.*, J.W. Dean, “A Role for Canada in Global Financial Reform” in B.K. MacLean, ed., *Out of Control: Canada in an Unstable Financial World* (Ottawa: Canadian Centre for Policy Alternatives & James Lorimer, 1999) 131; R. Culpeper, “Financial Fragility, Capital Controls and Economic Policy” in MacLean, *ibid.*, 111; J. Loxley, “Financial Fragility, Global Capital Markets and Global Governance” in MacLean, *ibid.*, 97; B.K. MacLean, “The Transformation of International Economic Policy Debate, 1997-

instituting an international tax on short-term foreign exchange transactions (the Tobin tax),⁹² developing regulations to discourage short term lending and capital flight,⁹³ developing national and international measures to monitor cross-border investments, peer inspection and supervision of national financial institutions,⁹⁴ and imposing longer time horizons for measuring profit on institutional investors and the investment management industry.⁹⁵

In addition to these regulatory reforms, others suggest that there is potential for pension funds to become a mediative mechanism themselves, one that ultimately leads to a capitalism in which corporate ownership is socialized.⁹⁶ Aglietta for example, argues that trade unions have a critical role to play here for if they “are to regain the power to influence the distribution of income, they must realize that the battle to be fought and won is the battle for control of company shareholdings.”⁹⁷ Indeed Blackburn and others have criticized the labour movement for failing to advocate for, or take a larger role in pension fund management, particularly as a condition of government concessions such as tax deductions that are given to employers providing occupational pensions.⁹⁸ The next chapter looks at the history of the labour movement’s relation to pension plans and the

98” in MacLean, *ibid.*, 67; J. Stanford, “Waiting for ‘It’: The Mechanics of Financial Boom and Bust” in MacLean, *ibid.*, 43.

⁹² See e.g. A.C. Michalos, “In Defence of Tobin Taxes” in MacLean, *ibid.*, 145.

⁹³ Dean, *supra* note 91 at 135.

⁹⁴ *Ibid.* at 138.

⁹⁵ M. Aglietta, “Shareholder value and corporate governance: some tricky questions” (2000) 29 *Economy & Society* 146 at 158-59 [hereinafter “Shareholder value and corporate governance”].

⁹⁶ “Capitalism at the Turn of the Century”, *supra* note 22 at 80.

⁹⁷ *Ibid.*

⁹⁸ “New Collectivism”, *supra* note 11.

movement's politicization regarding participation in pension fund management and decision making as a means to control capital.

CHAPTER TWO: PENSION FUND ACTIVISM: THE HISTORICAL CONTEXT

... [T]he introduction of employer-sponsored welfare benefits served a series of interrelated ideological, organizational and labour market functions for the corporate sector.⁹⁹

... [P]rivate pensions can better be seen as a compromise to the state rather than as a victory over capital, because labour did not struggle for private pensions. It fought long and hard for public pensions but was forced to turn to private pensions as the result of machinations of the state and capital.¹⁰⁰

Introduction

This chapter traces the development of pension plans and the politicization of the labour movement regarding participation in pension fund management and decision making as a means to control capital. It provides an overview of the development of private and public pensions and places this development in the context of the struggle between labour and capital for the control of the industrialized workplace beginning in the late nineteenth century. It argues that the renewed interest by members of the labour movement in control of pension fund investment can be seen as a continuation of this struggle.

Employer-based pension plans initially developed as part of a strategy of corporate welfare provision designed to control and fragment the labour force. As the number of private pensions grew in Canada and elsewhere, the exponential growth of the funds created a new tool for the corporate sector to support its own accumulation process and that of the market generally. The Canadian labour movement had historically been

⁹⁹ Deaton, *supra* note 44 at 119.

opposed to employer-based pensions because of their use by corporate employers to control workers and fragment the labour movement. Instead it lobbied for the creation of a universal public pension scheme, only becoming politicized about control of private pension funds after conceding defeat in the struggle for universal public pensions. This history helps to explain some of the limitations of the investment strategies pursued by labour movement pension fund activists that will be discussed in the third and fourth chapters. At the same time, it also sets the stage for the possibility of more transformative pension fund strategies which will be discussed in the final chapter.

The Development of Pension Plans

Both occupational and state-provided pensions are relatively recent phenomena, associated largely with the development of capitalism in advanced industrialized countries. Prior to industrialization, the extended family provided support to individuals throughout the life cycle.¹⁰¹ Today, as Richard Deaton notes, “[i]n advanced industrialized countries, as a result of complex historical and institutional processes, financial responsibility for the non-working or dependent elderly generally tends to fall on the state and the actively employed labour force.”¹⁰²

The expansion of occupational pension plans in Canada mirrored the development of industrial capitalism in the country. While there were few plans in the early 1900s, the number of plans more than doubled between 1910 and 1929. This increase coincided

¹⁰⁰ J. Stafford, “The Class Struggle and The Rise of Private Pensions, 1900-1950” (1987) 20 *Labour/Le Travail* 147 at 158 [hereinafter “Class Struggle”].

¹⁰¹ There were some exceptions to this. Some military veterans received pensions, and there were artists who were fortunate enough to have a patron willing to support them in their old age. Medieval manors also supported those without an extended family by providing them with material goods. *Ibid.* at 155.

“with early American corporate penetration of the Canadian market,”¹⁰³ and the unilateral introduction of corporate welfare programmes such as employer provided pension plans, was one of the strategies used by American corporations to promote employee loyalty, control workers, and undermine the power of unions.¹⁰⁴

As a number of labour scholars have pointed out, the introduction of corporate welfare programs such as employer-provided pensions, health care, education, insurance, profit-sharing, housing and recreation facilities, was a strategy utilized by corporations in their struggle with workers over control of the industrialized, mechanized workplace. They find the roots of corporate welfare programmes in the changes in production processes between 1880-1920 brought about by industrialization and the introduction of scientific management theories into the workplace.¹⁰⁵ These changes meant that workers exercised little autonomy over the production process, performing instead a small task within a larger production process: “[s]kills and trades which were previously required became less and less necessary; former teams and work groups were being destroyed by detailed division of tasks and functions; mechanization was rapidly altering daily work experience.”¹⁰⁶

¹⁰² Deaton, *supra* note 44 at 50-51.

¹⁰³ *Ibid.* at 79.

¹⁰⁴ *Ibid.*; J. Rifkin & R. Barber, *The North Will Rise Again: Pensions, Politics and Power in the 1980s* (Boston: Beacon Press, 1978) at 85; N. Tudiver, “Forestalling the Welfare State: The Establishment of Programmes of Corporate Welfare” in A. Moscovitch & J. Albert, eds., *The Benevolent State: The Growth of Welfare in Canada* (Toronto: Garamond Press, 1987) 186 at 188; See generally M. E. McCallum, “Corporate Welfarism in Canada, 1919-39” (1990) 71:1 *Canadian Historical Review* 46.

¹⁰⁵ McCallum, *ibid.*; K. Stone, “The Origins of Job Structures in The Steel Industry” (1974) 6 *Rev. of Radical Political Economics* 61; Tudiver, *ibid.* at 186-87.

¹⁰⁶ Tudiver, *ibid.* at 187. See generally H. Braverman, *Labor and Monopoly Capital* (New York: Monthly Review Press, 1974) particularly c. 3 & 4.

While these changes increased productivity and gave management control over the production process, the mechanization of the process led to problems of worker dissatisfaction and motivation, a high turnover of workers, and increased unionization.¹⁰⁷ Employers responded with corporate welfare programmes designed to attract workers and then to bind them to the company by creating a dependency on the employer provided benefits.¹⁰⁸

Employers chose the type of programmes that would be available to workers and defined the terms of eligibility. Many programmes, including pension plans, were contingent on the worker remaining with the company for a particular length of time. For example, a 1928 survey by the Ontario Department of Labour found that the majority of companies that provided regular pension plans to employees, or pension assistance to favoured workers, required them to have worked between twenty to twenty-five years to qualify.¹⁰⁹ In addition, the terms of many plans allowed companies to terminate the pension of an employee who joined a union or went on strike.¹¹⁰ In other cases, programs were limited to employees who showed “proper interest” in the company, a term which did not include support for union activities either within the company or elsewhere.¹¹¹ For some employees, the employer’s disciplinary power extended into retirement as many

¹⁰⁷ Tudiver, *ibid.* 187-88.

¹⁰⁸ *Ibid.* at 188-89; McCallum, *supra* note 104 at 48; McCallum’s article provides detail about the extent to which the employer controlled company towns in resource industries such as mining and forestry: “[w]hether resource towns were run by the company or given a separate corporate existence with an elected town council, the main employer was often responsible for providing essential services such as water, power, and sewers. In many towns, the company also built the schools and the churches” (at 49).

¹⁰⁹ Ontario Department of Labour, *Survey of Industrial Welfare in Ontario* (Toronto, 1929) 26-27 cited in McCallum, *ibid.* at 53.

¹¹⁰ “Class Struggle”, *supra* note 100 at 156.

plans allowed termination of pension payments if a retiree's behaviour met with company disapproval.¹¹²

As corporate welfare programmes were introduced or expanded, industrial councils,¹¹³ composed of both management-appointed and worker-elected representatives, were established in many Canadian workplaces.¹¹⁴ These councils were mandated to provide recommendations to the employer about a wide range of issues including health and safety, wages, hours of work, recreation and education. However, workers' recommendations, particularly those related to hours of work and wages, generally met with limited success. Workers on Massey-Ferguson's industrial council, for example, were successful in advocating for health and safety measures such as "the hiring of a plant doctor ...; installation of drinking fountains and wash basins ...; and the placing of guards on exposed machinery,"¹¹⁵ but unsuccessful in efforts to reverse wage cuts or establish a paid vacation entitlement after five years of employment.¹¹⁶

Although acknowledging that employers who provided corporate welfare and employee representation programmes "deserve some credit"¹¹⁷ for providing employees more than "the lowest wage they could get away with,"¹¹⁸ Margaret McCallum and other labour historians point out that it is important to recognize that these measures were also

¹¹¹ Tudiver, *supra* note 104 at 188.

¹¹² McCallum, *supra* note 104 at 52.

¹¹³ They were also referred to as "work councils".

¹¹⁴ McCallum, *supra* note 104 at 58-61. By 1920, somewhere between 40 and 54 percent of unionized workers were covered by industrial councils. Tudiver, *supra* note 104 at 190.

¹¹⁵ Tudiver, *ibid.*

¹¹⁶ *Ibid.* at 191.

¹¹⁷ McCallum, *supra* note 104 at 50.

¹¹⁸ *Ibid.*

designed to “overcome worker resistance, improve worker motivation ... undermine workers’ collective action”¹¹⁹ and enhance a corporation’s public image.¹²⁰ Moreover, despite the fact that the majority of Canadian employees did not receive corporate welfare benefits, their existence helped reduce public pressure on governments to provide legislation recognizing workers’ rights and to create universal social security programs.¹²¹ The business community strongly resisted efforts to create such universal programs and pointed to their own programmes as evidence that they were not necessary.¹²² As McCallum comments, “[i]n providing employee benefits or creating industrial councils, employers wanted to forestall ... legislation compelling payment of a minimum wage, employer contributions to wage-replacement plans during periods of sickness or unemployment, the eight-hour day, or union recognition.”¹²³

Given the effects of corporate welfare programmes and industrial councils, it is not surprising that the union movement was suspicious of these measures, and strenuously opposed their introduction. Instead it focused its efforts on lobbying governments for the introduction of universal programmes such as pensions, and unemployment, sickness and disability insurance.¹²⁴

With respect to pensions, the struggle for a universal public pension program had been waged by the North American labour movement since the beginning of the twentieth

¹¹⁹ Tudiver, *supra* note 104 at 193.

¹²⁰ J. Stafford, “Retirement Pensions: Reinforced Exploitation” in J. Dickinson & B. Russell, eds., *Family, Economy and State: The Social Reproduction Process Under Capitalism* (London: Croom Helm, 1986) 285 at 297 [hereinafter “Reinforced Exploitation”].

¹²¹ McCallum, *supra* note 104 at 74.

¹²² *Ibid.* at 73; Tudiver, *supra* note 104 at 193.

¹²³ McCallum, *ibid.* at 50.

century when public pensions were introduced in European countries, Australia and New Zealand. Labour organizations in both Canada and the United States pressed governments to introduce a universal and comprehensive public pension program. In fact, there is no record of private pensions being discussed at meetings of large unions until a 1935 resolution passed unanimously by the American Federation of Labour opposing private pension plans.¹²⁵

The Canadian government's response to organized labour's pressure was limited. In 1908 it began to sell government annuities with generous terms to those individuals who were able to save privately. However, as with present-day RRSPs it was mainly the middle class who were able to take advantage of these annuities. In addition, the insurance industry, which correctly saw these annuities as unfair competition, vigorously opposed them. Over the next 30 years it won reductions in the maximum amount, the interest rates and mortality assumptions. They were eventually terminated in 1967.¹²⁶

Although the labour movement continued to lobby for a universal state sponsored pension program, its success was initially limited to the creation of a federal, means-tested pension plan of \$20 a month for needy Canadians over the age of 70.¹²⁷ The labour movement pressed for improvements to this plan, but the means test for those over 70 was not dropped until 1951 when a means-tested pension plan was created for people

¹²⁴ Tudiver, *supra* note 104 at 191.

¹²⁵ "Class Struggle", *supra* note 100 at 160.

¹²⁶ *Ibid.* at 159.

¹²⁷ *The Old Age Pension Act, 1927*, 17 Geo V, c. 35. This plan was a concession to the small Labour Party and other leftists in the House of Commons in exchange for their support of the minority Liberal government under MacKenzie King. *Ibid.*; Tudiver, *supra* note 104 at 191. Under the plan, the federal government provided the pensions on a cost-sharing basis with participating provinces.

ages 65 to 70.¹²⁸ By the time the Canada Pension Plan (CPP) was introduced in 1964,¹²⁹ it was understood to be a supplement to private pensions.

It was during World War II and the post-war period that the most significant expansion of private pension plans occurred with the establishment of approximately two-thirds of Canadian occupational pension plans.¹³⁰ This happened despite the fact that the collapse of the mainly pay-as-you-go¹³¹ corporate pension plans and other corporate welfare programmes, and the widespread unemployment and low wages during the Depression had shown that the corporate world could not keep the promise implied by its welfare programs – namely that corporations, not the state, could take care of workers throughout their lives.¹³² This expansion also occurred despite the fact that the Depression had created a more militant labour movement in Canada, one which had historically opposed private pension plans and other forms of corporate welfare.¹³³ As unemployment increased and wages declined, workers, unable to address these issues through industrial councils, increasingly joined trade unions.¹³⁴

¹²⁸ *The Old Age Security Act*, 15-16 Geo VI, (2nd Sess.), c. 18 removed the means test for those over 70, and replaced *The Old Age Pension Act, 1927*. *The Old Age Assistance Act*, 15 Geo VI, c. 55 provided a means-tested pension for those between 65-70. "Class Struggle", *ibid.* at 160. Barbara Murphy points out that at this time, business, particularly the industrial sector, supported the OAS as a means to both placate the labour movement and to relieve some of the burden of private pension costs. B. Murphy, *Corporate Capital and the Welfare State: Canadian Business and Public Pension Policy in Canada Since World War II* (M.A. Thesis, Carleton University, 1982) [unpublished] at 16 and 91-93.

¹²⁹ *Canada Pension Plan*, 13-14 Elizabeth II, c. 51.

¹³⁰ Deaton, *supra* note 44 at 79.

¹³¹ Under pay-as-you-go systems, the contributions by or for current workers are used to fund current pension benefits.

¹³² McCallum, *supra* note 104 at 73; "Reinforced Exploitation", *supra* note 120 at 293-94.

¹³³ Tudiver, *supra* note 104 at 194-95; "Class Struggle", *supra* note 100 at 154.

¹³⁴ Tudiver, *ibid.* at 194.

Deaton sets out three principal reasons for the expansion of private pension plans during this period: first, pension benefits were exempt from wage control measures instituted during the war, and governments encouraged employers and workers to establish pension plans instead of salary increases because pensions were seen as non-inflationary;¹³⁵ this was coupled with the fact that income tax regulations were clarified to provide tax exemptions for income that an employer or employee contributed to a pension plan;¹³⁶ and third, unions began to seriously negotiate for pension plans.¹³⁷

The decision to actively bargain for corporate welfare benefits represented a recognition by the union movement that its battle for universal social programs such as pension plans had been largely unsuccessful. As one trade unionist commented, “[u]nions decided that they would attempt through bargaining to win for their members what they were unable to convince government to provide for all its citizens.”¹³⁸ In the

¹³⁵ Deaton, *supra* note 44 at 79.

¹³⁶ In 1919, s. 2(7) of *An Act to amend the Income War Tax Act, 1917*, 9-10 George V. c. 55, provided that employees could deduct pension contributions from their income. 1928 amendments permitted corporations to elect to exempt pension fund income from taxation. *An Act to amend the Income War Tax Act, 1917*, 18-19 Geo. V. c. 12, s. 6(h). Further amendments a decade later permitted corporations to deduct “irrevocable” contributions to occupational pension plans. This exemption was made retroactive to 1928. *An Act to amend the Income War Tax Act, 1917*, 2 Geo. VI c. 48, s. 5(m). Tudiver, *supra* note 104 at 162; see also “Class Struggle”, *supra* note 100 at 161-63.

¹³⁷ Deaton, *supra* note 44 at 79.

¹³⁸ *Ibid.* at 121 quoting P. Henle, Assistant Director of Research, AFL-CIO, quoted in D. Allen, *Fringe Benefits: Wages or Social Obligations?* (Ithaca: Cornell University Press, 1969) at 255. It is important to note that although the labour movement gave up its staunch opposition to private pensions, it has not been blind to the ways in which the private pension system, which covers a limited percentage of the Canadian work force (41 percent of Canadian workers in 1999, down from 45 percent in 1991) privileges certain workers and in turn fragments the labour movement. It has continued to lobby for improvements to the public pension system in Canada. *Pension Plans in Canada*, *supra* note 6 at 5; “Class Struggle”, *supra* note 100 at 171; J. Myles, “Demography or Democracy? The “Crisis” of Old-Age Security” in J. Curtis, E. Grabb & N. Guppy, eds., *Social Inequality in Canada: Patterns, Problems, Policies*, 2nd ed. (Scarborough: Prentice-Hall Canada, 1993) 416 at 423; M. Townson, “Overview of Retirement Income System: Women’s Perspective” in *Roundtable on Canada’s Aging Society and Retirement Income System* (Ottawa: Caledon Institute of Social Policy, 1996) 27 at 29; see generally Murphy, *supra* note 128. Examples of recent

United States, the National Labour Relations Board had ruled that pensions and other welfare benefits, which it deemed to be wages, were a mandatory subject of collective bargaining.¹³⁹ During the postwar period, unions such as the United Auto Workers and the United Steelworkers of America began campaigns to negotiate these welfare benefits. While the decision to actively negotiate for corporate welfare benefits such as pensions represented a significant concession on the part of the labour movement, it should not be forgotten that the ability of unions to negotiate good benefit packages provided material benefits to their members and generally served as good public relations for the union movement.¹⁴⁰

These American developments influenced Canadian labour unions' approach to the issue, particularly as a number were actually part of American-based "international" unions.¹⁴¹ In 1948 the Canadian Congress of Labour passed a resolution recommending that collective bargaining efforts include negotiating adequate private pension plans.¹⁴² In 1952 the American Federation of Labor published a pamphlet designed to help union executives with the technical issues involved in setting up and operating private company

Canadian Labour Congress documents include B. Baldwin, *Comments on "Gender Implications to the Canada Pension Plan" Prepared for the House of Commons Standing Committee on Finance* (Ottawa: Canadian Labour Congress, 1997); Canadian Labour Congress, *Proposed Changes to the Canada Pension Plan: Bold Steps, No Progress* (Submission to the House of Commons Standing Committee on Finance Concerning Bill C-2, An Act to Create the Canada Pension Plan Investment Board) (Ottawa: Canadian Labour Congress, 1997).

¹³⁹ *Inland Steel Co. v. NLRB*, 170 F.2d 247 (7th Cir. 1948) cert. denied, 336 U.S. 960 (1949) [hereinafter *Inland Steel*].

¹⁴⁰ Deaton, *supra* note 44 at 127-28. Deaton argues that unions now have a "vested interest" in negotiating for, and expanding employee benefit and pension plans.

¹⁴¹ *Ibid.* at 120.

¹⁴² The Canadian Congress of Labour and the Trades and Labour Congress merged in 1956 to form the Canadian Labour Congress.

pension plans.¹⁴³ Interestingly, the provision of employer-sponsored pension plans was actually of greater importance to Canadian workers than to their American counterparts as the CPP was introduced almost 30 years after the *Social Security Act of 1935* in the United States created a compulsory pension plan based on payroll deductions.¹⁴⁴

In the post-war period, the significance of private pensions to capital shifted from their use as a means to control the labour force, to their direct use as a means of capitalist accumulation.¹⁴⁵ Most plans, even those that were contributory, were administered by the employer, and investments were managed in-house or by outside investment managers such as an insurance or trust company.¹⁴⁶ Companies often used pension funds for self-investment purposes, either through the purchase of company stocks and bonds, or direct loans to the company.¹⁴⁷ More generally, as discussed in the previous chapter, pension funds were invested in capital markets through the purchase of stocks, bonds and real estate.¹⁴⁸

During this period the state also took on an increased regulatory role over pension plans and their investment practices. Income tax regulations stipulated that pension plans

¹⁴³ "Class Struggle", *supra* note 100 at 160.

¹⁴⁴ McCallum, *supra* note 104 at fn 41, p. 65. *Social Security Act* of August 14, 1935, c. 531, 49 Stat 620 (codified as subchapter II (§ 401 et seq.) of c. 7 of Title 42, *The Public Health and Welfare*).

¹⁴⁵ "Reinforced Exploitation", *supra* note 120 at 295; see generally Deaton, *supra* note 44 at c. 6. It should not be forgotten that private pensions do still function as a means to control and fragment the labour force although in a perhaps less obvious fashion.

¹⁴⁶ "Class Struggle", *supra* note 100 at 161-62; "Reinforced Exploitation", *ibid.* at 303; Tudiver, *supra* note 104 at 198.

¹⁴⁷ *Labor's Capital*, *supra* note 40 at 92.

¹⁴⁸ The significance of private pension funds to the accumulation of capital can be seen in the fact that one of the issues in the debate surrounding the introduction of the CPP and subsequent amendments to the Plan, was a concern by the business community that in moving funds from private to public pension plans, a major source of investment capital would be removed from the control of the private sector. Deaton, *supra* note 44 at 185-86; Murphy, *supra* note 128 at c. 2; Myles, *supra* note 138 at 423-24.

that qualified for income tax exemptions had to have a funding mechanism that would ensure the pension promise could be delivered.¹⁴⁹ This was to ensure that the plans would not collapse in economic hard times as many of the pay-as-you-go plans had during the Depression. Investments were also regulated through income tax regulations. Before 1956, investments were regulated by the *Canadian and British Insurance Companies Act*¹⁵⁰ and restricted to particular countries' government bonds, certain corporate bonds and equity shares that met certain requirements. Up to 15 percent of a pension fund could be invested in shares.¹⁵¹ The restrictions on equity shares were removed in 1965.¹⁵² These changes, coupled with the 1955 changes to trust company practices which permitted them to pool small pension plan reserves for investment, led to the growth of pension plans as significant pools of investment capital.¹⁵³

The increase in the number of plans and their anticipated growth brought concern from the state, the corporate sector and eventually from labour, about the effect of pension funds and their expected growth on ownership and control of productive property. In the United States, for example, in 1959, reports prepared for two liberal think-tanks looked at the question of whether pension funds could control corporations, although from radically different perspectives. In *Pension Funds and Economic Freedom*,¹⁵⁴ a report prepared for the Fund for the Republic, Robert Tilove looked at the

¹⁴⁹ E. Gillese, "Pension Plans and the Law of Trusts" (1996) 75 Can. Bar. Rev. 221 at 227 [hereinafter "Pension Plans"].

¹⁵⁰ 22-23 Geo. V. c. 46, consolidated in R.S.C. 1952, c. 31.

¹⁵¹ "Class struggle", *supra* note 100 at 163.

¹⁵² *Ibid.* at 164.

¹⁵³ *Ibid.* at 165.

¹⁵⁴ (New York: The Fund for the Republic, 1959).

question of whether occupational pension plans restricted economic freedoms by concentrating economic power in the hands of the small financial elite that invested and managed pension fund investments. He concluded that there was no evidence of this problem, although he recommended that this question be revisited on a regular basis to determine “whether concentration of economic power or the use of pension funds to that end has or has not developed.”¹⁵⁵

He also touched on the question of whether unions had made any use of the potential power to influence corporate behaviour or concentrate economic power. Tilove noted that although there was potential for unions to use their pension funds to purchase the control of corporations, and to vote their stock in an influential manner, he commented that “the magnitude of this potential is, however, matched by labor’s current disinterest in its use.”¹⁵⁶

The second report, *Pension Funds and Economic Power*,¹⁵⁷ prepared for the Twentieth Century Fund by Paul Harbrecht, looked more generally at the impact of pension trusts on the institution of private property. Harbrecht was interested in whether the growth of pension funds meant that worker beneficiaries were becoming the owners of the means of production, and if in turn, this meant that economic decision-making was becoming more open and democratic. His conclusion was that this was not the case.

¹⁵⁵ *Ibid.* at 86.

¹⁵⁶ *Ibid.* at 69.

¹⁵⁷ *Pension Funds and Economic Power* (New York: The Twentieth Century Fund, 1959).

Instead he observed, “property rights of the pensioner in one of these funds are ... reduced to an absolute minimum.”¹⁵⁸

Unlike Tilove, who had determined that pension fund accumulations had not concentrated economic power in a financial elite such that it created a “significant public problem,”¹⁵⁹ Harbrecht argued that those who invested pension funds held considerable economic power:

financial authority is almost wholly turned over to a relatively small group of banks. ... It is a point of pride made by many managements that they in no sense control the investment of pension funds, the voting of stock or the placement of debt capital which the trustees manage. The net result is a large gain in economic power of the financial community.¹⁶⁰

He did recognize that successfully bargaining for employer-funded pensions could become a new source of power for labour, and he noted that organized labour was beginning to demand increased involvement in decision-making about pension fund investment.¹⁶¹

With respect to the impact of pension funds on the institution of private property, Harbrecht argued that pension trusts challenged traditional understandings of property since they could not be said to be “owned” by anyone: “[s]uch a phenomenon in a capitalist society, which has traditionally considered the distinction between public and private ownership to be adequate and complete, challenges us to find a rational

¹⁵⁸ *Ibid.* at 284.

¹⁵⁹ Tilove, *supra* note 154 at 86.

¹⁶⁰ Harbrecht, *supra* note 157 at 284.

¹⁶¹ *Ibid.* at 91-100.

framework to accommodate it.”¹⁶² This question of ownership has continued to underpin much of the thinking and debate about the progressive power of pension fund investment.

More than a decade later Peter Drucker published *The Unseen Revolution. How Pension Fund Socialism Came to America*,¹⁶³ in which he made the provocative claim that the United States was the world’s first socialist country, since workers, through their pension funds, owned more 25 percent of the equity capital of American business, with “the largest employee pension funds ... control[ing] practically every single one of the 1,000 largest industrial corporations in America.”¹⁶⁴ However, Drucker failed to address the point that Harbrecht had made earlier, that the workers who were the pension plan beneficiaries did not control or direct the corporations in which their pension funds were invested.

Later that decade, Barber and Jeremy Rifkin politicized the pension plan issue in *The North Will Rise Again: Pensions, Politics and Power in the 1980s*,¹⁶⁵ which looked at the economic decline in the northern industrial states in the United States. They highlighted the fact that the beneficiaries, employees and their unions had very little, if any control of their pension funds. Instead they were controlled by a small group of financial institutions which often invested the funds in other regions, in non-union companies or in companies that violated labour rights.

¹⁶² *Ibid.* at 11.

¹⁶³ (New York: Harper & Row, 1976).

¹⁶⁴ *Ibid.* at 2.

¹⁶⁵ *Supra* note 104.

Like Harbrecht, Rifkin and Barber saw pension funds as a new form of private property with ownership falling “somewhere in the middle of private and public,”¹⁶⁶ characterizing it as “social capital.” They argued that control of pension funds could be another source of power for organized labour as well as a means to preserve jobs in the northern industrial corridor. They reviewed some of the early labour involvement in pension fund investment decisions¹⁶⁷ and issued a call to the labour movement to take control of their social capital:

When companies engage in unfair labour practices, or ship their operations South or abroad to avoid union shops, it is not just some phantom abstraction called “the owners” who are making those decisions. The owners, in part, are unions and unionists, and when companies engage in a systematic campaign to break the trade-union movement in this country, ... they are able to succeed in large measure because the unions have given over their control of pension-fund capital to the private banking sector to use against them.¹⁶⁸

Canadian Labour Movement Pension Fund Activism

In Canada, unions began to recognize the power of pension funds in the early 1970s. During that decade the Canadian Labour Congress (CLC), the Canadian Union of Public Employees (CUPE) and the United Steelworkers (Canadian region) all endorsed policy positions advocating the joint administration of pension plans, including the management of fund investments.¹⁶⁹

Efforts to increase labour participation did not seem to yield the increased decision-making role advocated by labour. Since the early 1990s, however, there has

¹⁶⁶ *Ibid.* at 83.

¹⁶⁷ *Ibid.* at c. 17.

¹⁶⁸ *Ibid.* at 169.

¹⁶⁹ Deaton, *supra* note 44 at 157.

been renewed interest on the part of the Canadian labour movement and trade unionists in other countries in pension plan governance, including the management of pension fund investment, with many unions expressing “concern about limited labour participation in governance structures, despite the growing incidence of joint trusteeship and [advisory] ... bodies since the 1980s.”¹⁷⁰

This renewed interest has arisen in part because of the recognition of the role that institutional investors play in many of the financial problems associated with global capitalism outlined in the previous chapter, and in part because the labour movement has watched as the deferred wages in their pension funds were invested in corporations that utilized non-union labour, violated environmental, labour or human rights, laid off unionized labour, or moved production to another region or country, and found that they had little or no ability to affect these decisions, or to advocate for investment that would have collateral benefits such as the creation of jobs or the provision of services such as child care or housing.

Internationally, the labour movement has taken a number of steps to gain more control over their pension fund investments. In Canada, these steps have ranged from aggressively advocating for joint trusteeship of pension plans, including for pension investment decision-making,¹⁷¹ to pursuing particular investment practices or programs. Since 1990, the CLC has issued a number of policy statements advocating a stronger role for union members in investment decision-making. It has also held workshops on

¹⁷⁰ Falconer, *supra* note 14 at 6.

¹⁷¹ Deaton, *supra* note 44 at 150-59; *Ibid.* at 7.

pension fund issues at its conferences. At a February 1998 workshop on pension fund investment at the CLC's Jobs and the Economy Conference, participants recommended that there be increased examination of "capital market investment alternatives for pension funds,"¹⁷² more pension fund investment tracking, and enhanced education and training opportunities for pension trustees and members.¹⁷³

As well, the National Union of Public and General Employees (NUPGE) has passed a number of resolutions advocating the joint control of pension funds, and for the creation of education programs for union members about pension fund management and investment practices.¹⁷⁴ It has also produced a number of research papers about pension fund control and trusteeship.¹⁷⁵ Other unions such as CUPE have developed education programs for their members who are trustees and bargaining committee members.

Although there are some private sector pension plans, most notably in the construction trades, in which union members have joint or sole trusteeship,¹⁷⁶ the labour movement has tended to be most successful in its efforts to secure joint trusteeship with multi-employer and some public sector funds, as well as with some union staff plans.

Based on a 1998 survey conducted by the Ontario Public Service Employees' Union

¹⁷² I. Carmichael, *Survey of Union Pension Trustees* (Canadian Labour Market Productivity Centre & the Ontario Public Services Employees' Union, 1998) at 4 [hereinafter *Survey of Trustees*].

¹⁷³ *Ibid.*

¹⁷⁴ *Ibid.*

¹⁷⁵ *It's Our Money: What Workers Need to Know About Pension Governance and Control* (Nepean: National Union of Public and General Employees) [hereinafter *It's Our Money*]; *What did the Kirby report really say about the appointment of pension plan trustees?* (Nepean: National Union of Public and General Employees, 2000).

¹⁷⁶ The unions that have sole trusteeship tend to be those that unilaterally established the fund in the absence of employer support. I. Carmichael, *Union Pension Funds, Worker Control and Social Investment in Canada: Implications for Labour Education* (Ph.D. Dissertation, Ontario Institute for the Study of

(OPSEU) and the Canadian Labour Market and Productivity Centre (CLMPC) that looked at the extent to which union members and unions have control over investment decision-making,¹⁷⁷ the CLMPC estimates that approximately one-third of pension assets are under some form of joint trusteeship.¹⁷⁸ These forms of joint trusteeship range from a board of trustees composed of equal numbers of employer and union trustees with each party selecting its representatives, or making recommendations to the government regarding appointments, to advisory committees with equal employer and union representations which make recommendations to a trustee or board of trustees.¹⁷⁹

The most significant developments in Canada have been in Quebec, where provincial pension legislation requires that a pension committee which is separate from the employer administer the plan.¹⁸⁰ This committee must include at least one member elected by plan participants, one elected by retirees and former plan members, and an independent member.¹⁸¹ Unions may negotiate additional representation in the form of joint or sole trusteeship through collective bargaining. In addition, the committee must have an annual general meeting to present its annual report, provide additional information and elect representatives to the committee.¹⁸²

In terms of the investment practices and programs pursued, union initiatives have included shareholder activism initiatives including greater attention to proxy voting,

Education, University of Toronto, 2000) [unpublished] at 85 [hereinafter *Worker Control and Social Investment*].

¹⁷⁷ *Survey of Trustees*, supra note 172.

¹⁷⁸ Falconer, supra note 14 at 7.

¹⁷⁹ *Survey of Trustees*, supra note 172 at 11-12.

¹⁸⁰ *Supplemental Pension Plans Act*, S.Q. 2001, c. R-15.1.

¹⁸¹ *Ibid.*, s. 147.

investment screening and various forms of economically targeted or community development investments. Shareholder activism encompasses a number of activities that can be undertaken by pension funds as shareholders in particular corporations. The more well-known initiatives are shareholder resolutions put forward at a corporation's annual general meeting. These can range from proposals relating to executive compensation to proposals directed at operational practices. Recent examples of shareholder proposals supported by Canadian pension plans include a motion put forward by a Quebec-based shareholder rights group to place limits on the Royal Bank of Canada's executive stock option plans,¹⁸³ and resolutions asking Sears Canada and the Hudson's Bay Company to improve their codes of conduct and purchase contracts to include the International Labour Organization's (ILO) *Declaration on Fundamental Principles and Rights at Work*,¹⁸⁴ and to establish an independent monitoring process to evaluate compliance.¹⁸⁵

Another lower-profile form of shareholder activism is what is sometimes referred to as "corporate dialogue" or "corporate engagement." This involves raising concerns with the corporation through letters and meetings with corporate management or directors. Falconer suggests that high profile shareholder activism in Canada masks this "Made-in-Canada" approach to shareholder activism – an "even greater incidence of formal and informal consultation and negotiation on corporate governance matters behind

¹⁸² *Ibid.*, s. 166.

¹⁸³ K. Howlett, "Teachers opposes Royal's stock bylaw" *The Globe and Mail* (20 February 2001) B3.

¹⁸⁴ ILO General Conference, 86th Sess., (1998), online: <<http://www.ilo.org/public/english/10ilc/ilc86/com-dtxt.htm>>.

¹⁸⁵ Shareholder Association for Research and Education, "Labour Investors Gather Broad Support in Anti-Sweatshop Vote" (2001) 1 Prospectus 4 [hereinafter "Labour Investors"]; Shareholder Association for

closed doors.”¹⁸⁶ This form of shareholder activism is particularly important for institutional investors in a small capital market like Canada’s since the size of the market combined with institutional investors’ large holdings make it difficult for investors to simply sell their shares if they disagree with corporation management practices because such sales of large blocks of shares often drive the share price down.¹⁸⁷ Canada’s small capital market also make it difficult for institutional investors to find a comparable replacement investment. As part of their work to become more active shareholders, some pension plans are paying greater attention to the ways that their proxies are voted and are developing labour friendly guidelines to direct their investment managers, proxy voting services or in-house managers.

A number of pension plans in Canada also screen their investments in various ways. Some use exclusionary or negative criteria to prohibit investment in corporations that derive revenue from for example, tobacco, alcohol, gambling, nuclear power, or military arms. Others screen investments using positive screening criteria such as community involvement, employee relations, human rights practices. Aspects of these criteria are given positive and negative ratings and investment is limited to those corporations that receive a certain combined rating.¹⁸⁸ Still others use a “Best-of-Sector” approach which evaluates companies in comparison to their industry counterparts and

Research and Education, “Proxy Vote at Sears Canada and Hudson’s Bay Co: Shareholder Proposals on Labour Standards and Reporting” Trustee Alert (5 April 2001) [hereinafter “Proxy Vote at Sears Canada”].

¹⁸⁶ Falconer, *supra* note 14 at 21.

¹⁸⁷ *Worker Control and Social Investment*, *supra* note 176 at 52-54.

¹⁸⁸ T. Moore, Presentation as part of Panel: “Ethical Screening of Workplace Pensions: Some Union Experience” (Canadian Labour Congress National Pension Conference, 5 February 2001) [hereinafter “Some Union Experience”].

invests in the corporation within the sector that best meets its screening objectives. This allows pension plans to keep their investments adequately diversified.¹⁸⁹

The labour movement has also been involved in creating screened investment products which can be purchased by institutional investors such as pension plans. For example, Working Enterprises Ltd., which provides services for unions and their members through its group of companies, has created two ethically screened index funds. The Canadian one tracks the TSE 300, and the American one tracks a Standard & Poor's index. They are passive investment products that invest in those companies on the index that meet the fund's screening criteria.¹⁹⁰ Some private firms, such as Real Assets Management, also provide similar services to institutional investors.

Economically targeted investment practices include investments designed to support job creation, community economic development or the provision of social needs such as affordable housing.¹⁹¹ They are investments that "obtain both market-grade returns¹⁹² and economic or social benefits by addressing perceived financing gaps and under-investment."¹⁹³ In British Columbia, Concert Properties,¹⁹⁴ a non-profit real estate company created with the investments of several building trades unions' pension funds,

¹⁸⁹ Some pension plans that use one or more of these screening methods are the OPSEU Staff Pension Plan, the Public Service Alliance of Canada Staff Plan, and the United Church of Canada Pension Plan.

¹⁹⁰ P. Chapman, Presentation as part of Panel: "Ethical Screening of Workplace Pensions: Some Union Experience" (Canadian Labour Congress National Pension Conference, 5 February 2001).

¹⁹¹ Some of the literature separates economically targeted investment and community economic development. In this paper, the term "economically targeted investment" includes both forms of investment.

¹⁹² Returns that match the returns for similar types of investments that do not necessarily provide the additional economic or social benefits.

¹⁹³ Falconer, *supra* note 14 at 32.

¹⁹⁴ Formerly Greystone Properties.

employs unionized labour to build non-profit housing in Vancouver.¹⁹⁵ In Quebec, a number of pension plans pool their funds through the Caisse de Dépôt et Placement du Québec (the “Caisse”) which has an explicit mandate to promote provincial economic development.¹⁹⁶ The Caisse has a number of investment subsidiaries with investment programmes aimed at supporting small and medium-sized companies in the province.

Recently, some of the umbrella organizations in the Canadian labour movement have undertaken initiatives to assist union pension trustees with the practical initiatives outlined above. In February 2001 the CLC held its first National Pension Conference with workshops on a wide range of issues from ethical investment and shareholder campaigns, to the relationship of union trustees to their members. The CLC has indicated a commitment to providing more “union-centred” training to union pension trustees and other members.

In British Columbia, Working Enterprises Ltd. has recently established SHARE, the Shareholder Association for Research and Education. SHARE’s mandate is to “help support the labour movement’s increasing involvement in all aspects of pension investment.”¹⁹⁷ Specifically SHARE will provide training to pension trustees and administrators; research on legal issues related to socially responsible institutional investment; and assistance with proxy voting policies and procedures. Its Director of Law and Policy has recently drafted a paper reviewing the law with respect to the

¹⁹⁵ See generally *Worker Control and Social Investment*, *supra* note 176 at c. 10.

¹⁹⁶ Deaton, *supra* note 44 at 225, 318-22. The Caisse was created in 1965 by the provincial government to manage the Quebec Pension Plan, Quebec’s CPP equivalent.

¹⁹⁷ P. Chapman, “New Labour Shareholder Organization Launched at B.C. Federation Convention” (2001) 1 Canadian Labour Congress Pension News 8 at 8 [hereinafter “New Labour Shareholder Organization”].

relationship between pension trustees' fiduciary duties and socially responsible investment, arguing that pension plan trustees are not prohibited from investing funds in a socially responsible manner and arguing further that "there is significant legal and empirical support for viewing socially responsible investment practices as a requisite element of prudent and loyal trusteeship."¹⁹⁸ It has recently published a guide to assist trustees interested in developing a pension plan Statement of Investment Policy and Procedures that permits socially responsible investment practices.¹⁹⁹

While there is increasing interest and work on the part of the Canadian labour movement, particularly from public sector unions, to exert more control over their pension fund management and investment practices, it is important to note that the labour movement is not united in its support for strategies which focus on controlling pension management and investment in the capitalist economy. The Canadian Auto Workers, for example, takes the view that these strategies ultimately fail to address the real problem – the structure of the capitalist economy.²⁰⁰ They also object to co-management of pension funds as blurring the "division of responsibility implicit in the traditional understanding of occupational pensions."²⁰¹ These concerns will be discussed in more detail in the next two chapters.

¹⁹⁸ G. Yaron, "The Socially Responsible Pension Trustee" (2001) 20 Est. Tr. & Pens. J. 305 at 308.

¹⁹⁹ Shareholder Association for Research and Education, *A Guide to Incorporating Active Trustee Practices into Statements of Investment Policies and Procedures* (Vancouver: Shareholder Association for Research and Education, 2002) Executive Summary Available Online: <www.share.ca/resource/publications.htm>.

²⁰⁰ S. Gindin, "Putting the Con Back in the Economy" *This Magazine* 25:8 (May 1992) 17; See also *Worker Control and Social Investment*, *supra* note 176 at 17, 85-90.

²⁰¹ *Paper Boom*, *supra* note 20 at 374.

Conclusion

This chapter has sought to place the development of occupational pensions in their historical context and to highlight their role in the ongoing struggle between capital and labour for control of the production process and over the distribution of income.

Occupational pensions were initially a cost-effective mechanism for management to promote worker loyalty and undermine union power. Over time as the size of the pension funds increased, their role as a source of investment capital took on greater importance. The labour movement has challenged these developments, first by resisting the creation of occupational pensions and lobbying instead for a universal pension program, and later by advocating for a greater role in pension fund management and investment decision-making, along with promoting investment practices which aim to influence corporate management and practice, promote long-term productivity, sustainability and ultimately help regulate financial markets. However it is important to note that the labour movement is not united in its support for the latter approach.

The next two chapters look at the theoretical and practical limitations of these strategies created by pension law and corporate law. Chapter three applies pension law theory and practice to some of the assumptions that underpin pension fund activists' strategies. In particular, it examines two arguments that they put forward. These are first, that pension funds are workers' deferred wages which belong to them, and they should therefore have more control over how their pension funds are invested, and second, that if workers' or their representatives had more say about how "their" funds were invested, they would and could consider criteria other than or in addition to monetary rate of return

in making investment decisions. The fourth chapter examines corporate law theory and practice with a focus on the uncertainty in corporate law about the legal nature of the share, which mediates the relationship between the shareholder and the corporation, and the contradictions that exist within modern corporate law between separate corporate personality doctrine on the one hand and shareholder ownership “rights” on the other. It examines the implications of these uncertainties for pension fund activists’ strategies.

CHAPTER THREE: THEORETICAL LIMITATIONS: PENSION FUND ACTIVISTS MEET PENSION LAW

Introduction

The sheer size of pension funds, their influence on national and global capital markets and the various negative ways in which pension fund investments have affected workers make strategies of pension fund activism appear particularly attractive as means to affect both “capitalism and its corporations”.²⁰² In putting forward these strategies, pension fund activists explicitly or implicitly advance two general arguments to support them. First, they argue that pension funds represent workers’ capital in the form of deferred wages, and workers or their representatives should have more control over how they are invested. Secondly, they suggest that if workers or their representatives had a greater influence over how “their” funds were invested, they would consider more than short-term and monetary rates of return criteria in making investment decisions. These arguments rely on a number of assumptions about ownership of pension funds. Upon closer examination, however, these assumptions are not clearly supported by existing pension law theory or practice. This chapter looks at the ways in which basic pension law doctrine conflicts with these arguments, or limits them to rhetoric rather than reality.

Just Whose Money Is It? The Ownership Question

One of the labour movement’s basic justifications for pension fund activism is that pension funds are created from money that would otherwise be given directly to

²⁰² P. Ireland, “Corporations and Citizenship” (1997) 49 Monthly Review 10 at 26 [hereinafter “Citizenship”].

to organize. This perspective also understands pensions to be deferred wages in that the contributions would otherwise be going to increase workers' wages.

Collective bargaining regimes also recognize pension contributions as a form of deferred wages. Pension contributions are usually negotiated as part of the total wage package.²⁰⁵ In the United States, a 1949 ruling of the National Labour Relations Board held that pensions and other welfare benefits, which it deemed to be wages, were a mandatory subject of collective bargaining.²⁰⁶ As Deaton comments, this decision also affected Canadian collective bargaining because many Canadian workers belonged to Canadian locals of American-based "international" unions.²⁰⁷

And yet the pension law system which governs questions of pension fund ownership and investment is unclear about whether pensions are deferred wages, and just who "owns" the money placed in trust and when they own it. Indeed, in "Pension Plans and the Law of Trusts," in which she sought to initiate the development of an analytical framework for pension law, Eileen Gillese argues that the deferred wages question is one that must be resolved.²⁰⁸

²⁰⁵ Deaton, *supra* note 44 at 122-23; P. Longhurst, "Why Employee Benefits" in R. Koskie et al., eds., *Employee Benefits in Canada*, 3rd ed. (Brookfield: International Foundation of Employee Benefit Plans, 2001) 1 at 3.

²⁰⁶ *Inland Steel*, *supra* note 139.

²⁰⁷ Deaton, *supra* note 44 at 120. American labour law divides collective bargaining subject-matter into mandatory and permissive areas. In Canada, the duty to bargain has been interpreted broadly to include "those matters the parties could consent to have included in an agreement." G.W. Adams, *Canadian Labour Law*, 2nd ed., looseleaf (Aurora: Canada Law Book, 1993) at para. 10.1470.

²⁰⁸ "Pension Plans", *supra* note 149 at 250.

Pension law incorporates aspects of a number of fields of law including trust, corporate, labour, contract and tax law. Pensions plans are usually created using two documents, a pension plan text, and a trust agreement:

When the decision is made to create a pension plan, a plan text is drafted. The plan text is a contract and it contains a variety of promises. ... [T]he employer determines how to ensure that there are funds available to provide the promised benefits. Often, the employer chooses to use a trust to ensure the security of funds.²⁰⁹

The documents are usually separated so that the plan text can be modified without amending the trust agreement.²¹⁰ Legislation sets out minimum standards for the information that must be included in both documents.²¹¹ The plan text sets out eligibility requirements, provides information about vesting and the formula for determining the benefits available under the plan, and explains how surplus funds will be used during the lifetime of the plan and when it is wound-up.²¹² The trust agreement contains provisions found in standard trust agreements including provisions that set out how funds will be received, invested and disbursed; the mechanisms for the appointment, resignation, or removal of trustees; the trustees' investment and management powers; the fees related to the plan, such as trustee or legal fees, that can be paid out of the fund; reporting, record keeping and accounting requirements; and trust amendment or termination conditions and procedures.²¹³

²⁰⁹ E. Gillese, "Contribution Holidays" (1995) 15 Est. & Tr. J. 136 at 163-64 [hereinafter "Contribution Holidays"]

²¹⁰ Koskie et al., *supra* note 205 at 500.

²¹¹ See e.g. s. 10 of the *Pension Benefits Act*, R.S.O. 1990, c. P.8, s. 10 [hereinafter *Ontario Pension Benefits Act*].

²¹² "Pension Plans", *supra* note 149 at 229-30.

²¹³ *Ibid.* at 230; Koskie et al., *supra* note 205 at 503.

The two documents are governed by different systems of law: the plan text by contract law; the trust agreement by trust law. As Gillese points out, this creates uncertainty about which system of law will govern when there are disputes. This is particularly so when changes to one document affect the other. She suggests that a central barrier to the development of a consistent legal approach to pension law is that “the nature of a pension trust has not been settled.”²¹⁴ Two pension fund ownership issues that have been the subject of many disputes, the ownership of surplus when a pension fund is wound-up, and the right of employers to take contribution holidays while the pension is on-going, illustrate the problem.

Pension plan surpluses can arise in two circumstances. During a plan’s lifetime an actuarial surplus can exist when the plan is fully funded and actuarial calculations determine that the plan’s assets exceed its liabilities. In this case, employers and/or employees may take contribution holidays – “using actuarial surplus to fund current service costs in place of contributions.”²¹⁵ When a pension is wound-up a surplus exists if there are assets remaining after those that must be used to provide the promised pensions are deducted. Not surprisingly, disputes frequently arise over the ownership of both types of surplus.

Employees, relying on trust principles, argue that all the money contributed to the fund represents deferred wages. The wages and benefits they bargain for together constitute the employer’s total compensation package. The money contributed to pension

²¹⁴ “Pension Plans”, *ibid.* at 236.

²¹⁵ Koskie et al., *supra* note 205 at 492.

funds would otherwise have been given to them as wages. The fact that the contributions are put in a segregated trust fund to benefit the employees indicates that it is money that no longer belongs to the employer. The money and the investment income it generates belongs to employees and they are entitled to any surplus. This argument is further supported by the fact that pension legislation contains implicit assumptions that pensions are deferred wages, that employers' pension plan contributions are given tax exemptions and the growth of the funds accumulated in pension trusts is not taxed.²¹⁶ "The reason for those tax concessions is to encourage the setting aside of pension funds ... and to enable those funds to grow to a level at which they can provide adequate retirement income security for the beneficiaries. The object is not to enable employers to accumulate assets for their own use."²¹⁷

Employers on the other hand rely on contract principles to argue that a pension plan is a contract to deliver pensions to workers based on fixed formulas set out in the plan text. The employer puts aside money to ensure that the promises will be delivered and once these have been paid out, any excess belongs to the employer.²¹⁸ This approach gives paramountcy to the plan text over the pension trust which is understood simply to be a mechanism for delivering the pensions promised in the plan text. The fact that in defined benefit plans the employer must make up any shortfalls in the trust fund if the contributions combined with investment income are not sufficient to deliver the promised

²¹⁶ B. Adell, "Pension Plan Surpluses and the Law: Finding a Path for Reform" in *Task Force on Inflation Protection for Employment Pension Plans, Research Studies, Volume 2* (Toronto: Queen's Printer for Ontario, 1988) 209 at 238-39; "Pension Plans", *supra* note 149 at 237.

²¹⁷ Adell, *ibid.* at 239.

²¹⁸ "Pension Plans", *supra* note 149 at 230-31.

pensions adds weight to this approach. It is further reinforced by the fact that in the early 1940s when pensions began to come under greater regulatory scrutiny and a funding mechanism to deliver the pension promise became a legal requirement under the *Income Tax Act*, insurance contracts between the employer and a third party insurer were initially the predominant funding vehicle.²¹⁹

As Gillese comments “[i]t is this tension between competing equities which makes it impossible to simply say that where trust and contract conflict, trust law and principles are to prevail.”²²⁰ The courts have adopted a case-by-case analysis in disputes over surplus in which they have tended to base their decisions on close examination of virtually all plan-related documentation including the current plan text and trust documents, previous versions of these documents including those of predecessor plans, and communications to employees, rather than ruling on the larger and more general surplus ownership arguments put forward by the employer and employees.²²¹

An example of this is *Schmidt v. Air Products of Canada Ltd.*²²² the leading Supreme Court of Canada pension law case, which looked at the question of the ownership of pension plan surplus in a pension plan that was a merger of two earlier plans. Gillese suggests that *Schmidt* illustrates the beginnings of the analytical framework for pension law which she is seeking to develop in her article.²²³ This is one in which trust law and equity principles provide the framework for pension law, and the

²¹⁹ *Ibid.* at 227 & 236.

²²⁰ *Ibid.* at 231.

²²¹ M. Zigler & A.N. Kaplan, “Pension Plan Surpluses” in Koskie et al., *supra* note 205, 222 at 224.

²²² [1994] 2 S.C.R. 611 [hereinafter *Schmidt*].

²²³ “Pension Plans”, *supra* note 149 at 236.

principles and approaches of the other intersecting fields of law providing guidance when conflicts develop.²²⁴

Air Products Canada Ltd. (“Air Products”) was a company founded in 1983 through the merger of Stearns-Roger Canada Ltd. (“Stearns”) and Catalytic Enterprises Ltd. (“Catalytic”). Both companies had defined benefit pension plans which had been converted from defined contribution plans. At the time of the merger both plans were in surplus positions. The plans and their funds were merged into two identical plans, one for the Construction Division employees, and one for senior management. The merged plans were also contributory defined benefit plans with terms that gave Air Products the right to decide how to spend any surplus on termination. In 1988 the pension plan was terminated after most of Air Products’ assets were sold. The plan had a surplus of more than \$9 million.²²⁵

Air Products sought a declaration from the Alberta Court of Queen’s Bench that it owned the surplus. The employees of the Construction Division disputed this claim. They also sought an order that Air Products repay the contribution holidays it had taken from 1985 to 1988 – close to \$1.5 million – to the fund.²²⁶

The Supreme Court of Canada, after reviewing all the plan related documents, held that Air Products owned the surplus derived from the Stearns plan. The majority

²²⁴ *Ibid.* at 250.

²²⁵ *Schmidt, supra* note 222 at 626-27.

²²⁶ *Ibid.* at 627. Although the case related only to the Construction Division employees’ pension plan, the results also affected senior management’s plan. *Ibid.* at 626.

held that the former Catalytic employees owned the Catalytic plan surplus.²²⁷ On the issue of the contribution holidays, the Court held that Air Products had been entitled to take them even where the actuarial surplus used arose from the Catalytic plan.²²⁸

Gillease argues that the apparent contradictions in the results can be reconciled by an approach which fully acknowledges that a pension plan using a trust as the funding mechanism is subject to both contract and trust law. Under this approach, while the plan is on-going, contract law has paramountcy and the plan text (the contract) is used to resolve disputes “which relate to the pension plan when it is ongoing.”²²⁹ When the plan terminates, trust law has paramountcy and trust law principles govern disputes over ownership of the trust fund surplus.²³⁰

This approach is further supported by the collective bargaining practice in which unions often negotiate changes to the pension plan, such as improved benefits or early retirement for certain plan members, which are paid out of the actuarial surplus. When unions negotiate changes to the pension plan they generally do so only on behalf of current workers. Yet plan changes that are negotiated under the collective agreement may affect pension trust assets and the interests of retirees and deferred vested employees²³¹ whose contributions to the trust were made well before the existing collective agreement was negotiated. As Gillease points out “[i]f the funds were subject to trust principles, the

²²⁷ On this issue alone McLachlin J. and Sopinka J. each wrote dissenting judgements holding that Air Products owned the Catalytic plan surplus.

²²⁸ *Schmidt*, *supra* note 222 at 675.

²²⁹ “Contribution Holidays”, *supra* note 209 at 164.

²³⁰ *Ibid.*

use of the funds to increase benefit levels for active plan members but not for retirees would be a breach of trust.”²³²

When these issues have arisen, the courts have again taken a flexible approach to the problem. They have not rigidly applied trust law to prevent changes to a pension plan from affecting pension trust assets, yet they have indicated that those involved in the collective bargaining process must consider the interests of all the stakeholders in the plan. In *Bathgate v. National Hockey League Pension Society*²³³ for example, Adams J. held that where assets have been irrevocably committed to retired members, a union cannot negotiate changes to the plan for current members out of this surplus. However he also held that in negotiating changes to the pension plan that affect the surplus or other elements of the trust, a balance must be achieved between the interests of current and former employees:

Trust law responds to the long gestation of pension arrangements and accommodates the welfare of former employees who often lack any other effective means to protect their interests. ... Trust law in this modern context, must accommodate and be responsive to key differences between the traditional settling of a trust and the ongoing administration of a pension plan in a changing economic environment. But employers, trade unions and trustees must also appreciate the central importance of pension arrangements to all employees and be vigilant of the dependent interests engrained in these plans.²³⁴

Gillease suggests that there is also a compelling social policy reason to favour this blended contract/trust law approach to questions of pension fund ownership as it

²³¹ These employees have a right to a pension the amount of which was determined when they left their employment or when the pension plan was wound-up, but it is not payable until a later date. Koskie et al., *supra* note 205 at 493.

²³² “Contribution Holidays”, *supra* note 209 at 164.

²³³ (1992) 11 O.R. (3d) 449 (G.D.) aff’d (1994) 16 O.R. (3d) 761 (C.A.), application for leave to appeal dismissed (1994) 19 O.R. (3d) 1 (S.C.C.) [hereinafter *Bathgate*].

encourages employers to create pension plans, especially defined benefit plans, which provide more secure retirement income than no plan, or employer contributions to an individual or group RRSP. This makes the ability of employers to take contribution holidays during the life of the plan an important incentive for them to create and continue pension plans.²³⁵

It might be argued that since legislation now requires new plans to provide for the distribution of surplus on termination,²³⁶ and, in some cases, sets out processes for determining surplus distribution, this issue has now been resolved. The legislative schemes, however, have not done this. Generally they require that employers and current and former employees negotiate an agreement about the distribution of surplus before the provincial regulator will authorize its release.²³⁷ Thus as Mark Zigler and Ari Kaplan write “[d]espite numerous studies, task forces and extensive academic commentary, the issue [of pension surplus ownership] has not been resolved conclusively by either the legislature or the courts, possibly, as noted by one judge, ‘because of the uncertain impact of an unqualified acceptance of either view.’”²³⁸

The flexible and case-by-case approach of the judiciary, the fact that the pension legislation “provides little or no guidance on the broad issues and questions ... such as

²³⁴ *Ibid.* at 511.

²³⁵ “Contribution Holidays”, *supra* note 209 at 166. It is important to note that pension plan texts do not automatically permit employers to take contribution holidays. In *Schmidt* the Court held that “whether or not a contribution holiday is permissible must be decided on the basis of the applicable plan provisions.” *Supra* note 222 at 653.

²³⁶ See e.g. Ontario *Pension Benefits Act*, *supra* note 211, s.1.

²³⁷ Zigler & Kaplan, *supra* note 221 at 222.

²³⁸ *Ibid.* quoting Adams J. in *Bathgate*, *supra* note 233 at 497.

entitlement to surplus, [and] the right to take contribution holidays”²³⁹ and the fact that there are potentially many “owners” of pension funds – unions, current workers, retirees, the employer - suggest that justifying involvement in pension plan administration and fund investment decision-making based on claims of fund “ownership” may have limited legal value.²⁴⁰ As Ghilarducci points out “the ambiguity of pension-fund-ownership designation weakens unions’ legal claims to pension-fund control.”²⁴¹ Moreover, in the case of defined benefit plans, whether contributory or non-contributory, asserting ownership “rights” may result in the imposition of unwanted liabilities on unions and their members to make up any short falls in the pension fund.²⁴²

The point here is not to suggest that workers or their representatives should have no involvement in pension fund administration and investment decision-making. Indeed as Ghilarducci has found, jointly managed plans generally supply better benefits to plan members regardless of whether the plan is a defined benefit or defined contribution plan.²⁴³ But concerns need to be raised about the legal and political consequences of the arguments put forward by pension fund activists in support of their “right” to have “control” of pension plan administration and investment decision-making.

²³⁹ “Pension Plans”, *supra* note 149 at 228.

²⁴⁰ Ownership rights may not be as uncertain in the case of defined contribution plans because the employees are entitled to the income from the investment of the defined contributions. However, the fact that the employees individually bear the pension fund performance risk means that the prospects for investments based on criteria other than market rates of return are limited. Also, it is worth noting that questions of pension fund ownership can arise in mixed defined benefit-defined contribution plans such as was the case in *Bathgate* where the defined contributions were used to purchase annuities which provided a pension at a defined benefit rate. The surplus ownership issues arose in *Bathgate* because assets remained after the purchase of the annuities. *Supra* note 233.

²⁴¹ *Labor’s Capital*, *supra* note 40 at 115.

²⁴² *It’s Our Money*, *supra* note 175 at 7; *Paper Boom*, *supra* note 20 at 374.

²⁴³ See generally “Small Benefits”, *supra* note 30.

This concern goes beyond the fact that justifying involvement on the basis of arguments about pension fund ownership is inaccurate and may have unintended consequences for workers and their representatives, to a more fundamental theoretical concern. As Ghilarducci points out, arguing about who “owns” pension funds tends to obscure the real issue, namely that pension fund activists want to change the way pension funds are invested. “The source of the funds can be traced to workers, but fighting over ownership rights avoids the real contest over just how pension funds should be used.”²⁴⁴ It also means that proponents of pension fund activism continue to work with, and think about, pension funds as private property that must be “owned” by someone instead of exploring the theoretical and political possibilities that flow from the fact that pension funds have many “owners” and “beneficiaries” – legal or otherwise. In many ways it is precisely this fact that makes pension funds attractive to those interested in using investment practices to try to control or moderate the behaviour of capital.

A second consequence of utilizing private property ownership arguments to justify pension fund activism is that it limits the claim made by proponents that with greater worker or union involvement in investment decisions, consideration can be given to investment criteria other than market rates of return. Although the courts and the legislatures have taken a flexible case-by-case approach to questions of surplus ownership, one area where pension law has been applied quite strictly is in relation to the duties and responsibilities that attach to trustees’ pension fund investment practices. The

²⁴⁴ *Labor’s Capital*, *supra* note 40 at 131.

next section looks at the ways in which fiduciary duty principles affect the aspirations of pension fund activists.

Rate of Return Criteria and Fiduciary Duties

Pension trustees' fiduciary duties to plan members have traditionally been understood by trustees, and to a large extent by the courts, to limit trustees' investment decision criteria to ones which focus on market rates of return. There are two issues that arise out of this focus. The first is simply the tension between long-term and short-term investment strategies. As discussed in the first chapter, despite the fact that pension funds are generally thought of as "patient capital," their investment practices have tended to focus on maximizing returns over the short-term. This in turn has helped create many of the problems in global financial markets discussed earlier, not the least of which are the ways that these practices create price volatility without productive return.²⁴⁵ The second issue relates to the larger issue of how to appropriately calculate the "rate of return." Should it be conceptualized simply in monetary terms, or are there other factors such as environmental and community sustainability, and labour and human rights standards that should be included?

The first part of this section provides an overview of trustees' statutory and common law fiduciary duties when investing trust assets, with particular attention to the effect of these duties on the criteria used to make investment decisions. It then looks at the effect of these fiduciary duties on the three pension fund investment practices being pursued by labour movement pension fund activists set out in the previous chapter –

shareholder activism initiatives including greater attention to proxy voting, investment screening, and various forms of economically targeted or community development investments. In all three cases, the “socially transformative” impact of these strategies is limited by fiduciary duty constraints. The final part of this section provides an overview of a number of other approaches to rate of return criteria that arguably provide a more accurate picture of true rates of return – both market and social.

Fiduciary Duties

Given that the purpose of a pension fund is to provide retirement income, the obligation of trustees is first and foremost to maximize investment returns.²⁴⁶

If ethical choices do not lower investment returns, the practical (and legal) reality is that trustees are unlikely to face judicial interdiction, regardless of their motivation. If investment returns are lowered, trustees are in trouble.²⁴⁷

In Canada, pension plan trustees are subject to both common law and statutory standards of prudence when investing pension fund assets. The common law standard of care, the minimum standard for all pension fund trustees in Canada, is that “which an ordinary prudent business person would exercise in conducting his or her own affairs.”²⁴⁸

Many Canadian pension fund trustees are also subject to a higher standard of care set out in pension legislation. The federal *Pensions Benefits Standards Act* (PBSA)²⁴⁹ governs all federally registered plans as well as plans in Manitoba and Saskatchewan.

²⁴⁵ “U.S. Pension Investment Policy”, *supra* note 47 at 8.

²⁴⁶ R. Tomassini, “Pension Funds and Socially Responsible Investing” in Koskie et al., *supra* note 205, 316 at 318.

²⁴⁷ E. Waitzer, “Pension Fund Trustees as Shareholders” (Paper presented at Conference on Strategies for Responsible Share Ownership, University of Toronto, 7 December 1990) at 8 cited in J. Quarter, *Canada’s Social Economy* (Toronto: James Lorimer, 1992) at 148.

²⁴⁸ *Fales v. Canada Permanent Trust Co.*, [1977] 2 S.C.R. 302. M. Mazzuca & R. Tomassini, “Pension Fund Investments: Legal Aspects” in Koskie et al., *supra* note 205, 272 at 276.

They are the dominant investment rules in Canada, as pension legislation in many provinces adopts the PBSA's investment rules by reference.²⁵⁰ The PBSA, along with a number of provinces, requires that trustees and plan administrators "exercise the care, diligence and skill ... in the investment of the pension fund that a person of ordinary prudence would exercise in dealing with the property of another person."²⁵¹ This standard is also applied to agents such as investment managers.

This higher standard, which requires trustees to be more cautious in making investment decisions on behalf of others than they would be in making investment decisions for themselves, is also found in the common law. In *Re Whiteley, Whiteley v. Learoyd*, Lord Justice Lindley stated that "[t]he duty of a trustee is not to take such care only as a prudent man would take if he had only himself to consider, the duty rather is to take such care as an ordinary prudent man would take if he were minded to make an investment for the benefit of other people for whom he felt morally bound to provide."²⁵² In addition the legislation places a higher prudence standard on trustees who, because of

²⁴⁹ R.S.C. 1985 c. 32 (2nd Supp.), as am. [hereinafter *PBSA*].

²⁵⁰ Some provinces (Alberta, British Columbia, Newfoundland and Nova Scotia) combine the PBSA rules with their own. Others (Prince Edward Island, the Northwest Territories, the Yukon and Nunavut) do not have any investment rules. Pension plans registered in Ontario used to be subject to specific investment standards found in the *Pension Benefits Regulation*, R.R.O. 1990, Reg. 909, but recent regulations now require that, as of 1 January 2001, plans must comply with the PBSA investment rules. They must dispose of any investments that do not comply by no later than 1 January 2005. *Regulation to amend Reg. 909 of R.R.O. 1990*, O. Reg. 144/00.

²⁵¹ *PBSA*, *supra* note 249, s. 8 (4); *Pension Benefits Act*, R.S.N.S. 1989, c. 340, s. 29(1); *Ontario Pension Benefits Act*, *supra* note 211, s. 22(1), (5); *The Pension Benefits Act*, R.S.M. 1987, c. P32, s. 28.1 (2); *Pension Benefits Act*, S.N.B. 1987, c. P-5.1, s. 17(1); *Pension Benefits Standards Act*, R.S.B.C. 1996, c. 352, s. 8(5); *Supplemental Pension Plans Act*, *supra* note 180, s. 151.

²⁵² (1886) 33 Ch. D. 347 at 355 (C.A.).

their profession or skills, have a higher standard of knowledge than the average person.²⁵³

Trustees are also subject to common law duties of loyalty and impartiality which require that they act honestly and impartially, treating all beneficiaries with an even hand. These duties also require that they: act in good faith in the best interests of all plan beneficiaries; avoid delegating ultimate decision-making authority; and ensure that they are not in conflict of interest situations with the beneficiaries.²⁵⁴

In applying these standards, courts have focused on the investment decision-making process, rather than the ultimate performance of the chosen investment. In the context of pension fund activist strategies, proponents have sought to include consideration of factors other than market rates of return into this decision-making process. While the law does not strictly prohibit consideration of these factors as part of the investment decision-making process, the trustees' duties of prudence and loyalty require that they must be secondary to consideration of market rates of return. There is no Canadian judicial authority on when an investment decision-making process that includes consideration of factors other than market rates of return will violate trustees' duties of loyalty and prudence. There are however, a number of cases in Britain and the United States which have considered these issues. These cases give some indication of how Canadian courts might respond to similar cases.

²⁵³ For example, section 22(2) of Ontario's *Pension Benefits Act* states that "The administrator of a pension plan shall use in the administration of the pension plan all relevant knowledge and skill that the administrator possesses or, by reason of his or her profession, business or calling, ought to possess." *Supra* note 211. British Columbia's legislation does not impose this higher standard.

²⁵⁴ E.E. Gilgese, *The Law of Trusts* (Concord: Irwin Law, 1997) at 5, c. 9; See generally D.W.M. Waters, *The Law of Trusts in Canada*, 2nd ed., (Toronto: Carswell, 1984) at c. 17 – 19.

Cowan v. Scargill

The leading case in the area is *Cowan v. Scargill*,²⁵⁵ a British case which considered the question of whether the union-appointed trustees of the Mineworkers' Pension Scheme, a jointly trustee pension plan for industrial employees of the National Coal Board, had breached their fiduciary duties in refusing to approve the fund's annual investment plan unless the plan prohibited new foreign investments and provided for the timely divestment of existing foreign investments, and prohibited investments in industries in direct competition with the coal industry.²⁵⁶ Sir Robert Megarry, V.C. held that the trustees had breached their fiduciary duties. At the time, there was little jurisprudence in the area. Megarry, V.C. considered three authorities in reaching his decision, *Evans v. London Co-op Society Ltd*,²⁵⁷ *Blankenship v. Boyle*,²⁵⁸ *Withers v. Teachers' Retirement System of the City of New York*.²⁵⁹

In *Evans*, the Court considered Rule 7, a provision in the London Co-operative Society's Pension Plan (LCS), established in 1927, which provided that fund assets not needed to pay benefits had to be loaned out to the Society at agreed upon interest rates. The loans were used by the Society to create employment and improve working conditions.²⁶⁰ Between 1933 and 1962, the LCS loaned the assets to the Society at below-

²⁵⁵ [1984] 2 All E.R. 750 (Ch. D.) [hereinafter *Scargill*].

²⁵⁶ *Ibid.* at 752-53.

²⁵⁷ [1976] C.L.Y. 2059 (Ch.D.). The case is not officially reported. The full text appears unofficially in R. Ellison, *Private Occupational Pension Schemes*, vol. 1, App. III. (London: Oyez, 1979) at 356 [hereinafter *Evans* cited to Ellison].

²⁵⁸ 329 F.Supp. 1089 (D.C., 1971) [hereinafter *Blankenship*].

²⁵⁹ 447 F.Supp. 1248 (S.D.N.Y., 1978) aff'd, 595 F.2d 1210 (2d Cir., 1979) [hereinafter *Withers*].

²⁶⁰ *Evans*, *supra* note 257 at 361.

market interest rates, which were not subject to negotiations between the parties. Instead, the rate of interest remained the same, and appeared to be set by the Society.

The Court held that Rule 7 permitted the Pension Committee to lend funds to the Society at less than market rates of interest provided both parties agreed to this.²⁶¹ It held however, that the plan trustees were in violation of their fiduciary duty to the beneficiaries in not regularly negotiating the rate of return.²⁶² It is worth noting that the Court indicated that it was possible that there might be circumstances in which it would be in the best interests of beneficiaries for the funds to be loaned to the Society at less than market interest rates:

The Pension Committee may come to the view that in all the circumstances it is for the advantage of their beneficiaries as a whole that the Society should be permitted to have the loan of pension money at a rate lower than the Society would have to pay to an outside lender. On the other hand I think that only in the most exceptional circumstances would the Pension Committee be justified in lending pension money to the Society indefinitely in return for a rate of interest significantly lower than that obtainable on a bank deposit or on deposit with a first-class authority.²⁶³

Megarry, V.C. held that *Evans* was a decision about whether Rule 7 of the Trust Fund took the case outside of the general laws of trust, and that it had little application to the facts in *Scargill*.²⁶⁴ It is worth noting that subsequent commentators have noted that *Evans* supports the view that trustees can take a long-term approach to the “best interests” of beneficiaries, that they can consider plan members’ interests as *employees*, and that

²⁶¹ *Ibid.* at 364-65.

²⁶² *Ibid.* at 366.

²⁶³ *Ibid.* at 365.

²⁶⁴ *Scargill*, *supra* note 255 at 763. R. Megarry, “Investing Pension Funds: The Mineworkers’ Case” in T.G. Youdan, ed., *Equity, Fiduciaries and Trusts* (Toronto: Carswell, 1989) 149 at 155.

less-than-market rates of return do not, in themselves, breach trustees' fiduciary duties, if they are permitted by trust documents.²⁶⁵

In *Blankenship*, at issue were the actions of trustees for the United Mine Workers of America Welfare and Retirement Fund in allowing huge amounts of cash to accumulate in interest-free accounts at the National Bank of Washington,²⁶⁶ a bank owned by the United Mineworkers of America, and in investing in stocks of electrical utility companies and transferring a substantial portion of the share proxies to a Union. This was done to encourage these companies to use union-mined coal.²⁶⁷

The District Court for the District of Columbia held that these investment decisions were made primarily in the interests of the union and that the trustees had violated their duty of undivided loyalty to all the beneficiaries.²⁶⁸ As Megarry, V.C. stated: "The court re-affirmed the duty of undivided loyalty to the beneficiaries that a trustee owes, and did not accept that regard should also be paid to the union or its members who generated some of the income of the fund, or to the industry as a whole."²⁶⁹

Withers was a case in which the courts permitted pension plan trustees to make investments that provided less-than-optimal market rates of return. The U.S. District Court, S.D. New York upheld the decision of the trustees of the Teachers' Retirement System (TRS) to purchase \$860 million in New York City bonds. At the time, the City

²⁶⁵ Manitoba Law Reform Commission, *Ethical Investments by Trustees* (Winnipeg: Manitoba Law Reform Commission, 1993) at 25; Yaron, *supra* note 198 at 339-40.

²⁶⁶ At times this cash represented nearly 30% of the Fund's total assets. *Blankenship*, *supra* note 258 at 1096.

²⁶⁷ *Ibid.* at 1105-1106.

²⁶⁸ *Ibid.* at 1099, 1106.

²⁶⁹ *Scargill*, *supra* note 255 at 764.

was facing bankruptcy, and the purchase was part of a plan by TRS and four other pension plans to purchase close to \$2.53 billion in City bonds over two and a half years to prevent the City from going bankrupt.²⁷⁰ The bonds had a low rating and were virtually unmarketable, but the trustees had imposed a number of conditions designed to protect the TRS before they agreed to purchase them.²⁷¹

The Court upheld the TRS decision because the main reason for the trustees' decision was the fact that the City's contributions to the plan outweighed the income from existing assets and employee contributions, and upon bankruptcy these contributions would cease.²⁷² In preventing the City from going bankrupt, the trustees were helping ensure that the City could continue to contribute to the TRS.²⁷³

As Megarry, V.C. and other commentators have noted, while the court upheld an investment decision that was not motivated primarily to maximize returns, the unique circumstances of the case give it limited value as a precedent.²⁷⁴ Moreover, one could argue that the decision *was* made with the best financial interests of the beneficiaries in mind since without the City contributions, the pension plan would have spent all its reserves within ten years.²⁷⁵

In his decision in *Scargill*, Megarry, V.C. set out the following principles. First, trustees must exercise their investment powers in the best interests of both present and

²⁷⁰ *Withers*, *supra* note 259 at 1250.

²⁷¹ *Ibid.* at 1253-1255.

²⁷² *Ibid.* at 1251-52.

²⁷³ *Ibid.* at 1259.

²⁷⁴ *Scargill*, *supra* note 255 at 764; Tomassini, *supra* note 246 at 319; J.D. Hutchinson & C.G. Cole, "Legal Standards Governing Investment of Pension Assets for Social and Political Goals" (1980) 128 Univ. of Penn. L.R. 1340 at 1363.

future beneficiaries.²⁷⁶ The court recognized that the investment restrictions, which were designed to protect the mining industry in Britain, would benefit those who were active employees, but found that other beneficiaries (deferred pensioners, retirees, and the surviving spouses and children of deceased miners) would gain little.²⁷⁷ Second, that in most cases, the best interests of the beneficiaries is their best financial interests.²⁷⁸ Third, trustees must put aside their own personal political and social views when making investment decisions.²⁷⁹ And fourth, trustees must consider the need to adequately diversify fund investments.²⁸⁰

There are a number of factors that should be considered when assessing the impact of *Scargill*. First, the union trustees did not investigate the financial implications for the fund of screening out all foreign investments and investments in entire industries. As Roberto Tomassini comments “[t]he court’s decision might have been different if the trustees had proposed an investment screening policy that they could demonstrate would not impact negatively on the investment performance of the fund, given the availability of comparable competitive investments.”²⁸¹ Megarry, V.C. later suggested that the case might have been decided differently if the trustees had sought to adopt an investment

²⁷⁵ Megarry, *supra* note 264 at 155.

²⁷⁶ *Scargill*, *supra* note 255 at 760 & 762.

²⁷⁷ *Ibid.* at 764.

²⁷⁸ *Ibid.* at 760.

²⁷⁹ *Ibid.* at 761.

²⁸⁰ *Ibid.* at 762.

²⁸¹ Tomassini, *supra* note 246 at 319.

policy which simply indicated a preference for investments which were domestic and did not compete with the coal industry.²⁸²

And second, he indicated that in certain rare instances, where there were trust beneficiaries “with strict views on moral and social matters” it would be possible for trustees to decide not to invest in companies that derived revenue from, for example, alcohol, tobacco, or armaments, even if this meant that the fund would receive reduced financial returns. He commented that “the beneficiaries might well consider that it was far better to receive less than to receive more money from what they consider to be evil and tainted sources.”²⁸³ However, the trustees would have to satisfy a heavy burden of proof that all classes of beneficiaries would “benefit” from such an investment policy.²⁸⁴

Although the jurisprudence since *Scargill* has not grown significantly, there have been some additional trust fund cases in both Britain and the United States in which courts have considered the conditions under which trustees can consider factors other than market rates of return as part of the investment decision-making process.

Board of Trustees v. City of Baltimore

In the *Board of Trustees v. City of Baltimore*,²⁸⁵ the Court of Appeals of Maryland considered the legality of a Baltimore City ordinance requiring its employee pension plans to divest their South African holding over a two-year period. Under the ordinance

²⁸² Megarry, *supra* note 264 at 157-58. It is also worth noting that the union trustees were represented by a layperson, the defendant and union president, Arthur Scargill. Megarry comments that “[o]ne cannot say what would have emerged had the defendant’s case been presented by a Chancery silk, particularly in the bound and rebound of ideas between Bench and Bar” (at 152).

²⁸³ *Scargill*, *supra* note 255 at 761.

²⁸⁴ *Ibid.* at 762.

²⁸⁵ 562 A.2d 720 (M.D.C.A., 1989) [hereinafter *Baltimore*].

the trustees could suspend the divestment process at any time for up to 90 days if the fund's rate of return was substantially lower than the previous five years average, if it would be inconsistent with generally accepted investment standards, or if it would lead to financial losses for the fund.²⁸⁶ The trustees challenged the ordinance arguing that it required them to violate their duties of prudence and loyalty to the beneficiaries. They alleged that the ordinance would negatively affect fund performance and impair their investment manager's active management style.

The ordinance was upheld at both trial and on appeal. In terms of the claim that the ordinance would negatively affect the funds performance, at trial, the Circuit Court for Baltimore City found that despite being no longer able to invest in 120 of the 500 companies on the Standard & Poor's 500 Index and having to invest in smaller companies whose stock prices tended to be more volatile, in the long run these stocks perform as well as or better than larger companies.²⁸⁷ It also held that the initial costs of the divestment process to the funds (a \$750,000 one-time divestiture cost and an approximately \$300,000 increase in broker's fees) and the ongoing costs (\$1.2 million per year) were insignificant costs to the funds given their size.²⁸⁸ In upholding the trial judgment, Eldridge, J. writing for the Court of Appeal stated that

[A] trustee's duty is not necessarily to maximize the return on investments but rather to secure a "just" or "reasonable" return while avoiding undue risk. ... Thus, if, as in this case, social investment yields economically competitive returns at a comparable level of risk, the investment should not be deemed imprudent.

²⁸⁶ *Ibid.* at 724.

²⁸⁷ *Ibid.* at 726.

²⁸⁸ *Ibid.* at 727.

... Moreover, given the vast power that pension trust funds exert in American society, it would be unwise to bar trustees from considering the social consequences of investment decisions in any case in which it would cost even a penny more to do so. ... [I]f, ... the cost of investing in accordance with social consideration is *de minimis*, the duty of prudence is not violated.²⁸⁹

In terms of the effect on the plan's money manager's active management style, the trial court found that this would be insignificant as replacement stocks could be found in every sector. It also noted that since money managers tend to invest in a small range of "known" stocks, the ordinance simply required them to do additional research to find comparable replacements.²⁹⁰

Martin v. The City of Edinburgh District Council

This is another South African divestment case. In *Martin v. The City of Edinburgh District Council*²⁹¹ Edinburgh City Council had instructed its investment advisors to report on any of its trust fund (public and charitable) investments in South Africa and propose alternative investments. The Court took issue, not with the policy itself, but with the process followed in its development. It was concerned that the trustees had not first determined whether it was in the best interests of the trusts and their beneficiaries to divest from South Africa. It held that the City Council had breached its fiduciary duties "in pursuing a policy of disinvesting in South Africa without considering expressly whether it was in the best interests of the beneficiaries and without obtaining professional advice on this matter."²⁹²

²⁸⁹ *Ibid.* at 737.

²⁹⁰ *Ibid.* at 726.

²⁹¹ *Martin v. City of Edinburgh District Council*, [1988] S.C.L.R. 90 (O.H.) [hereinafter *Martin*].

²⁹² *Ibid.* at 96.

Harries v. Church Commissioners for England

At issue in *Harries v. Church Commissioners for England*²⁹³ were the investment decision-making criteria used by trustees of a charitable trust. The Bishop of Oxford and other members of the clergy alleged that the Church Commissioners for England Board of Governors, who were responsible for investing Church of England assets, had breached their fiduciary duties in giving financial criteria overriding importance in making investment decisions. They claimed that the Board had to consider the underlying purpose for which the trust was created, namely “the promotion of the Christian faith through the Church of England,”²⁹⁴ and argued that the Board should not invest in a manner that was in conflict with this purpose, even if it meant financial loss.²⁹⁵

The Board had a very progressive “ethical investment policy” which stated in part that “[w]hile financial responsibilities must remain of primary importance (given our position as trustees), as responsible investors we continue to take proper account of social, ethical and environmental issues.” It did not invest in alcohol, armaments, gambling, newspaper, or tobacco companies. Nor did it invest in South African companies or companies with major parts of their business there. When it invested in companies with small parts of their business in South Africa, the Board tried to make sure that the companies followed progressive social and employment policies. It also paid

²⁹³ [1993] 2 All. E.R. 301 (Ch.D.) [hereinafter *Harries*].

²⁹⁴ *Ibid.* at 302.

²⁹⁵ *Ibid.*

attention to local community and environmental interests when looking at property development opportunities.²⁹⁶

In his decision, Sir Donald Nicholls, V.C. reaffirmed that trustees' decisions should be primarily concerned with furthering the purposes of the trust, and that these purposes are best served by seeking maximum return on trust assets.²⁹⁷ He found that the Board had an ethical investment policy that did not conflict with the purposes of the Church of England.²⁹⁸ He noted that in some "comparatively rare" instances the most prudent investment for a trust fund might be in a company engaged in a business in direct conflict with the purposes of the trust, such as a charity for cancer research investing in cigarette companies. Alternatively, the investment might interfere with the ability of the charity to do its work. In such cases he stated that the trustees might be bound not to make the investment. In any event, they would have to weigh carefully the financial losses from not making the investment against the difficulties that the charity would face in conducting its work.²⁹⁹ Much has been made of this exception. However, it is important to remember that, as the Supreme Court of Canada confirmed in *Schmidt*, pension funds are not purpose trusts.³⁰⁰ Purpose trusts are those that do not have a beneficiary: "[f]unds are deposited in trust in order to see that a particular purpose is filled; people may benefit, but only indirectly."³⁰¹

²⁹⁶ *Ibid.* at 306-307.

²⁹⁷ *Ibid.* at 304.

²⁹⁸ *Ibid.* at 309.

²⁹⁹ *Ibid.* at 304-305.

³⁰⁰ *Schmidt*, *supra* note 222 at 640-41.

³⁰¹ *Ibid.* quoting Pension Commission of Ontario in *Arrowhead Metals Ltd. v. Royal Trust Co.* (March 26, 1992), unreported, at pp. 13-15, cited by Adams J. in *Bathgate*, *supra* note 233 at 510.

Summary of Principles

A number of pension fund investment principles can be distilled from these decisions. Trustees have an undivided loyalty to all classes of fund beneficiaries and must exercise their investment powers in the beneficiaries' best interests.³⁰² However they may also consider the interests of the beneficiaries in other roles such as employees.³⁰³ Trustees must put aside their own personal political and social views, or those of the organizations that appointed them as trustees, when making investment decisions.³⁰⁴

Prudence standards in the context of pension fund investment are more concerned with the decision-making process than with the actual results of particular investment decisions.³⁰⁵ As part of a prudent process trustees must obtain appropriate advice and consider the need to adequately diversify fund investments.³⁰⁶ They must also have discretion to deviate from their investment policies if it would be imprudent to continue to follow them. This applies regardless of whether or not the policies mandate consideration of investment criteria other than rates of return.³⁰⁷

³⁰² *Scargill, supra note 255; Blenkenship, supra note 258; Baltimore, supra note 285.*

³⁰³ *Evans, supra note 257.*

³⁰⁴ *Scargill, supra note 255; Blenkenship, supra note 258.*

³⁰⁵ *Scargill, ibid.; Martin, supra note 291.* This is further supported by statements from regulatory bodies such as the Pension Commission of Ontario which reaffirmed that it is the process "through which investment strategies and tactics are developed, adopted, implemented and monitored" that is at issue when determining if trustees have met the appropriate standard of prudence. Pension Commission of Ontario, *PCO Bulletin* (May 1990) 1(2) at 12.

³⁰⁶ *Scargill, ibid.* at 763.

³⁰⁷ *Baltimore, supra note 285.*

In most cases, the best interests of the beneficiaries are their best financial interests³⁰⁸ but it is not imprudent to consider factors other than rate of return so long as there are alternative investments available with similar risk and return profiles and the fund can remain appropriately diversified.³⁰⁹ It is also not necessarily imprudent to incur additional costs in implementing an investment policy that considers factors other than market rates of return, so long as the implementation costs are relatively insignificant in comparison with the size of the fund.³¹⁰ In implementing an “alternative” investment policy, it is prudent for trustees to canvass the interests of beneficiaries.

In short, pension fund trustees are able to consider investment criteria other than market rate of return, so long as market rate of return is the paramount or primary consideration. While trustees may consider other criteria such as a company’s labour and environmental practices or the human rights records of countries that a corporation operates in, generally they can only screen or divest their investments if alternative investments exist providing market rate of return and risk factors that are similar to the screened investment.

Fiduciary Duty Constraints on Pension Fund Activists’ Investment Strategies

The “socially transformative” impact of investment practices being pursued by labour movement pension activists is limited by these fiduciary duty constraints. Pension fund investment policies generally include provisions indicating that market rates of return are the paramount investment decision-making criterion, and that trustees can

³⁰⁸ *Scargill, supra note 255; Harries, supra note 293.*

³⁰⁹ *Baltimore, supra note 285.*

deviate from the investment policy if it would be (financially) imprudent to follow it. Practices such as shareholder activism, screening and economically targeted investing, often referred to collectively as socially responsible investment (SRI), can be pursued as long as the rate of return to the fund is not negatively affected.

Further evidence of the concern with market rate of return is the fact that many commentators recommend that trustees developing investment policies which include SRI take some additional prudence measures to ensure they are protected from liability if returns are less than anticipated. These measures include obtaining the input and consent of plan participants, and providing on-going information to plan participants about the policies and investment returns.³¹¹ Thus any investment practice that has the potential to increase the risk of reducing the pension payout must be undertaken only with the informed consent of plan members who are willing either to take a reduced pension, or to increase pension fund contributions to offset the loss.

Shareholder Activism

Shareholder activists need to be concerned that their shareholder proposals will not negatively impact the company and share value. The proposals have to be carefully framed as being designed to improve shareholder value. For example, recent shareholder proposals coordinated by SHARE and supported by a number of shareholders including the Canadian Labour Congress Staff Pension Plan and the Régime Complémentaire de

³¹⁰ *Ibid.*

³¹¹ M.O. Hylton, "Socially Responsible Investing: Doing Good Versus Doing Well in an Inefficient Market" [1992] 42 Am. U. L. Rev. 1 at 48-49; Tomassini, *supra* note 246 at 323 & 325.

screens. In developing and implementing these screens prudence standards require that, in the vast majority of cases, financial interests must be of primary concern to the trustees, and they must ensure that the pension funds remain appropriately diversified.³¹⁶ Thus, trustees must have discretion to deviate from their screens if their effect would be detrimental to the fund's rate of return or its diversification.

This limits the ability of trustees to consistently apply the screen to all investments and moderates the effectiveness of screening as a means to influence corporate behaviour. Indeed, trustees implementing screens have acknowledged the moderate nature of the type of corporate reform that their screens encourage. As Terry Moore, a trustee of the Ontario Public Service Employees Union (OPSEU) Staff Pension Plan, stated in materials that were part of a presentation to the CLC National Pension Conference in February 2001:

We are under no illusion (sic) that the use of ethical screening will in any fundamental sense change the nature of capital or capitalist behaviour. But we believe that ethical screening can be part of a political process to educate union members and the public about specific aspects of corporate behavior and to help mobilize members against those practices.³¹⁷

Advocates of Best-of-Sector screening would argue that it both ensures that pension funds remain adequately diversified, and provides a greater incentive to corporations in a particular sector to improve their practices than does an investor boycott

³¹⁵ "Proxy Vote at Sears Canada", *ibid.*

³¹⁶ As noted in *Harries, supra* note 293 and *Withers, supra* note 259 there are rare instances where this is not the case.

³¹⁷ T. Moore, "OPSEU Staff Pension Plan Ethical Screening Experience" Materials distributed to support presentation as part of Panel: "Ethical Screening of Workplace Pensions: Some Union Experience" (Canadian Labour Congress National Pension Conference, 5 February 2001) at 3. [copy on file with author].

of the entire sector. On the other hand, the fact that prudence standards make it difficult for Canadian institutional investors to boycott entire sectors, means that if the standards that are being screened for, such as environmental or labour standards, are uniformly low across the sector, funds may find themselves investing to a certain extent in the “best of bad lot” and providing little incentive for corporations to improve their standards.

Trustees interested in implementing screening policies often obtain member consent before implementing the screen. For example, trustees of the OPSEU Staff Pension Plan, which incorporates a “labour screen” into its investment decision-making, consulted members about divesting from South Africa and developing the screen. As one of the trustees explained, “[w]e went to the membership at an AGM; we wanted their consent and we got a vote on screening out investments to South African and anti-union companies with 95% of members in favour. Then, ... we asked for an ongoing tracking of our screen to measure the economic impact on the plan.”³¹⁸ The OPSEU Staff Pension Plan’s labour screen assigns positive or negative points to criteria ranging from unionization, diversity, investment in the community, the labour environment and provision of employee benefits. Aspects of these criteria are given positive and negative ratings and investment is limited to those corporations that receive a certain combined rating.³¹⁹

It is also worth noting that the institutional investors that do engage in some form of investment screening tend to be a small subset of the institutional investor community,

³¹⁸ T. Moore, Trustee, OPSEU Staff Union Pension Plan quoted in *Worker Control and Social Investment*, *supra* note 176 at 102.

often with religious or political interests. In its *Canadian Social Investment Review 2000*, the Social Investment Organization found that most of the funds managed by investment management companies that are screened in some manner are managed on behalf of “religious institutions, pension plans, particularly union trustee pension plans, public institutions such as universities and hospitals, and foundations.”³²⁰ It is not surprising then that union staff plans and church staff pension plans with a relatively small number of highly politicized members, such as the OPSEU Staff Pension Plan, appear to be the most active funds in terms of investment screening.

In 1988 the provincial legislature in Ontario stepped in to add additional protection to trustees who implemented screens for South African investments with the support of plan participants. The *South African Trust Investments Act*,³²¹ which was repealed in 1997 following the end of apartheid in South Africa, stated that trustees who complied with the Act would not be in breach of their fiduciary duties for divesting from South Africa or refusing to invest in South Africa. Section 3 of the Act provided that:

Despite the *Trustee Act* or any other law, a trustee who acts in accordance with this Act and in a reasonably prudent manner does not commit a breach of statutory or other legal duty by,

- (a) disposing of a South African investment *even if the value* of the property for which the trustee is *responsible decreases or fails to increase sufficiently* as a result; or
- (b) refusing to acquire a South African investment.³²²

³¹⁹ “Some Union Experience”, *supra* note 188.

³²⁰ Social Investment Organization, *Canadian Social Investment Review 2000: A comprehensive survey of socially responsible investment in Canada* (Toronto: Social Investment Organization, 2000) at 9 [hereinafter *Social Investment Review 2000*].

³²¹ R.S.O. 1990, c. S-16. Repealed by *An Act to simplify processes and to improve efficiency in the Ministry of the Attorney General*, S.O. 1997, c. 23, s. 12.

³²² *Ibid.*, s. 3. [emphasis added].

The legislation required that trustees of funds with more than 100 beneficiaries had to determine that the majority supported these actions, with a further stipulation that this majority had to have a “combined beneficial interest” in more than half of the trust assets. For trusts with fewer beneficiaries, trustees had to give written notice of their investment plans to all of them. If they did not receive a notice of opposition within 60 days from the majority of beneficiaries with a combined beneficial interest in more than 50 percent of trust assets, the trustees could proceed.³²³

Economically Targeted or Community Investment

Trustees considering developing or investing in economically targeted or community investment projects, must ensure that the primary consideration in deciding to do so is the rate of return to the fund, factoring in the risks associated with the investment. Thus consideration of collateral benefits such as the creation of affordable housing or a better living environment, the creation of jobs for pension plan members or others, or encouraging a productive economy, must be secondary. This is particularly problematic in the context of investments that have a collateral benefit of either creating work for existing plan participants, or creating new jobs and consequently new plan members, since the potential increase in contributions to the fund is not considered as part of the “investment return” when considering whether to invest in the project. Prudence standards would appear to make it difficult for trustees to factor in contributions to the

³²³ *Ibid.*, ss. 4(2) & 4(3).

fund that “depend on the employment of participants” in assessing the rate of return to the pension fund.³²⁴

Thus the constraints placed on trustees by traditional trust law prudence standards in the context of investing in economically targeted or community development projects reveal a larger limitation of the application of trust law standards of prudence. Namely, these standards were created to regulate the investment of income derived from an initial allocation of capital to a trust, while pension trusts funds receive two streams of income, ongoing income from contributions by employers and employees,³²⁵ and the income from fund investments. As Ghilarducci points out

[R]egulators have treated pension funds like any other kind of trust whose only income source is investment returns ... The fiduciary’s duty ... was to obtain risk-adjusted maximum rates of return in capital markets regulators viewed as “free” and “efficient.” Yet pension funds also obtain a substantial amount of income from contributions.³²⁶

Rethinking Returns: Challenging Market Conceptions of Value

Although trustees’ fiduciary duties require the primary investment criterion to be financial – the risk-adjusted market rate of return – some commentators argue that the investment practices pursued by labour movement pension fund activists in fact have the long-term effect of increasing shareholder value and the market rate of return.³²⁷ Thus “a prudent financial evaluation of any particular investment or investment policy may

³²⁴ “U.S. Pension Investment Policy”, *supra* note 47 at 10.

³²⁵ Unless there is a contribution holiday.

³²⁶ “U.S. Pension Investment Policy”, *supra* note 47 at 10.

³²⁷ See The Just Pensions Project, *Just Pensions: Socially Responsible Investment and International Development: A Guide for Trustees and Fund Managers* (May 2001). online: <<http://www.justpensions.org/???>> at 5; “New Labour Shareholder Organization”, *supra* note 197 at 8; J.

include, and may require, consideration of many social factors such as labour stability, environmental performance and other social or ethical values.”³²⁸ Regardless of whether these practices increase shareholder value and rate of return, the fact remains that investment decisions are still made within a framework in which value continues to be measured by market rates of return. The social, political or economic benefits of particular investments can be considered, but an investment can only be made if these benefits either enhance the market rate of return, or provide a reason for preferring the particular investment over others with similar risk-adjusted market rate of return expectations.

Many supporters of pension fund activism had higher hopes for the strategies. They hoped that they could be used to challenge market rates of return as the exclusive measurement of value and to develop criteria that provided a more accurate picture of investment returns - both market and social. Criteria such as job creation, environmental and community sustainability, and real productivity, would all be considered as part of such a new conception of value.³²⁹

One of the reasons trustees have been restricted to making investment decisions within a framework in which value continues to be measured by market rates of return is connected to the most widely accepted equity portfolio management theory – modern portfolio theory. Modern portfolio theory underpins an investment approach which

Frooman, “Socially Irresponsible and illegal behaviour and shareholder wealth: a meta-analysis of event studies” (1997) 36(3) *Business and Society* 221; Yaron, *supra* note 198 at 308, 354-56.

³²⁸ Tomassini, *supra* note 246 at 324-25.

³²⁹ *Labor’s Capital*, *supra* note 40 at 115.

requires those managing investment funds such as pensions to construct a portfolio with a range of investments types and risks: “the theory combines speculative and “safe” investments in an effort to generate consistent portfolio gains.”³³⁰ According to modern portfolio theory, the only accepted investment criteria are risk and return.

The final part of this section provides an overview of modern portfolio theory and its limitations as a measurement of “true” rates of return, and examines approaches to rate of return criteria that arguably provide a more comprehensive picture of investment returns – both market and social.

Modern Portfolio Theory³³¹

The assumptions of modern portfolio theory ... prevent social investment and economic innovation. Conversely, investments with serious social risks cannot be opposed on social grounds.³³²

Trustees must ensure that pension fund investments are adequately diversified and that their investment strategies reflect accepted portfolio management practice. In the area of equity investments, modern portfolio theory (MPT) underpins investment practice, and while it developed as a theory to guide stock market investing, it also appears to be applied to other types of assets held by investment funds.³³³

MPT focuses on two types of risk, “market” risk and “specific” risk. As the name suggests, market risk is associated with overall market conditions. This “type of risk rises and falls in direct response to general economic conditions that affect the entire

³³⁰ W.B. Phillips, Jr. “Chasing Down the Devil: Standards of Prudent Investment Under the Restatement (Third) of Trusts” (1997) 54 Wash. & Lee L. Rev. 335 at 348.

³³¹ This overview draws on the following: *Ibid.* at 347-53; *Worker Control and Social Investment*, *supra* note 176 at 36-57; and “U.S. Pension Investment Policy”, *supra* note 47.

³³² *Worker Control and Social Investment*, *ibid.* at 40.

market.”³³⁴ This contrasts with the specific risk of an individual investment producing less than expected returns, and the effect of this risk on overall portfolio returns. Trustees can mitigate the effects of specific risks by building a diversified portfolio that resembles the overall market. This portfolio will be more vulnerable to market risk than specific risks, since a diversified portfolio will reduce the potential impact of more speculative investments on the overall portfolio while allowing trustees to potentially improve the overall rate of return with the purchase of such investments. Under this approach though, the only investment criteria that can be considered are market risk and return.³³⁵ “an efficient portfolio offers the maximum return for a given average level of risk. ... The risk is the variance of an asset’s expected return around a norm in comparison to a low-risk benchmark like cash or treasury bills.”³³⁶

Investment diversification makes intuitive sense in terms of “not putting all one’s eggs in the same basket.” But MPT and its focus on risk and return is built on perfect capital market theory which assumes that “every investment’s return compensates for its risk and the only way to reduce risk without sacrificing return is to diversify well.”³³⁷ It also assumes that markets are inherently efficient and allocate resources to the most productive investments; that investments are priced to accurately reflect the value of a company based on freely available information about the investment and its risk; and that every investor has an equal effect on the capital markets.

³³³ Barber & Ghilarducci, *supra* note 61 at 292.

³³⁴ Phillips, *supra* note 330 at 349.

³³⁵ “U.S. Pension Investment Policy”, *supra* note 47 at 5.

³³⁶ *Worker Control and Social Investment*, *supra* note 176 at 39.

³³⁷ Barber & Ghilarducci, *supra* note 61 at 304.

As numerous economists have shown, this is simply not the case. In the context of pension fund investment practices, commentators have identified a number of flaws in these assumptions. First, pension funds are simply too large to have a “neutral impact” on financial markets.³³⁸ Second, pension capital is flowing to speculative, short-term investments rather than long-term productive ones.³³⁹ Third, the existence of capital gaps, investment opportunities that have somehow been passed over by the market, undermines the notion of a perfectly efficient market.³⁴⁰ And fourth, capital markets are not free, unfettered entities, they are “creatures of comprehensive regulation designed to steer capital markets toward particular social needs.”³⁴¹

Perfect capital market and modern portfolio theory present an approach to investment value which focuses on narrow financial criteria of risk and return and exclude other factors such as a corporation’s human capital, research and development capabilities, or an investment’s ability to create jobs or other social benefits such as housing. This approach also makes it difficult to invest in a new or innovative industry without a rate of return history.³⁴² In short, MPT’s assumptions about the market and appropriate investment criteria mean common investment practice excludes criteria other than risk and return, and seriously limits the possibility that investment returns provide an accurate picture of both market and social rates of return. These assumptions also limit

³³⁸ “U.S. Pension Investment Policy”, *supra* note 47 at 8; *Worker Control and Social Investment*, *supra* note 176 at 54; “Institutional investors”, *supra* note 22 at 103-104.

³³⁹ “U.S. Pension Investment Policy”, *ibid.*; Hebb, *supra* note 60; “Institutional investors”, *ibid.* at 105-106.

³⁴⁰ “U.S. Pension Investment Policy”, *ibid.* at 6; Barber & Ghilarducci, *supra* note 61 at 286.

³⁴¹ “U.S. Pension Investment Policy”, *ibid.* at 5.

³⁴² *Worker Control and Social Investment*, *supra* note 176 at 40 & 49.

the possibility that investment practice will always allocate capital to its most productive uses.

Searching for the Truth: Alternative Approaches to Rate of Return Measurement

Pension funds are not dead trusts that are passively sustained by investment income. They are dynamic organisms that feed on investment, income, and jobs.³⁴³

Critics of MPT and its focus on rate and return suggest that investors need an evaluative approach that allows them to consider the social benefits of their investments in financial terms. Barber and Ghilarducci, for example, argue that although MPT can be used as part of the investment decision-making process, “it provides an insufficient framework from which to make investment decisions or to regulate pension funds’ financial behaviour.”³⁴⁴ They are interested in facilitating greater pension fund investment in economically targeted investment, which they argue can be undertaken without reducing investment returns. They propose a “whole participant” approach to pension fund investment which takes into account the fact that plan members are both future recipients and current workers. Thus pension investments should look to sustaining a strong economy to keep plan members working and contributing to the fund, and ensure investment income continues to grow.³⁴⁵

They argue that current pension investment criteria put the interests of retirees ahead of other plan members.³⁴⁶ Instead they suggest that in addition to risk and return

³⁴³ “U.S. Pension Investment Policy”, *supra* note 47 at 10.

³⁴⁴ Barber & Ghilarducci, *supra* note 61 at 309.

³⁴⁵ *Ibid.* at 287.

³⁴⁶ *Ibid.* at 309; “U.S. Pension Investment Policy”, *supra* note 47 at 9.

criteria, trustees should broaden the range of investment considerations to include the effect of investment decisions on all plan members, both retirees and those currently employed, and on the economy generally. They argue that this is well within trustees' fiduciary duties of loyalty and prudence and that "it should serve to broaden fiduciaries' range of tools to meet their duty."³⁴⁷

Barber and Ghilarducci write in the United States where the federal *Employee Retirement Income Security Act of 1974* (ERISA)³⁴⁸ governs the investment practices of private-sector pension plans, the vast majority of pension plans. They suggest that the Department of Labor (DOL), which enforces ERISA, should clarify that trustees can consider the effects of investments on all plan members and the economy in general, and further, that DOL should develop regulations to assist trustees in evaluating, benchmarking and monitoring the performance of economically targeted investments. This process would incorporate the collateral benefits that are presumed to accrue to plan members and the economy in general, to achieve a prevailing rate of return.³⁴⁹ Ghilarducci and Barber however, offer few suggestions as to how to actually quantify these collateral benefits in financial terms.

Isla Carmichael, a Canadian researcher, has sought to develop mechanisms to do this. Her doctoral dissertation, *Union Pension Funds, Worker Control and Social Investment in Canada: Implications for Labour Education*, assesses the returns, both

³⁴⁷ Barber & Ghilarducci, *ibid.*

³⁴⁸ 29 U.S.C. §§ 1001 et seq. (1988). Public sector plans are regulated by municipal, county and state legislation, but have generally adopted ERISA prudent investment standards. *Ibid.* at 292-93.

³⁴⁹ Barber & Ghilarducci, *ibid.* at 309.

market and social, on pension fund investments in Concert Properties and Mortgage Fund One, a real estate development company and mortgage trust company respectively, created through the pooling of a number of union pension fund investments. Concert employs only union labour, and Mortgage Fund One's loan conditions require the employment of union labour.

Carmichael developed social accounting models designed to assess the social benefits in financial terms, and evaluate an investment's capacity for productive growth and long-term sustainability. Her model utilized an accounting approach known as value added accounting. Popular in the United Kingdom in the late 1970s and early 1980s, it defines income (or value) more broadly than traditional accounting to include income generated for all stakeholders, not just for shareholders.³⁵⁰

Value added accounting generates financial statements that indicate the net income or "total value" created by a company, and how it is distributed to all the parties who have an interest in the corporation's productivity and wealth creation such as: employees, through wage and benefits; governments, through taxes net of government grants; creditors and shareholders, through interest payments and dividends; and the corporation itself, through reinvestment in the business through depreciation costs and retained profits.³⁵¹ The percentage change for each category can be measured on a yearly basis, allowing measurement of the long-term sustainability of the enterprise. In

³⁵⁰ Gary Meek and Sidney Gray discuss the history of the development and use of the value added statement in the United Kingdom in "The Value Added Statement: An Innovation for U.S. Companies?" *Accounting Horizons* (June 1988) 73.

³⁵¹ For a sample of a value added statement see *Ibid.* at 76.

comparison, in traditional income statements, employee wages, benefits and training are subsumed into operating costs, and dividends and taxes are deducted from the corporation's total (gross) profits.³⁵²

For pension funds, value added accounting provides a mechanism to value productive growth and to monitor the potential for company sustainability over the long-term. Other factors that contribute to productive growth and sustainability such as worker training programs, research and development initiatives or risk management plans can also be included as, for example, reinvestments in the business. They could also be depreciated over a number of years. This contrasts with traditional accounting practice which would deduct these costs from earnings in the year the expenses are incurred, thus setting them up as costs that reduce reported corporate earnings and ultimately reduce shareholder value.³⁵³

Carmichael uses two social accounting models that adapt the value added accounting framework to calculate the benefits of investment by pension funds in Concert Properties and Mortgage Fund One. The first accounting model looks at the net benefits of the investment to pension fund stakeholders: plan members as workers through job creation, the fund itself, through increased contributions and dividends, and government

³⁵² *Worker Control and Social Investment*, *supra* note 176 at 120-23.

³⁵³ This raises an important point about the ways in which accounting is not a neutral, objective process but is in fact infused with biases, social norms and political choices. Carmichael provides an overview of the "growing literature asserting that accounting not only describes or reflects but also affects institutions in the social, corporate, financial and global arenas through its interpretative role in re-creating reality." For example, traditional accounting valuations of corporations cost capital investments such as equipment or buildings over a period of years, while other investments such as research and development or worker training are deducted from earnings in the year the cost is incurred. All of these investments are

through increased tax revenue net of foregone taxes on pension contributions. In essence, this model operationalizes Barber and Ghilarducci's "whole participant approach" outlined above, except that it does not quantify the benefits or costs to the economy in general.

Carmichael's second model is designed to measure the financial and social benefits or costs of the investment to the wider community. It uses multipliers from an Input-Output Model developed by the Analysis and Evaluation Branch, Ministry of Finance, British Columbia with assistance from Statistics Canada designed to assess economic impacts, and looks at some of the same variables considered in the first social accounting method but in a different context.³⁵⁴

The value of the jobs created is linked to the benefits which accrue from the type of work performed, in this case constructing rental and market housing, and the direct and indirect effects of job creation. Here for example, the social value of creating rental housing in Vancouver can be factored into the accounting, since it was highly unlikely that it would have been built by other real estate development companies.³⁵⁵ Multipliers are also used to calculate the indirect jobs created off-site from Concerts projects, and the projects' contributions to increased productivity in the community, and the taxes raised for all levels of government.³⁵⁶ These benefits can be compared with the total costs of Concerts projects to determine the social costs or benefits of the investment(s).

investments in the present *and* future value of a company, yet only the capital expenditures are depreciated over a period of years. *Ibid.* at 112; See generally 111-18.

³⁵⁴ Multipliers can be used to estimate economic interdependence. See discussion in *Ibid.* at 241-43.

³⁵⁵ *Ibid.* at 264.

³⁵⁶ *Ibid.* at 241-45; 264-66.

This second social accounting model allows consideration to be given to the collateral benefits of an investment to the larger community, instead of restricting it to the collateral benefits to plan members alone. Yet, while the second social accounting model provides a technique for evaluating an investment and calculating its social costs or benefits to the larger community in financial terms, it seems unlikely that in the absence of legislative protections, trustees could use such accounting alone in making their investments. Carmichael recognizes this, suggesting that a more politically palatable and incremental approach might have pension funds report on the social and economic benefits of their fund investments.³⁵⁷ This could be done voluntarily or instituted as a legal requirement. In Britain, recent amendments to the occupation pension plan regulations require all funds to disclose the extent to which they consider social, environmental or ethical criteria in the investment policy.³⁵⁸ While this is not a formal social accounting requirement, it does indicate that socially responsible pension investment practices can be supported by government action.

Even Carmichael's first accounting model and the suggestions by Barber and Ghilarducci for operationalizing a "whole participant approach" which combine traditional risk and return criteria with the evaluation of collateral benefits, would be difficult to use on their own in the absence of regulatory changes, unless they were used simply to compare investments with similar risk adjusted return expectations. Carmichael's classification of the government as a plan stakeholder also raises some

³⁵⁷ *Ibid.* at 267.

questions. She justifies the classification of the government as a plan stakeholder because of the tax subsidies it gives to pension plan contributions and the regulatory role it has over pension plans. However, it appears that the government's interests would be more properly considered in the second accounting model as part of the benefits of investments to the wider community. It is worth pointing out that Barber and Ghilarducci's proposal is made within the context of a number of proposals for legislative reform designed to regulate pension fund investment and to reform financial markets so that resources are better allocated to productive uses. Carmichael also calls on the government to institute regulatory changes to encourage economically targeted pension fund investments.

It seems clear then that the hopes of pension fund activists that their investment strategies could be used to challenge market rates of return as the exclusive measurement of value and to develop criteria that provide a more accurate picture of true rates of return – both market and social - are unlikely to be realized in the absence of regulatory reform. At best, these evaluative approaches allow for the comparison of investments with similar risk adjusted return expectations, a modest reform. I will return to the question of larger, more systemic and radical reforms to pension fund investment practices in the fifth chapter.

Conclusion

Current pension law theory and practice limit some of the ideas and ideals that underpin strategies of pension fund activism. In particular the claims that pension funds

³⁵⁸ *The Occupational Pension Schemes (Investment, and Assignment, Forfeiture, Bankruptcy etc.) Amendment Regulations, S.I. 1999/1849.*

are “workers’ capital” representing their “deferred” wages, and that greater worker or union involvement in investment decisions could allow for consideration of criteria other than market rate of return, are affected by pension law principles and practice. In the absence of regulatory reform, pension law theory and practice reduce the transformative potential of the investment strategies pursued by pension fund activists to moderate progressive reform proposals. Pension fund trustees can implement social and political investment screens, pursue shareholder activism or engage in economically targeted investing, so long as the rate of return to the fund is not negatively affected. They can also report on the economic and social costs of their investments, or require the corporations they invest in to do the same.

The next chapter examines corporate law theory and practice and their implications for pension fund activists’ strategies. In particular, it looks at the uncertainty in corporate law about the legal nature of the share, which mediates the relationship between the shareholder and the corporation, and the contradictions that exist within modern corporate law between separate corporate personality doctrine on the one hand and shareholder ownership “rights” on the other.

CHAPTER FOUR: CORPORATE LAW THEORY: THE LIMITS OF SHAREHOLDER OWNERSHIP

It used to be the left who emphasized the limits to capitalism and the right who told us of its adaptability. Now, however, it is the right, ... who candidly stress the incompatibility of workers rights and welfare states with the elementary laws of capital (presented, of course, as “natural”), while the (erstwhile) left is reduced to insisting on the malleability and improvability of both capitalism and its corporations.³⁵⁹

Introduction

Strategies of pension fund activism rely heavily on assumptions about the power and influence of pension funds as shareholders of the corporations they invest in. Pension fund activists argue that pension funds can and should use their shareholding powers to influence the behaviour of these corporations. Whether they are advocating for greater shareholder activism, involvement in proxy voting, investment screening, or economically targeted investing, a central assumption about corporations that underpins pension fund activists’ strategies is that shareholders “own” the companies they invest in. A comprehensive guide to Canadian employee benefits, for example, states that shareholders have the right to vote on corporate governance matters “because [they] are the corporation’s owners.”³⁶⁰

This chapter argues that the uncertainties in corporate law about the legal nature of the share and shareholding, along with the contradictions between separate corporate personality doctrine on the one hand and shareholder ownership “rights” on the other create uncertain foundations for corporate governance reform proposals that rely on ideas

³⁵⁹ “Citizenship”, *supra* note 202 at 26.

of “shareholder ownership.” This raises questions about the potential of pension fund activist strategies to temper corporate behaviour and improve corporate governance, so long as these strategies are built on assumptions about the power of shareholder ownership.

The Historical Development of the Modern Corporation

The corporation and corporate law as we know it, in which the corporation has a separate corporate legal personality and a large number of shareholders, each with limited liability, have their origins in the “joint stock company” and joint stock company law, originally a branch of partnership law.³⁶¹ In the eighteenth century, “the formative period” of modern English partnership law,³⁶² corporate law was essentially concerned with partnerships. Importantly, it distinguished between two types of corporate investor - lenders who provided money to a corporation, and partners whose investments were tied up in, or used in the production process with no guarantee of return.

The legal rights accorded each type of investor was determined by the nature of their investment returns rather than their involvement in the management of the company. Lenders, since they received a guaranteed return on their investment (the money capital plus interest), were understood to stand outside the corporation and its management. Partners, who received a share of the corporate profits, were dependent on the fortunes of the company for their returns and therefore had more risk attached to their investment,

³⁶⁰ G.P. Dzuro et al., “Pension Funds as Shareholders” in Koskie et al., *supra* note 205, 286 at 286.

³⁶¹ P. Ireland, “Company Law and the Myth of Shareholder Ownership” (1999) 62 Mod. L. Rev. 32 at 38 [hereinafter “Shareholder Ownership”].

³⁶² *Ibid.* at 37.

were understood as insiders and were presumed by the law to be involved in the management of the company.³⁶³ At both common law and equity,³⁶⁴ partners had an interest in partnership assets and were liable for partnership debts.³⁶⁵

This distinction reflected to a large extent the economic reality facing lenders and partners at the time, and in fact continues to make sense for modern day partnerships. However, its application to the development of the joint stock company shareholder and the joint stock company, the precursor of the modern corporation, has created a number of theoretical and practical difficulties within modern corporate law.

Joint stock companies were originally considered a form of partnership, albeit a rather large one, and were referred to as “extended” or “public” partnerships. What distinguished them from other forms of partnership was their larger than average number of shareholders, the relative inactivity of the shareholders in the management of the company,³⁶⁶ and the freely transferable nature of their shares.

³⁶³ *Ibid.*

³⁶⁴ Common law is the body of law that develops over time through judicial decision making rather than by statute. Equity is a system of justice administered according to rules of fairness and natural justice in a particular situation, rather than the stricter rules of common law or statutes. Equity’s object is to “render the administration of justice more complete, by affording relief where the courts of law are incompetent to give it, or to give it with effect.” *Black’s Law Dictionary*, 6th ed., s.v. “equity”. Decisions in equity supersede conflicting common law and statute-based decisions. In the eighteenth century, legal remedies could be sought in either courts of equity or courts of law. Today equitable and legal rights and remedies are available in the same court. *Ibid.* s.v. “equity” and “common law”. *Oxford English Dictionary Online*, s.v. “common law” and “equity”.

³⁶⁵ At common law they were understood to hold personal property of the partnership as tenants in common or joint tenants, and to hold partnership land as tenants in common. Partnership property was treated in equity as “though held by all the partners on trust to be used for the proper business purposes.” “Shareholder Ownership,” *supra* note 361 at 37-38.

³⁶⁶ Ireland does comment though that “compared to their latter-day counterparts eighteenth and early nineteenth joint stock company shareholders took a much greater supervisory interest in their investments. Some companies even financially penalised proprietors who neglected to attend general meetings in person or by proxy.” *Ibid.* at 41.

Like other forms of partnership they were understood to be aggregates of individuals rather than separate corporate entities.³⁶⁷ Even those joint stock companies that incorporated, an act which conferred some legal rights that other forms of partnerships did not have, including the creation of a separate legal entity, were not understood to be *completely separated* from their shareholders. “There was, ... no suggestion ... that the separate corporate legal entity was an object completely emptied of people. On the contrary, incorporated companies were regularly conceptualised as their members merged into a legally distinct entity.” Unlike many corporate law scholars, Paddy Ireland, Ian Grigg-Spall and Dave Kelly argue that it was not the act of incorporation that “was the source of complete separation”³⁶⁸ of the company and its shareholders, instead it was the development of the joint stock company share as a separate form of property.³⁶⁹ Changes in the Companies Act in the nineteenth century simply reflected this development.

The ‘complete separation’ of companies and their members, which emerged for the first time in the nineteenth century, was reflected in the changed consequences attributed to incorporation, but incorporation was not its source. This must be sought elsewhere, in the changing economic and legal nature of the joint stock company share.³⁷⁰

Initially, despite the fact that joint stock company shares were understood to be freely transferable, they were linked to the company’s assets and understood legally as

³⁶⁷ *Ibid.* at 39.

³⁶⁸ P. Ireland, “Capitalism without the Capitalist: The Joint Stock Company Share and the Emergence of the Modern Doctrine of Separate Corporate Personality” (1996) *J. Legal Hist.* 41 at 47 [hereinafter “Capitalism”].

³⁶⁹ P. Ireland, I. Grigg-Spall & D. Kelly, “The Conceptual Foundations of Modern Company Law” (1987) 14 *J. L. & Soc.* 149 at 151. See also *Ibid.*

³⁷⁰ Ireland, Grigg-Spall & Kelly, *ibid.*

equitable interests in them, in the same way that shares in smaller partnerships were linked to partnership assets.³⁷¹ Ireland points out that even at this early stage, the characterization of shareholders as both the company and the owners of its assets was somewhat tenuous.³⁷² At the time, though, the absence of well developed public share markets meant joint stock company shareholders were often unable to sell their shares. Thus there was originally a “material basis for the assertion of a property nexus between shareholders and the company’s assets”³⁷³ since shareholders’ capital could be tied up in the productive assets of the company for long periods of time.³⁷⁴

After 1825, though, the need for considerable amounts of capital for industrial enterprises such as the railway system led to an expansion in the size and number of joint stock companies, and in many industries they began to replace partnerships.³⁷⁵ The scale of investment, particularly in the railway system, also dramatically increased the number of joint stock company shares and shareholders.³⁷⁶ As a result, by mid-century a public market for joint stock company shares had developed, and the shares became assets that could easily be converted into money.³⁷⁷

³⁷¹ *Ibid.* at 158.

³⁷² “Shareholder Ownership”, *supra* note 361 at 40.

³⁷³ *Ibid.*

³⁷⁴ *Ibid.*

³⁷⁵ *Ibid.* at 41; Rutherford, *supra* note 27, *s.v.* “joint stock company”.

³⁷⁶ At the time, commentators wrote of the increasing accessibility of the stock market to the public in much the same way that the massive entry of individual investors and pension funds (representing the average worker) into the stock market in the 1990s has been written about as a “democratization” of the stock market. For example, one commentator wrote that “[i]n every street of every town, persons were to be found who were holders of railway shares. Elderly men and women of small, realised fortunes, tradesmen of every order, pensioners, public functionaries, professional men, merchants, country gentlemen ... the mania had affected all.” T. Cooke & W. Newmarch, *A History of Prices, 1838-57*, vol. v. at 234 quoted in “Capitalism”, *supra* note 368 at 65.

³⁷⁷ Ireland, Grigg-Spall & Kelly, *supra* note 369 at 159.

By 1860, following a series of cases which considered the nature of shares in incorporated and unincorporated joint stock companies, shares were no longer understood to give the shareholder an equitable or legal interest in the company's assets.³⁷⁸ Instead they were understood to be themselves a form of property that could be freely sold and gave shareholders a right to a claim on the company's profits in the form of dividends. This evolving understanding served to separate joint stock company shares and shareholders from the company and its assets. Shareholders came to increasingly resemble money capitalists rather than industrial capitalists.³⁷⁹

Their legal redefinition reflected not only the fact that they had become essentially rights to profit – in many instances, this had long been the case – but rights to profit with a value of their own which could be freely and easily bought and sold in the marketplace. With this, shareholders were no longer 'tied' to their shares, nor to the companies of which they were members or its assets.³⁸⁰

This separation of joint stock company shareholder and company was further reinforced by a number of economic and legal developments which together "provided the foundations of the modern doctrine of separate personality."³⁸¹ Although many joint stock company shareholders had not been particularly active participants in running the company (through attending general meetings, for example), the expansion of the public share market led to an even greater decline in these activities. For rather than owning

³⁷⁸ The cases are reviewed in "Capitalism", *supra* note 368 at 50-60. See also "Shareholder Ownership", *supra* note 361 at 41, 47.

³⁷⁹ "Capitalism", *ibid.* at 68.

³⁸⁰ *Ibid.*

³⁸¹ *Ibid.*

directors, and in their actual powers. They were no longer understood to be directed and controlled by shareholders. Instead, they were understood to represent the company as an entity separate from the shareholders. As this conceptual shift was occurring, the rights of shareholders to influence every day corporate management decisions diminished as powers exercisable by shareholders at a general meeting were transferred to corporate boards.³⁸⁸

Despite the intent of legislators that they only apply to joint stock companies, the legislative changes between 1844 and 1862 compelling incorporation also permitted partnerships and sole proprietorships to incorporate and take advantage of limited liability protections.³⁸⁹ This led to the emergence in the late nineteenth and early twentieth centuries of the “private” company, which is a company characterized by a small number of members/shareholders, limited share transferability, and the private raising of capital.³⁹⁰ In fact, Ireland argues that the significance of *Saloman v. Salomon & Co.*,³⁹¹ “was not so much its establishment, or confirmation, of the doctrine of separate personality, as modern texts often suggest, but its recognition of the validity under the Companies Acts of the ‘private company’ and the extension to them of the already established principle of ‘complete separation’”.³⁹²

By century’s end, the combination of joint stock company shareholders’ limited liability, their more diversified share portfolios, their lack of involvement in management

³⁸⁸ *Ibid.* at 43.

³⁸⁹ “Limited Liability”, *supra* note 383 at 241-44.

³⁹⁰ *Ibid.* at 244-55.

³⁹¹ [1897] A.C. 22 (H.L.).

³⁹² “Capitalism”, *supra* note 368 at 45.

of the company, and the regular issuance of dividends had heightened the separation of shareholders from the company and its assets. These factors also meant that share purchases were no longer the highly speculative investments they had once been. Shares also began to have more “debt-like features”³⁹³ in that they increasingly provided a steady, predictable stream of income to the shareholder in the form of dividends.

These economic and legal changes set the stage for joint stock company law to develop from a branch of partnership law into its own separate body of law.³⁹⁴ And as the number of private companies increased, joint stock company law, designed to regulate “single entity, national companies whose shareholders had been relieved of any meaningful ownership function,”³⁹⁵ came to apply to most forms of business association from sole proprietorships and small private companies to large multinational companies.

Effect on Modern Corporate Law

The historical development of the joint stock company share from its origins as an equitable interest in corporate assets, to its emergence as a form of property, and the corresponding shifts in the role of the shareholder from industrial capitalist to one more closely resembling the traditional money capitalist, explain a number of features of modern corporate law. First, it helps explain the corporate management responsibilities traditionally held by corporate directors, officers and shareholders. Directors manage the corporation, officers exercise management responsibilities delegated to them by the board of directors and, while shareholders are not directly involved in the management of the

³⁹³ “Shareholder Ownership”, *supra* note 361 at 45.

³⁹⁴ *Ibid.* at 43.

company, they elect the board of directors and vote on various proposals put before them at general meetings. “Under this breakdown, shareholders are essentially passive; they have no power to initiate action, to control management, or to act in relation to the ordinary business of the corporation except as specifically provided in the articles or by-laws.”³⁹⁶

Second, while modern statute law in Canada has now abolished it,³⁹⁷ the doctrine of *ultra vires*, in prohibiting acts outside the scope of the corporate memorandum and articles, even if approved by all shareholders, initially provided legal protection to the share and the shareholder, “stabilising the share ... to enable more ‘rational’ decisions to be taken in the market by investors.”³⁹⁸ In making some corporate decisions beyond even the unanimous consent of all shareholders, the doctrine also helped reinforce the corporation’s separate legal personality.³⁹⁹

And third, although the share as property removed the direct links between the shareholder and corporate assets, the shareholder (and the share) is still linked to the company’s productive capital in ways that a lender, the traditional money capitalist, is not. The value of corporate shares is linked to the company’s profits and, in theory,

³⁹⁵ *Ibid.* at 44.

³⁹⁶ J.A. VanDuzer, *The Law of Partnerships and Corporations* (Concord: Irwin Law, 1997) at 183.

³⁹⁷ A Canadian company is not required to describe its activities in its articles of incorporation. *Canada Business Corporations Act*, R.S.C. 1985, c. C-44, as am., s. 16(1) [hereinafter *CBCA*]. Moreover s. 16(3) provides that if a company does do something that is contrary to its articles, the act is not invalid “by reason only that the act or transfer is contrary to its articles or this Act.” This protects third party interests. Shareholders can still use the oppression remedy provisions of the *CBCA* to seek relief from acts that are contrary to the articles (s. 241). Alternatively, they can seek an order restraining the corporation from acting in contravention of the articles, or directing that the corporation comply with the articles (s. 247). *Ibid.* at 72, 126-27, 156 n16.

³⁹⁸ Ireland, Grigg-Spall & Kelly, *supra* note 369 at 160.

³⁹⁹ “Shareholder Ownership”, *supra* note 361 at 43.

should change with them. Incorporation memoranda provide mechanisms for the payment of share dividends and for the repayment of capital when the corporation is wound-up.⁴⁰⁰

At the same time though, this continuing connection between the share and the productive assets of the corporation, and the limited residual shareholder "ownership" rights that are preserved or enhanced by corporate law statutes and case law, raise questions about whether corporate law doctrine has fully recognized the implications of the development of both the share as property and separate corporate personality, particularly in the case of public companies.

As Ireland points out this may also help explain why courts and commentators have such difficulties conceptualizing shares and shareholding. For example, the law and economics literature views the corporation as a nexus of contracts and focuses on the contractual rights (contained in the company's memorandum and articles) and statutory rights that a shareholder has against the company.⁴⁰¹ Despite the fact that proponents do not characterize shares as a debt, this focus on the share's contractual qualities highlights both the separation of the shareholder from the company, and the similarities between shareholders and the ordinary lender.⁴⁰²

⁴⁰⁰ Ireland, Grigg-Spall & Kelly, *supra* note 369 at 160.

⁴⁰¹ See B.R. Cheffins, *Company Law: Theory, Structure and Operation* (Oxford: Clarendon Press, 1997). For an overview and critique of this approach see W.H. Simon, "Contract Versus Politics in Corporation Doctrine" in D. Kairys, ed., *The Politics of Law: A Progressive Critique*, rev. ed. (New York: Pantheon Books, 1990) 387; M. Stokes, "Company Law and Legal Theory" in W. Twining, ed., *Legal Theory and Common Law* (Oxford: Basil Blackwell, 1986) 155.

⁴⁰² "Shareholder Ownership", *supra* note 361 at 45-46.

Another approach understands shares as property in themselves and as representing some sort of proprietary interest in the company, but not an interest in its assets. While clinging to the idea that the shareholder is a “member” of the corporation, this approach does not explain what it is about the share and shareholding that entitles the shareholder to this membership.⁴⁰³ As Ireland points out, neither approach can explain the widespread assumption in corporate law that shareholders own the corporation. Nor can they adequately justify corporate law’s continued theoretical separation of shareholders and debt-holders, in the face of their practical similarities.⁴⁰⁴

The theoretical differences between a creditor of the company and being a member are considerable from a legal point of view, but (at least in the case of a solvent and prosperous company) the practical consequences for investors, apart sometimes from tax considerations, are very similar ... an investment in debentures or debenture stock is very similar to an investment in shares: both are securities in the corporate sector of the economy offering different kinds of risk and different kinds of return.⁴⁰⁵

Ireland argues that modern corporate law has in fact “fail[ed] to take separate corporate personality seriously enough.”⁴⁰⁶ It upholds the separation of the company from its shareholders through strict enforcement of separate corporate personality doctrine and limited shareholder “ownership” rights, while at the same time continuing to characterize shareholders as corporate “owners” or “members” despite a number of factors, including: the very separation of shareholder and corporation and the limited shareholder ownership rights that are reinforced by separate corporate personality doctrine; the historical roots of

⁴⁰³ *Ibid.* at 47.

⁴⁰⁴ H. Hovenkamp, “The Classical Corporation in American Legal Thought” (1988) 76 *Geo. L.J.* 1593 at 1656-58.

⁴⁰⁵ L.S. Sealy, *Cases and Materials in Company Law* (London: Butterworths, 6th ed., 1996) at 420-21 cited in “Shareholder Ownership”, *supra* note 361 at 47.

the joint stock company share as a form of property in itself; and the tenuous connection between shares and company assets. This failure to take corporate personality seriously, or to place the modern corporation and share in its historical context, has important implications for strategies of pension fund shareholder activism.

Shareholder Activism

Modern corporate law's continued perpetuation of the idea that shareholders "own" the corporation, along with the fact that shareholders are perceived to be the constituency who will be most affected by corporate governance practices, explains why shareholders continue to be at the centre of debates about corporate governance reform. Two types of proposals for corporate governance reform have been built on assumptions about shareholder ownership of the corporation. The first asserts that shareholders need to exert more control and supervision over the corporation through practices such as shareholder activism and greater attention to proxy voting.⁴⁰⁷ The second type, often associated with proposals for a stakeholding approach to corporate governance, asserts that in addition to greater shareholder control and supervision, maximization of "shareholder value" should not be the only goal of corporate governance reforms.⁴⁰⁸

Since both approaches are built on assumptions about shareholder ownership of the corporation, proponents are "placed in the position of asking shareholders to give up some of the ownership rights, or of trying to persuade them to exercise

⁴⁰⁶ "Shareholder Ownership", *ibid.* at 47-48.

⁴⁰⁷ See e.g. J.P. Hawley & A.T. Williams, *The Rise of Fiduciary Capitalism: How Institutional Investors Can Make Corporate America More Democratic* (Philadelphia: University of Pennsylvania Press, 2000).

⁴⁰⁸ "Shareholder Ownership", *supra* note 361 at 32. For examples of this second type of proposal see R.W. Bauman, "Liberalism and Canadian Corporate Law" in R.F. Devlin, ed., *Canadian Perspectives on Legal Theory* (Toronto: Emond Montgomery, 1991) 75; J. Parkinson, "Company Law and Stakeholder Governance" in G. Kelly, D. Kelly & A. Gamble, eds., *Stakeholder Capitalism* (Houndmills: Macmillan Press, 1997) 142.

them in particular ('socially responsible') ways, either by arguing that it will be in their own best long-term interests to do so, or by appealing to their altruism."⁴⁰⁹

Not only does the history of the share and shareholding, the separation of shareholders from the company and its productive assets, and the emergence of the corporation as a separate legal entity raise questions about the legal basis for such an appeal to shareholder ownership rights, but given the fact that shareholders and shares, particularly of public companies, are difficult to distinguish from lenders (money capitalists) and forms of money capital, it appears that governance reforms that advocate for consideration of factors other than shareholder value are not likely to be successful, particularly for institutional shareholders such as pension funds that must give primary consideration to financial return.⁴¹⁰ Moreover, when called upon to decide between the interests of shareholders and others with an interest in corporate activity such as workers or the community in which a corporation operates, the courts, illustrating Ireland's contention that modern corporate law has failed to take separate corporate personality seriously enough, "have consistently treated the interests of the corporation as virtually coextensive with the interests of shareholders."⁴¹¹ Consideration of the concerns and interests of other stakeholders cannot interfere with running the corporation for the shareholders' benefit.

On a practical level, while traditional shareholder rights to elect directors and vote on proposals put before them have been somewhat enhanced by corporate legislation,

⁴⁰⁹ "Shareholder Ownership", *ibid.* at 33.

⁴¹⁰ *Ibid.* at 50.

⁴¹¹ VanDuzer, *supra* note 396 at 247.

these “ownership” rights are still relatively narrowly defined and provide limited opportunity for involvement in more direct management of the day to day affairs of the corporation. In Canada for example, the *Canada Business Corporations Act* (CBCA)⁴¹² has enhanced the matters about which shareholders can vote. Shareholders must approve fundamental changes to the corporation such as changes to the corporate articles and by-laws; the sale, lease or exchange of significant corporate property unless in the ordinary course of business; mergers; and the dissolution of the company.⁴¹³ Shareholders can call meetings, make proposals to be discussed at shareholder meetings, and they can, by unanimous shareholder agreement, assume the powers of the board of directors.⁴¹⁴ Shareholders can also apply to the courts for a number of remedies in instances when directors abuse their powers. These actions include derivative actions, in which shareholders can bring an action on behalf of the corporation,⁴¹⁵ and an action seeking relief from the “oppression” of shareholder interests by the directors’ actions.⁴¹⁶

While these rights are designed to allow shareholders more influence, or the potential to influence, corporate management decisions, their focus on directors’ management activities tends to ignore the reality that in public corporations unless the directors themselves hold senior management positions, they are not generally involved in “high-level management activities such as setting business objectives and policy,

⁴¹² *Supra* note 397. Most provincial corporate statutes are very similar to the *CBCA* model. *Ibid.* at 71.

⁴¹³ *CBCA, ibid.*, ss. 173, 103, 189(3), 183, 211 respectively.

⁴¹⁴ *Ibid.*, s. 106.

⁴¹⁵ *Ibid.*, s. 239.

⁴¹⁶ *Ibid.*, s. 241.

choosing the senior management personnel, and closely supervising their activities,”⁴¹⁷ thus directors have little involvement in management decisions, particularly since shareholder proposals are unlikely to be binding on management.⁴¹⁸

In addition, particularly in the context of large public corporations these enhanced “ownership” rights often provide little in the way of practical effect. Shareholder actions against directors are expensive and time-consuming. Shareholders may not have the expertise or the funds to hire professional advice to evaluate management’s performance through measures other than share price. In addition, as was mentioned earlier, significant time and energy is needed to put together shareholder proposals, or to organize shareholders to take a position on a particular proposal or to elect a new board of directors.⁴¹⁹

In 2001 for example, only 40 shareholder proposals were submitted to Canadian public corporations.⁴²⁰ While this likely represents an increase in the number of shareholder proposals when compared to the early 1990s,⁴²¹ it is worth noting that they were submitted by only eight shareholders. Of the 40 proposals, only the two which sought to make Sears Canada and the Hudson’s Bay Company improve their codes of conduct, purchase contracts and monitoring with respect to labour standards addressed

⁴¹⁷ VanDuzer, *supra* note 396 at 187.

⁴¹⁸ Bauman, *supra* note 408 at 79-81.

⁴¹⁹ VanDuzer, *supra* note 396 at 186.

⁴²⁰ Shareholder Association for Research and Education, *Year 2001 shareholder proposals submitted to Canadian corporations*, online: Shareholder Association for Research and Education <http://www.share.ca/proxy_voting/season_calendar.htm> [hereinafter *Year 2001 shareholder proposals*].

⁴²¹ For example, a 1993 study of shareholder proposals submitted to 480 Canadian corporations found that only one proposal had been submitted in 1990, and none in 1991 and 1992. C. McCall & R. Wilson, “Shareholder Proposals: Why Not in Canada?” (1993) 5:1 *Corp. Governance*. Rev. 12 at 12-13.

questions of socially responsible corporate management practices. As well, these two proposals were submitted by four of the eight shareholders. The other proposals submitted by the remaining four focused on more traditional matters such as auditor independence, cumulative voting or disclosure of information about directors.⁴²²

Not surprisingly, most pension fund proxy voting guidelines tend to focus on these traditional corporate governance matters.⁴²³ Even those pension funds that have adopted ethical investment guidelines as part of their proxy voting guidelines have tended to frame these in terms of information disclosure rather than the prohibition or mandating of particular policies or practices. Tellingly, this is looked on favourably because it does not inappropriately limit corporate management behaviour: “disclosure requirements may highlight the importance of ethical considerations ... and minimize the possibility of reputation damaging cover-ups. On the other hand, disclosure obligations themselves do not tend to be expensive to implement nor to rigidly constrain corporate activity.”⁴²⁴

Until recently, corporations did not have to circulate shareholder proposals that had as their primary purpose, “promoting general economic, political, racial, religious, social, or similar causes.”⁴²⁵ This placed constraints on the matters that pension fund shareholder activists could bring forward for discussion at shareholder meetings, and the exclusion clause was used a number of times by corporations to prevent shareholders from circulating shareholder proposals related to corporate social and environmental

⁴²² *Year 2001 shareholder proposals*, *supra* note 420.

⁴²³ Dzuro et al., *supra* note 360 at 288.

⁴²⁴ *Ibid.* at 295.

⁴²⁵ *BCA*, *supra* note 397, s. 137(5)(b).

practices.⁴²⁶ The definition of “solicitation” in the CBCA also made it difficult for shareholders to communicate with one another to coordinate shareholder proposals.⁴²⁷

Organizations such as the Taskforce on the Churches and Corporate Responsibility, Democracy Watch, and the Shareholder Investment Organization, have lobbied for changes to these provisions with some success. Recent amendments to the CBCA have, to some extent, relaxed these restrictions on shareholder proposals and communications. Under the amended legislation corporations can no longer refuse to circulate proposals whose primary purpose is “promoting general economic, political, racial, religious, social, or similar causes.”⁴²⁸ Instead they can only refuse to circulate a proposal if it “does not relate in a significant way to the business or affairs of the corporation.”⁴²⁹ This wording is based on the language used in the United States. The definition of “solicitation” has also been changed, making it easier for shareholders to communicate with each other about proposals (management and shareholder) without preparing a formal proxy circular.⁴³⁰ It remains to be seen how these changes will affect future shareholder proposals and activism.

If the experience in the United States is any indication though, commentators point out that prominent public pension funds such as the California Public Employees Retirement System (CALPERS) which are advocates of increased shareholder activism, have tended to focus on traditional corporate governance issues such as increasing the

⁴²⁶ *Social Investment Review 2000*, *supra* note 320 at 13.

⁴²⁷ *CBCA*, *supra* note 397, s. 147.

⁴²⁸ *Ibid.*, s. 137(5)(b).

⁴²⁹ *An Act to amend the Canada Business Corporations Act and the Canada Cooperatives Act and to amend other Acts in consequence*, S.C. 2001, c. 14, s. 59(3).

Fiduciary Capitalism

For a number of reasons, many commentators have greeted the emergence of institutional investors such as pension funds and mutual funds as significant players in equity markets as heralding a positive change in terms of their potential to improve corporate governance, corporate behaviour and the economy generally.⁴³⁴ For a number of reasons, pension funds in particular are seen to be at the forefront of this change. First, they are understood to represent long-term patient investment capital, with an interest in productive investment and long rather than short-term gains. Second, an increasing number of pension funds invest in pooled index funds, funds that hold all the securities in a major stock market price index such as the TSE 300.⁴³⁵ Both the pooled and indexed nature of the funds mean that investors cannot sell their shares in a particular corporation in the fund in order to object to management behaviour.⁴³⁶ And third, particularly in Canada, the fact that pension funds hold significant blocks of shares in most of the country's corporations means they cannot easily sell their shares to protest management behaviour without risking a drop in share prices and the potential of significant

⁴³³ T. Ghilarducci, J.P. Hawley & A.T. Williams, "Labour's Paradoxical Interests and the Evolution of Corporate Governance" (1997) 24 J. L. & Soc. 26 at 27-29; Henwood, *ibid.*; "Shareholder Ownership, *supra* note 361 at 51.

⁴³⁴ See *e.g.* Hawley & Williams, *supra* note 407; R.A.G. Monks and N. Minow, *Watching the Watchers: Corporate Governance for the 21st Century* (Cambridge: Blackwell Publishers, 1996) at 156-57.

⁴³⁵ Dzuro et al., *supra* note 360 at 286.

⁴³⁶ Some larger pension funds have been able to negotiate investment management contracts in which their proxies are segregated from the rest of the fund and voted according to the pension funds' instructions.

investment loss.⁴³⁷ Nor are they always able to find an appropriate alternative investment in Canada's relatively small capital market.

Commentators such as James Hawley and Andrew Williams characterize this shift in the nature and character of equity ownership as "fiduciary capitalism" because institutional investors such as pension and mutual funds act as fiduciaries for pension plan members and individual mutual fund investors.⁴³⁸ They suggest that institutional investors are "universal owners" with an interest not only in ensuring that the corporations they invest in are well managed, but in ensuring that the economy as a whole is healthy and productive.⁴³⁹ This universal interest stems in part, they argue, from the fact that institutional investors as shareholders "own *portfolios* of equity and not individual firms."⁴⁴⁰ This argument could also be made for individual investors, since they frequently hold a portfolio of mutual funds, or a portfolio of other market instruments. In light of this, it is difficult to see how institutional investors have a greater interest in a healthy productive economy than individual investors.

Hawley and Williams argue that this universal ownership status allows institutional investors to capture both the positive and negative externalities created by individual firm behaviour. Positive externalities such as the benefits of workplace

⁴³⁷ Dzuro et al., *supra* note 360 at 286; Hawley & Williams, *supra* note 407 at xiv. It remains to be seen whether the introduction of new systems of trading designed to help institutional investors sell large blocks of shares will help reduce the effect of institutional investor trading. These new systems include an "iceberg-order option" which breaks large orders into smaller blocks that are "automatically fed into the order book one at a time," and the "call market" which allows trading of large blocks of stock without having a significant effect on market price. "TSE offering iceberg trade option" *The Globe and Mail* (12 April 2002) B2.

⁴³⁸ Hawley & Williams, *ibid.* at xii.

⁴³⁹ *Ibid.* at xv.

training and education programs are captured within the diversified portfolios of institutional investors even if employees change jobs, and, while negative externalities such as pollution may not be a cost to one firm, they will ultimately be a cost to another in its portfolio.⁴⁴¹ “[I]t is in the economic interest of a universal owner to attempt to minimize the environmental damage of each of its firms since it will capture the long-term and society-wide benefits, although specific firms in its portfolio will bear the costs of cleanup or restructuring to produce in more environmental-friendly modes.”⁴⁴² Moreover, they argue that universal owner status gives institutional investors an interest in public policy issues in areas outside traditional macroeconomic issues such as the environment, health, education, and other programs to build human and physical capital. They suggest that institutional investors have to recognize this interest and develop programs and policies that recognize the implications of their status as universal owners.⁴⁴³

Their prescriptions for ways in which institutional investors can do this tend to focus on targeting the practices of individual corporations through strategies such as shareholder activism and proxy voting. They argue however, that in implementing these practices, universal owners have a duty to promote policies that encourage positive externalities which benefit the general economy such as the promotion of environmental standards or education and training programs, and to discourage those activities that

⁴⁴⁰ *Ibid.* at 98.

⁴⁴¹ Although they acknowledge that the costs of the negative externalities may be imposed on other sectors of the economy such as individual citizens, their arguments tend to assume that the costs of the externalities are all borne within the corporate sector.

⁴⁴² Hawley & Williams, *supra* note 407 at xv.

produce negative externalities, which they argue will ultimately become a cost to the universal owner. For “the size and the breath (sic) of their portfolio exposes them to economy-wide risks as well as positions them to receive economy-wide rewards.”⁴⁴³

Hawley and Williams state that institutional investors must “begin a process of extending the definition of prudential fiduciary duty to include attention to the universal aspects of their portfolios.”⁴⁴⁴ As they acknowledge, though, it appears unlikely that in the absence of government regulatory sanction, institutional investors, particularly pension funds, will be able to shift to a portfolio-wide approach to shareholder activism. If their actions as shareholders reduce a corporation’s share value and hence reduce the investment return, institutional investors are unlikely to be comfortable that they are acting within the scope of their fiduciary duties, even if their actions may provide benefits to the larger economy and their overall investment portfolio.⁴⁴⁵

More promising perhaps is Hawley and Williams’ suggestion that institutional investors should become more involved in public policy issues such as education, health, communications infrastructure and the environment, with a goal to promote long-term sustainable growth and productivity: “a universal owner that really wants to maximize the shareholder value of its portfolio would need to develop public policy–like positions and monitor regulatory developments and legislation on a number of key issues to the economy as a whole.”⁴⁴⁶ Indicating that every institutional investor does not have to

⁴⁴³ *Ibid.* at xvi-xv.

⁴⁴⁴ *Ibid.* at 99.

⁴⁴⁵ *Ibid.* at xvii.

⁴⁴⁶ *Ibid.*

⁴⁴⁷ *Ibid.* at 170, xv-xvi, 98.

lobby the government, although they should not be precluded from doing so, they suggest that organizations representing institutional investors such as the Council of Institutional Investors⁴⁴⁸ in the United States should monitor and develop policy positions about these issues.⁴⁴⁹

This recognition that individual firm and economy-wide productivity are affected by wider public policy issues which cannot be addressed through the market echoes similar calls within the environmental and women's movement for greater attention to be paid to long-term environmental sustainability, or the relationship between unpaid social reproductive work and paid productive work. For example, there have been calls for measures of wealth such as a country's Gross Domestic Product (GDP) to include measurements of unpaid social reproductive work and environmental wealth in addition to paid productive work.⁴⁵⁰ In Canada, the federal Ministry of Finance has indicated that it will work to develop environmental indicators to use in making economic and environmental policy.⁴⁵¹ Proponents argue that inclusion of these factors and others could

⁴⁴⁸ A Canadian equivalent might be the Pensions Investment Association of Canada.

⁴⁴⁹ Hawley & Williams, *supra* note 407 at 170.

⁴⁵⁰ J.A. Nelson, *Feminism, Objectivity and Economics* (London: Routledge, 1996) at 119-20; Commission for Environmental Cooperation, *The North American Mosaic: A State of the Environment Report* (Montreal: Commission for Environmental Cooperation, 2001) at 7-8; A. Mitchell, "GDP value must reflect eco-wealth, report says" *The Globe and Mail* (7 January 2002) A1.

⁴⁵¹ Department of Finance, News Release 2001-054, "Development of Environmental Indicators a Priority, Says Finance Minister" (25 May 2001). In a speech to the National Roundtable on the Environment and the Economy, Finance Minister Paul Martin indicated that eventually the government hoped to develop social indicators as well, but had chosen to develop environmental indicators first, because it seemed likely that it would be easier to reach agreement about the appropriate environmental indicators than about social ones. Department of Finance "Speech by the Honourable Paul Martin, Minister of Finance, at a Breakfast Organized by the National Round Table on the Environment and the Economy" (Toronto: May 25, 2001), online: Department of Finance <<http://www.fin.gc.ca>>. The federal Department of Finance is providing funding to the National Roundtable on the Environment and the Economy (NRTEE) to develop these indicators. The NRTEE is working with Environment Canada and Statistics Canada to develop indicators in six areas: "human capital; non-renewable natural resources; renewable natural resources; land and soils;

provide a more thorough understanding of the relationship between these factors and national human capital and production, and ultimately lead to macroeconomic policies which more effectively encourage long-term sustainability and real productivity.⁴⁵²

A variety of social movement groups such as environmental, women's and labour organizations have a long history of involvement in public policy issues such as education, health, workplace health and safety and the environment with goals broadly speaking, of encouraging long-term sustainable growth and real productivity. Hawley and Williams do not present compelling evidence that institutional investor involvement will necessarily augment these efforts, nor do they appear to consider whether institutional investors have, or how they will acquire the requisite expertise, to develop larger public policy positions.

Their proposal also raises a more general question: namely whether institutional investors' interest in long-term shareholder value justifies greater involvement in and influence on public policy issues. Is there something that they can add that is not addressed by the present involvement in public policy issues of social movement organizations, the labour movement and the business community? At present, given their fiduciary duty constraints and the constraints of global finance discussed in the first

air quality and atmospheric conditions; and, water resources." A. Born, C. Simard, & R. Smith, *National Roundtable on the Environment and Sustainable Development Indicators Initiative: Technical Guidelines for Indicator Selection* (Ottawa: National Roundtable on the Environment and the Economy, 2001) at 1. See also National Roundtable on the Environment and the Economy, *NTREE Indicators Overview Paper – Stakeholder Workshop* (Ottawa: National Roundtable on the Environment and the Economy, 2001).

⁴⁵² For example Nelson and Antonella Picchio argue that a more thorough understanding of the contributions of unpaid social reproduction work would lead to macroeconomic policies that would be less likely to rely on unpaid work to absorb their costs. Nelson, *supra* note 450 at 119; A Picchio, *Social*

chapter, it seems unlikely that institutional investors such as pension funds are well positioned to promote public policy decisions that encourage long-term sustainability and real productivity.

On the other hand, perhaps it is a way to combine the labour movement's interests in productivity and job creation with the power and prestige that attaches to financial wealth in Canada. It may be that, through their involvement in pension fund investment decision-making, labour movement pension fund activists will incrementally change institutional investment culture (both within their individual pension funds, and outside through their work with external investment managers), to focus on more socially responsible corporate practices and management, and long-term sustainability and real productivity.

Leaving aside the more practical obstacles to the emergence of institutional investors as "universal owners" with an interest in long-term sustainability and real productivity outlined above, there are more fundamental objections to the potential for institutional investors to reform or regulate capitalism. These are objections that are rooted in the historical development of the corporation as a separate legal personality and the personification of industrial capital, the emergence of the share as a form of property and the shift in the nature of the shareholder from industrial to money capitalist. This is a shift which effectively pushes the shareholder and the share outside the corporation and its assets.

Reproduction: The Political Economy of the Labour Market (Cambridge: Cambridge University Press, 1992) at 110-11.

Critics argue that attempts to re-assert shareholder ownership of the corporation in fact limit the possibilities for recognition of the corporation as a social institution which should be democratically and socially regulated. Ireland points out that the separation of the share and the shareholder from the corporation and its assets creates difficulties for those who, through strategies built on the “myths” of the shareholder as risk-taker, capital provider and corporate owner, seek to change and regulate corporate behaviour in more socially responsible ways, or to recognize it as a social institution.⁴⁵³ This is because these strategies fail to recognize that a central implication of the emergence of the corporation as a separate personality is that the means of production are no longer “private property to which notions of ‘ownership’, with their connotations of exclusivity and exclusion, are applicable.”⁴⁵⁴

In essence, these strategies attempt to recreate and “repersonify” the modern corporation to resemble the original joint stock company, a large “partnership” of investors who supply capital, a strategy which simply does not recognize the realities of the modern corporation. Ireland suggests that a more effective strategy would be to complete the separation of shareholders from the corporation, and recognize the corporation as a social institution that cannot be “owned” as private property, or itself be an “owner”. Instead he suggests that recognizing the corporation as a “network of social and productive relationships,”⁴⁵⁵ would create space to reconceive both the corporation and corporate assets and to think about ways to create democratic and social systems of

⁴⁵³ “Capitalism”, *supra* note 368 at 69; “Shareholder Ownership”, *supra* note 361 at 52-57.

⁴⁵⁴ “Shareholder Ownership”, *ibid.* at 55.

corporate regulation. This proposal has similarities with Mary Stokes' argument that corporate law should recognize that "a whole web of relationships of interdependence exists around and within the company"⁴⁵⁶ and that this web of relationships is captured in the corporatist/communitarian model of the company which also recognizes the separation of shareholder from the corporation and its property, although Stokes places great reliance on corporate management to determine community interests, rather than seeking a more democratic and socialized system of corporate regulation and control.

While Henwood does not ground his critique in the historical development of the modern public corporation, his critique of strategies of shareholder activism lead to similar conclusions. He argues that shareholder-centred governance reforms, with their focus on improving shareholder value, cannot provide the type of corporate regulation that many labour movement shareholders activists seek since "the point of the governance agenda, after all, is to increase shareholder wealth by increasing shareholder control."⁴⁵⁷ This in turn raises larger political questions about who should be governing corporations. He points out that the very existence of the corporate governance debate implies: "capital is admitting that corporations must be subject to some kind of oversight. If that's the case, then the question becomes oversight by whom, in what form, and in whose interest."⁴⁵⁸

⁴⁵⁵ *Ibid.* at 56.

⁴⁵⁶ Stokes, *supra* note 401 at 178.

⁴⁵⁷ Henwood, *supra* note 23 at 290.

⁴⁵⁸ *Ibid.* at 247.

The uncertainties of corporate law suggest then that the more appropriate political project for pension fund activists may be to think about ways to complete the separation of the corporation from the shareholder, reconceive both the corporation and corporate assets, and create democratic and social systems of corporate regulation.

As mentioned earlier the historical development of the joint stock company and the share explain a number of features of modern corporate law. So far most of the discussion in this chapter has looked at the effects of this history on the modern public corporation and pension fund activist strategies as they affect these corporations. However, although both private and public companies have the same legal form, private company shares do not trade on the public markets. Thus private company shareholders continue to be more closely connected to the productive capital of the company, and more closely resemble industrial capitalists: “[w]hatever the established legal consequences of incorporation, the shareholders of private companies can never ‘completely separate’ themselves from their companies in the same way as shareholders in public, joint stock companies.”⁴⁵⁹ The final section of this chapter looks at the question of whether pension fund investment in private corporations through economically targeted investment strategies leads to greater involvement in corporate management and direction, and whether by aiming to fill gaps in capital markets, the strategy can improve corporate behaviour and practice and lead to long-term sustainability and productivity.

⁴⁵⁹ Ireland, Grigg-Spall & Kelly, *supra* note 369 at 161.

There has been considerable commentary about the potential for economically targeted investment to promote long-term sustainability and real productivity and to improve corporate behaviour and practice.⁴⁶⁴ ETI activity is more prevalent in the United States where the Department of Labour has explicitly validated ETI programs as legitimate investment vehicles for ERISA pension plans, provided of course that the risk-adjusted return is similar to or better than a comparable investment.⁴⁶⁵ Many ETI programs have been studied by the American government, policy organizations, academics and researchers. They have documented ETI's ability to generate "both collateral benefits and risk-adjusted returns."⁴⁶⁶

Pension plan participation in these ETIs has been structured in a variety of ways. The State of Wisconsin Investment Board's (SWIB) "Invest in Wisconsin" Program which provides loans to state-based companies is run directly in-house by SWIB.⁴⁶⁷ The Public Employees Retirement Association of Colorado's partnership with the Colorado Housing and Finance Authority partners the pension plan with a government agency that does the actual investing by providing loans to small businesses in Colorado to purchase capital assets or update their facilities. The Massachusetts Technology Development Corporation and the Bureau of Asset Management, Office of the Comptroller, New York

⁴⁶⁴ See e.g. *Worker Control and Social Investment*, *supra* note 176; Canadian Labour and Business Centre, *supra* note 460; Barber & Ghilarducci, *supra* note 61; Falconer, *ibid.*; Fung, Hebb & Rogers, eds., *supra* note 30.

⁴⁶⁵ *Department of Labour Interpretative Bulletin 94-1 on Economically Targeted Investments* 29 C.F.R. § 2509.94-1 (1994).

⁴⁶⁶ Canadian Labour and Business Centre, *supra* note 460 at 6.

⁴⁶⁷ *Ibid.* at 11. SWIB invests the funds of the following: the Wisconsin Retirement System, the pension plan for most employees of state agencies and most local government; the State Investment Fund; and several smaller state trust funds.

City's Targeted Investment Programs are investment vehicles that pool the funds of a number of pension plans.⁴⁶⁸ Others such as the KPS Special Situations Fund⁴⁶⁹ are limited partnerships between pension funds and other institutional investors, and a private company which acts as general partner and oversees the investment decision-making.⁴⁷⁰ Investors can "opt out of individual investments."⁴⁷¹ The California Public Employees Retirement System's (CalPERS) California Emerging Ventures Program is a fund managed by an external investment advisor that selects venture partnership or secondary venture capital fund opportunities for investment using CalPERS's investment criteria.⁴⁷² The AFL-CIO's Housing and Business Investment Trusts provide opportunities for a number of pension plans to pool their funds in investment vehicles that are managed on behalf of the AFL-CIO in accordance with its investment criteria.⁴⁷³

In Canada there are currently fewer opportunities for pension fund involvement in economically targeted investment programs. Several of the more prominent ETI initiatives are linked to both the labour movement, particularly public sector pension funds, and government initiatives. Concert Properties and Mortgage Fund One, both private companies created with pooled pension fund investments, have their roots in partnerships between the labour movement, the City of Vancouver and the province of British Columbia. In New Brunswick and British Columbia, the investment corporations

⁴⁶⁸ *Ibid.* at 13-14, 21-22, 31-32.

⁴⁶⁹ Sponsored by KPS General Partners and Managers.

⁴⁷⁰ Canadian Labour and Business Centre, *supra* note 460 at 17-18.

⁴⁷¹ M. Calabrese, "Building on Success: Labor-Friendly Investment Vehicles and the Power of Private Equity" in Fung, Hebb & Rogers, eds., *supra* note 30, 93 at 105.

⁴⁷² Canadian Labour and Business Centre, *supra* note 460 at 19-20.

⁴⁷³ *Ibid.* at 27-28.

created by provincial legislation to invest public sector pension funds have each allocated a portion of these funds to private placement investments in the province and the region. The New Brunswick Investment Management Corporation (NBIMC) targets 2 percent of its assets to private investments in the province and the rest of Atlantic Canada, while the British Columbia Investment Management Corporation began to participate in venture financing and other private placements in 1995 and tries to invest in a manner that promotes economic growth in British Columbia.⁴⁷⁴ Its investment in the Western Technology Seed Investment Fund (WTSIF), a private pooled fund which provides seed capital to developing companies in the technology industry in Western Canada, is an example of this.⁴⁷⁵

The Caisse de Dépôt et Placement du Québec (the “Caisse”) is the largest and most developed example of economically targeted investing in Canada. The Caisse invests the funds of the Quebec Pension Plan (QPP) and a number of other pension plans. It is a creature of statute with an explicit mandate to promote economic development in the province and eighty percent of its asset allocations are in Quebec.⁴⁷⁶ As the Canadian Labour and Business Centre comments, it “initiated the earliest and most sustained engagement of Canadian pension funds in term lending, venture capital and other markets

⁴⁷⁴ *Ibid.* at 26, 35.

⁴⁷⁵ *Ibid.* at 25.

⁴⁷⁶ *An Act Respecting the Caisse de dépôt et placement du Québec*, R.S.Q. c. C-2; Falconer, *supra* note 14 at 14. The desire to promote economic development in Quebec is one of the reasons that the QPP has been a partially funded pension system since its inception. Deaton, *supra* note 44 at 62; R. Brown, “Canada Pension Plan: Financing” in *Roundtable on Canada’s Aging Society and Retirement Income System*, *supra* note 138, 59 at 63; M. Lizée, *Canadian Pension Funds and Active Ownership – An Overview*, Center for Working Capital Working Paper No. 6 (Washington: Center for Working Capital, 2002) at 8.

for privately-placed debt and equity.⁴⁷⁷ The Caisse has a number of investment subsidiaries including the Accès Capital network of regional development funds, Capital D'Amérique CDPQ, which invests in companies in various industries, and Sofinov a biotechnology venture capital company.⁴⁷⁸ It is also involved in joint venture initiatives with the provincial government and labour sponsored investment funds.⁴⁷⁹

Many of the Canadian ETI programs have not been in operation long enough to assess the extent of their collateral benefits, or studies have not yet been undertaken, although the Caisse's investment activities are widely acknowledged to have contributed to the Canadian venture capital market and to the economic development of Quebec. Carmichael, however, has documented the collateral benefits of pension fund investments in Concert Properties and Mortgage Fund One in terms of increased plan member employment and contributions, increased government revenue (net of foregone taxes on pension contributions), and the financial and social benefits of the investments to the wider community. She found that over a ten year period Concert "more than doubled its direct, attributable on-site employment in work for the community. ... [I]ts benefits in terms of productivity outweighed its total project costs, ... [and] the federal government had a net gain of \$8.7 million in its investment of foregone tax revenues on contributions and investment returns."⁴⁸⁰

⁴⁷⁷ Canadian Labour and Business Centre, *supra* note 460 at 23.

⁴⁷⁸ For an overview of Sofinov's activities see *Ibid.* at 23-24.

⁴⁷⁹ *Worker Control and Social Investment*, *supra* note 176 at 155; Falconer, *supra* note 14 at 13.

⁴⁸⁰ *Worker Control and Social Investment*, *ibid.* at iii.

ETIs generally take the form of debt financing to private companies in the form of loans and mezzanine financing,⁴⁸¹ and equity financing. With the exception of secured loans, the other types of investments would appear to link the investment and the investor more closely with the company and its success or failure. Such a link more closely resembles that of the industrial capitalist in eighteenth century partnerships, and one to which modern corporate law theory about shareholders as owners, and ideas about the greater risks of equity investments are perhaps more readily applied. This suggests that ETIs may provide greater opportunity for involvement of investors in the management of the companies that they invest in.

However, while there is some evidence of greater involvement in the management of companies by investors engaged in ETI, the practice does not appear to be widespread. Some ETIs provide opportunities for funds to become company directors. The Board of Directors of Concert Properties, for example, in which pension funds are the only shareholders, is composed of representatives of the larger funds and the President of the British Columbia Federation of Labour.⁴⁸²

In other cases, such as those in which a number of pension plans pool their funds in an investment vehicle with specific ETI goals, there may be union or pension plan representation on the investment vehicle's board, although individual pension plans are not represented on the Boards of the individual companies invested in. The Caisse does

⁴⁸¹ This is debt-like financing, generally in the form of an unsecured loan, that has some equity features, such as linked equity. It is often used to finance a management buyout. These loans rank after secured loans and before equity in the event the company is liquidated. Thus this type of financing is riskier than debt financing, although it generally has higher financial rewards. Falconer, *supra* note 14 at 36-37; Rutherford, *supra* note 27, *s.v.* "mezzanine finance".

have union representation on its Board of Directors, although individual pension plan trustees do not normally participate in its investment decision-making processes. However, individual pension plan investors or union representation is not required on the Boards of its subsidiaries.⁴⁸³

The investment vehicle may become directly involved in company management through means other than board directorship. In Canada, both the Caisse and the WTSIF provide the companies they invest in with advice and other support services which is particularly important for start-up companies. In the United States, KPS Special Situations Fund (KPS Fund) focuses on companies that are “undergoing financial distress or threat of closure, but which ... can be recovered with adequate financing and management.”⁴⁸⁴ The KPS Fund becomes directly involved in advising and acting as an intermediary in companies. Of particular interest to pension fund activists is its focus on improving labour-management relations and its active consultation with workers. It has facilitated worker investment in corporations including worker buyouts in a number of cases. Thus in this case, pension fund investments lead to greater worker involvement and representation in the companies KPS Fund invests in and works with. Although pension funds themselves are not directly involved in the companies, KPS’ current portfolio includes companies that employ more than 6,000 workers and “most of these

⁴⁸² *Worker Control and Social Investment*, *supra* note 176 at 194-95.

⁴⁸³ *Survey of Trustees*, *supra* note 172 at 6.

⁴⁸⁴ *Canadian Labour and Business Centre*, *supra* note 460 at 17.

jobs have been maintained due to investment by KPS ..., and a high proportion protected from all-but-certain company shutdown.⁴⁸⁵

It appears then that direct pension fund involvement in companies through ETI such as that found in Concert and Mortgage One Fund is unusual. The more common practice is for pension funds to invest in an intermediary ETI vehicle which has the requisite expertise to find and work with companies. It is important to note that investing through an intermediary also helps to diversify the pension fund's investment, and it spreads the risk associated with ETI among a number of investors and a number of investments within the vehicle.

While ETI provides only limited opportunities for direct involvement in company management and direction, the fact that ETI is a strategy directed towards the creation of companies and projects, suggests that pension fund wealth could be used to invest in a manner that addresses gaps in the market and encourages real productivity, local or regional investment, or provides socially beneficial services or products. This may not be as straightforward as it appears though. It is not clear, for example, that pension funds engaged in ETI through investments in the Caisse, the WTSIF and the NBIMC are assisting in the creation of the type of jobs and social benefits that pension plan activists aspire to help create. There do not appear to be investment criteria such as labour or environmental standards which address these concerns, nor have their investments been evaluated based on this criteria.

⁴⁸⁵ *Ibid.* at 18.

This is not to say that stimulating business in particular sectors of the economy or regions of the country is not important. But as Stanford points out in his critique of labour-sponsored investment funds that finance the start-up and expansion of small businesses, “small businesses, on average, pay lower wages, offer fewer employment benefits, are more resistant to unionization, are less productive, and invest less in real capital than larger businesses.”⁴⁸⁶ Pension funds therefore, need to identify the goals of their ETI program, be attentive to the types of collateral benefits they wish to achieve and design measures to assess the success of their investments in doing so.

There are also a number of practical barriers in Canada which discourage greater ETI involvement by pension funds and other institutional investors, and limit the transformative power of ETI as an investment strategy. Falconer’s *Prudence, Patience and Jobs: Pension Investment in a Changing Economy* documents the results of a survey of the membership of the Pension Investment Association of Canada (PIAC) in 1998-99 about the barriers to private investment activity. Key barriers identified by pension managers were as follows: the management-intensive nature and extra costs to the pension fund of the “private” investment process; the limited number of investment managers with expertise in the area; a lack of information about the market and long-term investment returns, and the difficulties in creating benchmarks to measure investment performance;⁴⁸⁷ a perception that the risk-adjusted returns are inadequate or unreliable; a

⁴⁸⁶ *Paper Boom*, *supra* note 20 at 369-70.

⁴⁸⁷ Federal pension regulations recognize this difficulty and require that all pension fund statements of investment policies and procedures outline “the method of, and basis for, the valuation of investments that are not regularly traded at a public exchange”. *Pension Benefits Standards Regulations 1985*, S.O.R./87-19, s. 7.1(1)(g).

concern that these types of investment have the potential to be significant failures which will result in liabilities for pension funds; and a lack of knowledge generally about these types of investments by pension funds trustees and a consequent lack of support for them.⁴⁸⁸

Based on the survey responses and examples from the United States, Falconer suggests a number of mechanisms that could be created to address these barriers. These include: the development of “best practices” for limited partnerships and other investment vehicles in areas such as fees, performance incentives; databases of private investment returns; tools for assessing investment performance; education programs for managers and trustees; more investment vehicles that pool pension fund investments and spread both the costs associated with private market investments and the risks; more private market specialists who can advise pension funds, manage investments and negotiations, or work for investment intermediaries; and greater government involvement in facilitating partnerships, cost-sharing and the development of many of these mechanisms.⁴⁸⁹

It is important to realize that the barriers to private market investment activity identified in the survey and the mechanisms suggested to address them apply to all private market investment activity, much of which may not be designed to produce the type of collateral benefits desired by pension fund activists. Thus, within the private capital market investment arena there is a need for all the mechanisms above with an ETI focus. That is, there is a need for investment intermediaries that focus on ETI investing.

⁴⁸⁸ Falconer, *supra* note 14 at 28-31.

⁴⁸⁹ *Ibid.* at 27-32; Canadian Labour and Business Centre, *supra* note 460 at 3.

benchmarks and evaluative tools to assess collateral benefits and ETI specialists to assist pension funds and the investment intermediaries.

The barriers and the recommendations point to poorly developed infrastructure for ETI and other forms of private market investment in Canada. And as with the other pension fund activist investment strategies reviewed, it appears that government regulatory and policy intervention is needed to help create a more favourable environment for ETI. A recent change related to venture capital announced in the federal budget is an example of the role that the government can play in promoting investment in private capital markets. Until the budget change, institutional investments in all limited partnerships, one of the main vehicles for venture capital and ETI initiatives, had generally been treated as foreign property and subject to the 30 percent foreign content limit on pension funds under the *Income Tax Act*.⁴⁹⁰ This tended to discourage private market investment through limited partnerships since most institutional investors preferred to fully utilize the 30 percent allotment for actual foreign investments.⁴⁹¹ The federal budget proposed amending the legislation so that investments in limited partnerships are no longer treated as foreign property.⁴⁹²

⁴⁹⁰ *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.), as am., Part XI; Department of Finance, *Budget Plan 2001* (Ottawa: Department of Finance Canada, 2001) at 226 [hereinafter *Budget Plan 2001*]. If the investor's stake in the partnership was less than 30 percent, the partnership was not considered foreign property.

⁴⁹¹ W. Stueck, "New rules expected to boost amount of venture capital" *The Globe and Mail* (7 January 2002) B1; *Budget Plan 2001*, *ibid*. The size of the foreign content limit and its effect on investment activity in Canada is an issue itself, but one that will not be addressed here.

⁴⁹² Draft Regulations Amending Section 5000(1.1)(c) of the *Income Tax Regulations*, C.R.C., c. 945, as am., have been prepared and can be found in P. Martin, *Explanatory Notes Relating to the Air Travellers Security Charge and to Income Tax* (Ottawa: Department of Finance Canada, 2002) at Appendix C. These regulations are not yet in force but will apply after 2001.

Even with government regulatory and practical assistance, investing in private capital markets through ETI may not be as transformative a strategy as it first appears. Despite the fact that ETIs invest in private companies, few pension funds appear to be directly involved in corporate management or direction, particularly since funds often participate in ETI through intermediary investment pooling vehicles which may or may not provide for pension fund or worker participation in investment decision-making. Although ETI strategies aim to produce collateral benefits, it is difficult to measure these benefits, and pension fund members may disagree about the kind of collateral benefits they want the fund to pursue. In addition, some of the more prominent Canadian ETI investment vehicles for institutional investors do not appear to impose social and environmental criteria on the kinds of jobs and social benefits that their investments create.

As well, the lack of a well developed ETI infrastructure in Canada, particularly the fact that there are few investment managers with ETI expertise, or ETI specialists to help facilitate ETI investments, along with the fact that ETI is a management-intensive form of investment which often has additional costs for a pension fund when compared with other forms of investment, can make ETI simply impractical for many pension funds. Pension fund investments in private placements such as ETI generally make up a small percentage of pension fund investments (although they are not insignificant investments in themselves).

Clearly an ETI infrastructure is needed if pension funds are going to be able to use ETI as an effective strategy for creating real productivity, and respond to social and

economic needs not properly address by capital markets. But pension funds are unlikely to be able to create such an infrastructure on their own, in part because of its costs. It will need to be developed by the venture capital industry, the labour movement or government, alone or in partnership. The mixed history of labour sponsored investment funds (LSIFs), which pool generously tax subsidized investments, and invest them in small and medium-sized Canadian businesses, suggests that such an infrastructure will have to be carefully developed, with attention paid to investment criteria and management.⁴⁹³

Conclusion

The uncertainty in corporate law about the legal nature of the share, which mediates the relationship between the shareholder and the corporation, the nature of shareholding, and the contradictions that exist within modern corporate law between separate corporate personality doctrine on the one hand and shareholder ownership “rights” on the other raise a number of questions about the potential of pension fund activist strategies to temper corporate behaviour and improve corporate governance that are built on assumptions about shareholder ownership. Shareholder activism and proxy voting in particular appear to be significantly affected by the limits of corporate law. Investment screening is also affected by these limitations since the strategy aims not only to influence asset allocation to companies exhibiting more favoured practices, but to seek

⁴⁹³ For a detailed critique of LSIFs, see *Paper Boom*, *supra* note 20 at 355-70. Tessa Hebb and David Mackenzie respond to some of this critique and provide a generally more positive assessment of LSIFs in “Canadian Labour-Sponsored Investment Funds: A Model for U.S. Economically Targeted Investments” in Fung, Hebb & Rogers, eds., *supra* note 30, 128.

to improve the behaviour of the selected corporations through shareholder activism and proxy voting practices. And, while economically targeted investing at first seemed to link the investor more closely to the company invested in, and to provide pension funds with greater opportunities to directly target their investments to address gaps in the market and encourage real productivity, local or regional investment, or the provision of socially beneficial services or products, in the absence of government regulatory assistance, the strategy does not appear to be as transformative as it first seemed.

The next chapter considers whether these pension fund activist strategies taken together and in the absence of government regulatory changes result in anything more than modest reforms. Is pension fund activism the most effective strategy to create real productivity, long-term sustainability and transform corporate management and practice? It also considers the directions that government regulatory reform should take in this area. And finally, it turns to the question raised earlier in this chapter of whether the uncertainties of corporate law, along with the limitations of pension law, make the reconception of both the corporation and corporate assets, and the creation of democratic and social systems of corporate regulation, a more appropriate and effective project for pension fund activists. It looks at some proposals for using pension funds to do this.

CHAPTER FIVE: ASSESSING THE STRATEGIES

Introduction

The potential for the strategies that pension funds activists are pursuing to lead to significant or transformative shifts in corporate and market regulation appear limited by pension and corporate law, as well as practical or logistical limitations. At best, the strategies appear to be moderate reform proposals, a tempering rather than a socializing of capital and corporations. The first section of this chapter provides a brief summary of the limitations, in the absence of government intervention or judicial interpretive shifts, of the main strategies pursued by pension fund activists that I have discussed: shareholder activism including proxy voting, investment screening and economically targeted investment. The second section considers the question of government regulatory intervention in greater depth. Government regulatory intervention would certainly improve the transformative potential of these pension fund investment strategies. However, I argue that it will fail to bring about the dramatic changes hoped for by labour movement pension fund activists particularly if the regulatory activity is limited only to pension funds' investment practices.

More importantly, a focus on facilitating these pension fund activist strategies, even if they are extended to other types of individual and institutional investors, is not likely to lead to more democratic and social systems of corporate regulation, which seems

to be the implicit goal of at least some of the proponents of pension fund activism.⁴⁹⁴ The last section of this chapter considers some alternative reform proposals that attempt to do this. Of particular importance to the labour movement is the emphasis that many of these strategies place on expanding or utilizing public pension systems, one of the original focuses of labour movement pension activism in Canada.

Reviewing the Limitations

The most important gains made by these pension strategies may ... be political rather than economic. Labor's pension activism helps create a hospitable climate for regulating and directing financial markets; these tactics do lay bare the central fact that labor creates capital (not only from the sweat of workers' brows, but, as noted earlier, through deductions from their pay) and that capital is not always invested to advance worker interests.⁴⁹⁵

The last decade has seen an increasing interest by members of the labour movement in using their pension fund investment activities to influence corporate management and practice, encourage productivity, local and regional development and encourage long-term growth and sustainability. This interest is a result of a number of factors. The exponential growth of pension funds has meant they have become increasingly important influences on financial markets and have significant effects on local, national and global economies. Pension funds and their investment practices have been linked to the problems discussed in the first chapter: an emphasis by institutional investors on maximizing share returns over the short-term which reduces the ability of corporations to focus on long-term development in the form of, for example, capital

⁴⁹⁴ See e.g. "New Collectivism", *supra* note 11; *Labor's Capital*, *supra* note 40 at c. 6 & 8; Deaton, *supra* note 44 at 343-51; *Worker Control and Social Investment*, *supra* note 176 at c. 6.

⁴⁹⁵ *Labor's Capital*, *ibid.* at 131.

investments, research and development, and worker training; the “herd mentality” of investment managers associated with the concentration of pension funds management; and the failure of market investment activities to generate productive activities in terms of job creation and capital investment.

Members of the labour movement have also objected to their pension funds being invested in corporations that use non-union labour, or have poor labour-management relations, violate environmental, labour or human rights, lay off unionized labour, or move production to another region or country. At the same time they found that they had little or no ability to affect these decisions, or to advocate for investment decisions with collateral benefits such as job creation or the provision of social services or other economic benefits.

Strategies that labour movement pension fund activists have utilized include advocating or negotiating for greater representation on pension plan boards of trustees through either joint or sole trusteeship, or they have worked to create advisory bodies to the boards. In terms of investment practices, they have focused on three in particular: shareholder activism including proxy voting, investment screening and economically targeted or community investing. They have sought to use these practices to influence individual corporate decisions, to encourage particular corporate practices such as adherence to labour or social standards, and to encourage investments that are sustainable, create jobs, or address social or economic needs that are not being adequately addressed by regular market allocations.

Although not always stated, some pension fund activists have hoped to create new conceptions of “value” through this work. These might be conceptions that would include factors other than monetary return, such as for example job creation, and social and environmental benefits. As I have argued in the preceding chapters, the transformative power of these strategies has been limited by both pension and corporate law, and in particular by the assumptions about pension fund and corporate ownership that underpin them.

In terms of pension law, two arguments underpin pension fund activist strategies. The first is that pension funds are workers’ deferred wages which belong to them, and they should therefore have more control over how their pension funds are invested. The second is that if workers’ or their representatives had more say about how “their” funds were invested, they would and could consider criteria other than or in addition to monetary rate of return in making investment decisions. That is, they would create new conceptions of value to be applied to the decision-making process. Pension law, which combines a number of fields, including contract and trust law, does not clearly support these assumptions. It is unclear in law whether pensions are deferred wages, who owns funds in the pension trust, and when they own it.⁴⁹⁶

On a more theoretical and strategic level, this focus on pension fund ownership tends to obscure the real issue, namely that pension fund activists want to change the way pension funds are invested. Moreover by arguing about who “owns” pension funds and attaching investment decision-making “rights” to this ownership, pension fund activists

fail to explore the theoretical and political possibilities that flow from the fact that pension funds have many “owners” and “beneficiaries” – legal or otherwise. This is one of the very reasons that pension funds appear to be attractive to those interested in using investment practices to try to control or moderate the behaviour of capital, or to socialize it.

Trust law principles and case law to date have made it clear that while investment criteria other than market rate of return can be considered by pension fund trustees, market rates of return must be the paramount or primary investment consideration. Investment practices such as shareholder activism, proxy voting, screening and economically targeted investing can be pursued so long as returns to the pension fund are not negatively affected. Alternative ways to measure the costs and benefits of investments such as value-added accounting methods outlined in the third chapter can be used to assess investments, but at the end of the day, it is market rates of return that must remain the primary investment criteria. Thus an investment with wider social and economic benefits such as affordable housing or job creation cannot be made if its risk adjusted monetary return expectation is less than a similar investment without the collateral benefits.

The constraints placed on pension plan investment decision-making, particularly in the context of economically targeted investing, reveal a limitation of the application of trust law principles to pension fund regulation. This is that trust law standards of prudence were created to regulate the investment of income derived from an initial

⁴⁹⁶ See generally “Pension Plans”, *supra* note 149, and the discussion in c. 3 above.

allocation of capital to a trust, and do not properly account for the fact that pension trust funds receive two streams of income: ongoing income from contributions by employers and/or employees, and the income from fund investments.

In terms of corporate law, pension fund activist strategies are built on assumptions about corporate “ownership”, and the powers that their position as shareholders brings to pension funds and other institutional investors. Yet as we saw in chapter four, the uncertainty in corporate law about the legal nature of the share, which mediates the relationship between the shareholder and the corporation, the nature of shareholding, and the contradictions that exist within modern corporate law between separate corporate personality doctrine on the one hand and shareholder ownership “rights” on the other all raise questions about the transformative potential of pension fund activist strategies that are built on these assumptions.

On a practical level, as outlined in chapter four, strategies of shareholder activism and proxy voting regarding corporate governance reform have limited scope, and are unlikely to move away from traditional corporate governance matters to become more directive in terms of corporate management practice. They are also unlikely to consider factors such as the interests of others affected by corporate decisions, if such considerations could reduce shareholder value. Nor does the strategy of ETI seem to be as promising as it first appeared. It does not appear to link the investor more closely to the company invested in, or to currently provide Canadian pension funds with greater opportunities to target their funding more directly to address gaps in the market, or provide particular economic or social benefits. This is because a number of practical

barriers limit the ability of pension plans to participate in ETI programs, or invest directly in such projects.

Thus these investment strategies appear to be moderate reform proposals which aim to temper corporate behaviour and the allocation of investment capital through the market rather than to socialize or democratize decision-making about corporations and the production process. In saying this I do not want to understate the need for and importance of even moderate reform proposals which address concerns about corporate governance and behaviour, and long-term productivity and sustainability. Some commentators such as Aglietta, in supporting a greater role for trade unions and employees in the governance of pension fund investment, see it as a regulatory mechanism to curb the excesses of the new regime of capitalist accumulation. He argues, for example, that if workers had more control of investments they could push for a shift from short-termism back to an investment focus on the longer-term, thus creating more stable corporate ownership, job stability and a link between real wages and productivity.⁴⁹⁷ These commentators would see pension fund activist strategies as a mediative mechanism to regulate and restrain capitalism, rather than to replace it with other systems of production.

⁴⁹⁷ "Capitalism at the Turn of the Century", *supra* note 22 at 81. It is not clear what evidence Aglietta relies on to assert that workers or their representatives would necessarily be inclined to push for such longer-term investment horizons, other than an assertion that the history of the trade union movement, at least in Continental Europe, "calls on them to transcend the corporate interests of individual trades and to voice the needs of the entire labour force." (at 81) As noted earlier, Aglietta suggests in a later article that regulators should impose longer time horizons for measuring profit on institutional investors and the investment management industry. "Shareholder value and corporate governance", *supra* note 95 at 158-59.

Greater representation of workers on pension plan boards of trustees or investment advisory bodies, and the development of union-designed and union-run trustee education programs,⁴⁹⁸ along with greater use of the various pension fund activist strategies reviewed in the previous chapters, may incrementally change institutional investment culture within individual pension funds and influence the practices of external investment managers. It may for example, lead to an increased focus on more socially responsible corporate practices and management, and long-term sustainability and productivity. This in turn may have an incremental effect on corporate management and practice.

And it may be that labour movement activism in the pension fund investment arena, combined with other local, national and global activities it pursues on its own or in concert with other social movement actors, such as consumer boycott or purchasing campaigns, the development of corporate codes of conduct, and campaigns to bring attention to exploitative working conditions, human rights violations or environmental degradation, will lead to a “[political] ... fencing-in [of] markets”⁴⁹⁹ and a curbing of the new regime of capitalist accumulation.⁵⁰⁰ At the very least, some suggest, it will help raise these issues in the public domain: “[t]he new labor campaign on investment can be a

⁴⁹⁸ For a larger discussion of these programs see *Worker Control and Social Investment*, *supra* note 176 at c. 15.

⁴⁹⁹ J. Habermas, “The European Nation-States and the Pressures of Globalization” (1999) 235 *New Left Rev.* 46 at 46.

⁵⁰⁰ For more discussion of labour movement activities in such campaigns, and work in coalition with other social movement groups see O’Brien, *supra* note 18.

success, whatever else it does, if it brings [these] ... ideas about reforming corporations into the mainstream.”⁵⁰¹

However, these actions and reforms all take place within the market arena and although this suggests “a slight shift in the locus of political struggle to the market (or at least an effort to do so) ... the potential for success in this arena is profoundly limited by the very foundational claim of the market as beyond the realm of politics.”⁵⁰² Thus at best pension fund investment strategies appear to be moderate reform proposals, a tempering rather than a socializing of capital and corporations.

In a number of places in the previous chapters I have mentioned the potential or need for government regulatory action to permit or encourage the pension investment strategies promoted by pension fund activists, particularly their hopes that the strategies could be used to challenge market rates of return as the exclusive measurement of value and to develop criteria that provide a more accurate picture of true rates of return – both market and social. The next section considers the question of government regulatory intervention in greater depth.

Government Regulation

... while pension fund pressures can discipline individual companies, real changes in corporate behavior will require laws that make all corporations more democratically accountable as well as new rules and incentives to encourage responsible business and investment practices.⁵⁰³

⁵⁰¹ Moberg, *supra* note 432 at 20.

⁵⁰² Fudge & Cossman, *supra* note 9 at 29.

⁵⁰³ Moberg, *supra* note 432 at 20.

A common theme in the assessment of the various pension fund strategies has been the potential of government regulatory intervention to strengthen the strategies' impact on investment practices and corporate management and practice. A variety of reforms have been suggested. Greater worker involvement in pension fund management through a range of means including bargaining for increased representation on boards of trustees or advisory committees, or joint or sole trusteeship, have been advocated by labour movement pension fund activists, along with representative bodies such as the CLC and NUPGE.⁵⁰⁴ In addition to increasing the opportunities for worker involvement in pension fund investment decision-making, Ghilarducci argues that worker representation in pension plan management ensures greater retirement security, regardless of the type of pension plan (defined benefit or contribution), or whether it is a single or multi-employer plan. "Worker representatives, namely unions, use their positions to ensure that pension fund growth translates into pension improvements and ultimately greater retirement income security."⁵⁰⁵

Quebec's legislative requirement that all pension plans establish a pension committee separate from the employer to administer the plan, with at least one member elected by plan participants, and another by retirees and former plan members, is one model that could be followed.⁵⁰⁶ Such a model, in separating the plan administration from the plan sponsor, helps democratize decision-making about pension plan

⁵⁰⁴ *Survey of Trustees*, *supra* note 172 at 4; *Worker Control and Social Investment*, *supra* note 176 at 273-76.

⁵⁰⁵ "Small Benefits", *supra* note 30 at 161.

⁵⁰⁶ *Supplemental Pension Plans Act*, *supra* note 180, s. 147.

administration and investment decision-making, without grounding this involvement in legally uncertain claims about worker ownership of pension plans. The legislative schemes mandating the joint trusteeship of a number of provincial public sector pension plans such as British Columbia's *Public Sector Pension Plans Act*⁵⁰⁷ and the *Ontario Public Service Employees' Union Pension Act, 1994*⁵⁰⁸ provide other legislative models. In other countries "with advanced and funded pension systems"⁵⁰⁹ worker representation is required on all pension plan boards. Switzerland, for example, makes joint governance mandatory.⁵¹⁰

Other legislative changes can help legitimize or lend support to pension fund activists advocating within their pension plans and within the investment community generally, for consideration of factors besides risk and rate of return in investment decision-making. Britain's *Occupational Pension Schemes (Investment, and Assignment, Forfeiture, Bankruptcy etc.) Amendment Regulations 1999*⁵¹¹ require all occupational pension plans to disclose the extent to which their investment policies consider social, environmental or ethical criteria in the investment decision-making process.⁵¹²

In Canada, Bill C-394, a private members bill introduced by Bloc Quebecois MP Stephan Tremblay in September 2001, proposes an amendment to the *PBSA* that is similar to the British regulation. The amendment would require federally regulated

⁵⁰⁷ S.B.C. 1999, c. 44, as am.

⁵⁰⁸ S.O. 1994, c. 17, as am.

⁵⁰⁹ "Small Benefits", *supra* note 30 at 178.

⁵¹⁰ For a discussion of the Swiss model see A.T. Maxwell, *Pension Plan Governance: The Employer's Conflicting Roles as Sponsor and Administrator* (LL.M. Thesis, Osgoode Hall Law School, York University, 1999) [unpublished] at 158-64.

⁵¹¹ *Supra* note 358.

pension plan administrators to report annually on “the social, ethical and environmental factors that have been considered, during that period, in the selection, retention and liquidation of investments under the administrator’s responsibility and in the exercise of any rights related to those investments, including voting rights.”⁵¹³ Although it is not expected to pass, the bill has helped raise the issue within Parliament and is supported by Canadian social investment advocates such as SHARE and the Social Investment Organization.⁵¹⁴

None of these amendments *require* consideration of factors other than rate of return, but the room they create for doing so could be valuable. While the case law appears to support consideration of these factors in investment decision-making, provided there are alternative investments available with similar risk and return profiles and the pension fund can remain appropriately diversified, decisions such as *Scargill*⁵¹⁵ discussed earlier have been widely interpreted as restricting consideration to financial criteria alone. Those advocating practices such as shareholder activism, proxy voting, screening and economically targeted investment often face difficulty convincing other investment committee members, investment managers and others that they are acting within the scope of their fiduciary duty.⁵¹⁶ In fact, the British regulation has been credited with

⁵¹² *Ibid.*, s. 2(4).

⁵¹³ Bill C-394, *An Act to amend the Pension Benefits Standards Act, 1985 (investment criteria)*, 1st Sess., 37th Parl., 2001, c.1 (1st Reading 20 September 2001).

⁵¹⁴ Social Investment Organization, *Pension SRI Bill Introduced to House of Commons* online: <<http://www.Socialinvestment.ca>> [hereinafter *Pension SRI Bill*]; Shareholder Association for Research and Education, *Private Members’ Bill Calls for SRI Disclosure by Pension Plans* (7 September 2001).

⁵¹⁵ *Supra* note 255.

⁵¹⁶ Yaron, *supra* note 198 at 2; Canadian Union of Public Employees, *The Fiduciary Duty of Pension Fund Trustees and Administrators* (Ottawa: Canadian Union of Public Employees, 2000) at 1-2.

having “a tremendous impact on the socially responsible investment industry in the UK, and ... spurr[ing] a large number of pension funds to adopt SRI policies.”⁵¹⁷

One legislative intervention that did permit consideration of factors other than, or ahead of, rate of return was Ontario’s *South African Trust Investments Act*⁵¹⁸ which protected trustees from liability for investment losses related to decisions to divest its investments related to South Africa or to stop making such investments, provided the trustees had determined sufficient member support for the plan. Certainly legislation could codify or enhance the common law protections provided to trustees who implement investment policies which consider factors other than rate of return with the demonstrated support of plan members. This is particularly the case if members support the plan in full recognition that, in the event of less than expected returns, contribution levels may need to increase, benefits may have to be reduced, or the policy will have to be revisited. This is not to say that these policies will necessarily lead to returns that are less than average returns for similar investments assessed only on rates of return. It simply recognizes that this is one of the primary concerns for trustees considering adopting these investment strategies.

None of these potential regulatory changes, though, address the hopes of many pension fund activists that their strategies could be used to challenge market rates of return as the only measure of value and to develop a conception of value that incorporated

⁵¹⁷ *Pension SRI Bill*, *supra* note 514. 59 percent of pension funds responding to a survey by the U.K.’s Social Investment Forum indicated that they had adopted socially responsible investment into their investment policies. E. Mathieu, *Response of UK Pension Funds to the SRI Disclosure Regulation*, UKSIF Report: 2000 (London: UK Social Investment Forum, 2000) at 33.

⁵¹⁸ *Supra* note 321.

both social and market “investment returns.” One suggestion for expanding traditional conceptions of value would be regulatory measures requiring the adoption of value added accounting practices which measure the net benefits of investments to all those affected by corporate activities, such as those discussed in chapter three. In addition to or instead of requiring pension funds to report on the extent to which they consider social, environmental or ethical criteria, they could be required to provide a value added accounting of their investments in terms of their social and economic benefits to plan stakeholders: plan members as workers through job creation, and the fund itself, through increased contributions and investment income. They could also be required to measure the economic and social benefits of their investments to the wider community.

Pension funds could also choose to adopt these accounting practices voluntarily as suggested by Carmichael,⁵¹⁹ or funds could require firms they invest in to provide such accountings. The current controversy over accepted accounting industry standards, and investor interest in more transparency in accounting may provide an opportunity for pension funds activists to advocate for this type of accounting.⁵²⁰

Proposals to develop alternative or expanded conceptions of value in the context of investment decision-making illustrate the need that both Gillese, writing in the Canadian context, and Ghilarducci, in the American, have identified for a more coherent pension law and policy framework. Gillese suggests that a central barrier to developing

⁵¹⁹ *Worker Control and Social Investment*, *supra* note 176 at 267.

⁵²⁰ For an overview of investor concerns see J. McFarland, “Companies putting on a squeaky clean face” *The Globe and Mail* (14 February 2002) B1.

an analytical framework is that “the nature of a pension trust has not been settled,”⁵²¹ while Ghilarducci points out that trust law principles as applied to pension funds do not adequately account for the fact that unlike traditional trusts, pension funds receive ongoing income from two sources, employer/employee contributions and the return on fund investments.⁵²²

Barber and Ghilarducci’s “whole participant” approach to investment decision-making recognizes this unique feature of the pension fund as a trust. They suggest that trustees’ fiduciary duties of loyalty and prudence should be legislatively expanded to include consideration of the effect of investment decisions on all plan members, both retirees and those currently employed, and on the economy generally.⁵²³ Indeed, a precedent for such a legislative expansion can be seen in Ontario’s *Loan and Trust Corporations Act*.⁵²⁴ Under the Act, the standard of care that directors and officers must meet is that of the “reasonably prudent director or officer ... under comparable circumstances.”⁵²⁵ This is a higher standard than that of directors and officers of non-deposit taking corporations.⁵²⁶ In addition, subsection 108(3) requires that directors and officers consider the interests of both shareholders and other parties:

In considering whether a particular transaction or course of action is in the best interests of the provincial corporation as a whole, a director or officer shall have due regard to the interests of the depositors, as well as the shareholders of the

⁵²¹ “Pension Plans”, *supra* note 149 at 236.

⁵²² “U.S. Pension Investment Policy”, *supra* note 47 at 10.

⁵²³ Barber & Ghilarducci, *supra* note 61 at 309.

⁵²⁴ R.S.O. 1990, c. L-25.

⁵²⁵ *Ibid.*, s. 108(2)(b).

⁵²⁶ *Re Standard Trustco Ltd. et al.* [1992] 15 O.S.C.B. 4322 at 4364-65.

corporation and, in the case of a trust corporation, shall also have due regard to the interests of the persons for whom it acts in a fiduciary capacity.⁵²⁷

It seems unlikely, though, that fiduciary duties could be legislatively expanded to the extent of asking trustees' to consider the impact of their investments on the whole economy, in part because it seems unlikely that trustees would have the requisite expertise to consider these factors. It is arguable that monitoring the economy and considering the impact of investment practices and regulatory changes to these practices should be a government rather than a pension fund responsibility. Finally, pension fund activists should not lose sight of the fact that pension funds exist to deliver pensions. It would be difficult for trustees to adopt investment strategies that benefited the economy, but negatively affected their pension funds. As Ghilarducci points out, "although pension funds play vital roles in financial markets and long-term employment contracts, they should ultimately be judged according to whether they deliver secure retirements."⁵²⁸

Ghilarducci and Barber's recommendations recognize a larger regulatory role for government in the economy, for their suggestion that fiduciary duties of loyalty and prudence be expanded is part of a larger program to regulate pension fund investment and reform financial markets so that resources are better allocated to productive uses. They propose the following mechanisms: worker representation on pension plan boards of trustees; tax incentives which encourage longer-term investing through taxes on short-term speculative investing and credits for long-range investing; the creation of investment vehicles and intermediaries for long-term investments such as "federal infrastructure

⁵²⁷ *Loan and Trust Corporations Act*, *supra* note 524, s. 108(3).

bonds, secondary markets for ETIs and community development loan funds,⁵²⁹ [and] well-staffed broker units to help structure viable investment projects for pension funds.”⁵³⁰

Implementation of these proposals would certainly encourage greater long-term productive investment by pension funds, and provide many of the mechanisms needed to encourage ETI and community investing in Canada.

Why Only Pension Funds?

Barber and Ghilarducci as well as Carmichael justify their calls for greater government regulatory involvement in pension fund investment activities in large measure because of the significant tax subsidies provided to pension contributions: “[t]his money could be returned to communities through investment that provides wealth by job creation and spill-over effects, rather than being used for the largely private gains of individual and institutional shareholders.”⁵³¹ While this is certainly a compelling argument, it does raise a larger question about whether occupational pension funds alone should be singled out for this type of regulatory involvement. For occupational pension fund contributions are not the only retirement income contributions to receive significant tax subsidies. Moreover, they also appear to represent a declining proportion of tax subsidized retirement income. The Canadian federal government’s 2001 tax expenditure estimates for example, show tax expenditures for individual RRSP contributions at \$5,940 million in 1996 with a projected increase to \$7,265 million in 2002. In contrast,

⁵²⁸ “Small Benefits”, *supra* note 30 at 158.

⁵²⁹ Intermediary investment vehicles, similar to mutual funds, that pool funds from pensions and invest them in a number of ETI projects, or provide community development loans.

⁵³⁰ Barber & Ghilarducci, *supra* note 61 at 291-92.

⁵³¹ *Worker Control and Social Investment*, *supra* note 176 at 137, 88. See also *Ibid.* at 288-89.

the net tax expenditure estimates for occupational pension plan contributions were estimated at \$4,930 million in 1996, with a projected decrease to \$4,055 in 2002.⁵³²

The tax benefits given to pension plan contributions have also led to criticism of investment approaches such as economically targeted investing that seek to encourage collateral benefits to plan members in that they perpetuate the inequities that exist between those who are covered by occupational pension plans and those who are not. Deaton, for example, argues that the tax exempt status of pension contributions and income results in those without pension coverage supporting those who have the benefits of occupational pension plan coverage. This inequity is increased by investment strategies that focus on benefits such as job creation and service provision to plan members.⁵³³

As well, as Harmes and others have pointed out, despite their size, pension funds pale in comparison to the size of institutional investors such as mutual funds and hedge funds.⁵³⁴ Thus if the larger goal of pension fund activists is to encourage real productivity, job creation, and long-term sustainability as well as to influence corporate management and practice, it might be more effective to turn their efforts to lobbying for regulatory change that affects all investors and market actors. Why not press for regulatory changes that require investors and corporations to account for the social, environmental and ethical impacts of their activities; that tax short-term speculative investment; that create tax incentives for long-term productive investment with collateral

⁵³² *Tax Expenditures and Evaluations 2001*, *supra* note 7.

⁵³³ Deaton, *supra* note 44 at 339-40.

social and economic benefits; and create intermediaries and investment vehicles for such investment?

Neither an approach that focuses on pension fund investment practices nor an approach that applies these practices and associated regulatory reforms to the larger investment community is likely to lead to more democratic and social systems of corporate regulation, which seems to be the implicit goal of at least some of the proponents of pension fund activism. The last section of this chapter therefore considers some more far-reaching reform proposals that attempt to do this. Of particular importance to the labour movement is the emphasis that these strategies place on expanding or utilizing a public pension system, one of the original focuses of labour movement pension activism in Canada as outlined in the second chapter in its efforts to gain greater control over the production process.

Imagining More Transformative Strategies

... it is not merely new forms of industrial organization that we need, but a “new driving mechanism, a new rationality, a new economic logic” to replace the capitalist market, however difficult that might be to imagine let alone achieve. Without addressing the question of the growing dominance of material and social life by the capitalist market and its imperatives, reconceptualizing corporations or insisting on good corporate citizenship are doomed to failure.⁵³⁵

Labor needs a coalition to demand socialized capital investment within a coherent industrial policy framework so that ownership-based rights claims do not result in competition with other pension fund “owners.”⁵³⁶

⁵³⁴ “Institutional investors”, *supra* note 22 at 101-102; *Paper Boom*, *supra* note 20 at 377.

⁵³⁵ “Citizenship”, *supra* note 202 at 27.

⁵³⁶ *Labor’s Capital*, *supra* note 40 at 131.

One of the central criticisms of the moderate reformist nature of strategies of pension fund investment activism is that they fail to fully confront the corporation as a social institution. Greater worker participation, and investment practices which consider social, environmental and ethical factors and attempt to regulate corporate behaviour and practice, do not “democratize” decisions in the corporate and economic sphere. Although they increase access to decision-making and influence to some who have not traditionally been involved in the management of large pools of money, access still depends on “ownership” claims to wealth. And the investment rules, in the absence of regulatory intervention, have changed little, if at all.

Pension fund activists have not fully explored the possibilities created by the fact that pension funds have many “owners” and “beneficiaries” – legal or otherwise. Nor have their strategies adequately considered the suggestion that the uncertainties of corporate law make completing the separation of the corporation from the shareholder, and creating democratic and social systems of corporate regulation, a more appropriate and meaningful political project. In short, they have not challenged the limitations of pension law and corporate law with strategies that recognize the corporation and markets as social institutions that should be democratically and socially regulated. There are a number of analysts who have proposed investment strategies that incorporate pension funds, both private and public, along with other investors and aim to encourage productive investment which encourages long-term productivity and sustainability along with more public and democratic direction and accountability.

One approach is Roberto Unger's proposal for pension reform outlined in *Democracy Realized: The Progressive Alternative*.⁵³⁷ Unger proposes unifying all pension plans - public, private, and social insurance schemes. Middle-income employees and their employers would continue to contribute to their funds, while high income workers would have a portion of their contributions re-distributed to low-income workers' social-insurance accounts.⁵³⁸ Part of the money from these plans would be channeled into "social investment funds" which invest in public venture-capital operations, that in turn enhance production within the nation-state.⁵³⁹ Thus social savings would be used to create productive capacity within a nation-state. Unger does not set out any parameters for the types of productive operations that would be encouraged, nor does he define "public venture-capital operations." He focuses on the fact that by building productive capacity through savings internal to it, the state would be able to reduce its reliance on foreign capital and investment. He states that the "social investment funds" would create increased opportunities to finance "the small and the new" by opening "additional channels between saving and production."⁵⁴⁰ It is not clear though, how these investment funds, in the absence of investment parameters, would open new channels of investment. While Unger may ultimately rely too heavily on traditional market forces of investment, production and profit to create his system, it represents an alternative vision, and one which aims to channel pension funds savings into productive investments.

⁵³⁷ *Supra* note 34.

⁵³⁸ *Ibid.* at 149.

⁵³⁹ *Ibid.* at 149-50.

⁵⁴⁰ *Ibid.* at 161.

Ghilarducci suggests that strategies that focus on private pension fund provision alone are unlikely to lead to changes in conceptions of investment “value” that actually incorporate factors other than market rates of return into the decision-making, rather than considering them when evaluating investments of similar market rates of return. Nor are they likely to significantly change investment practices that encourage short-term speculative investing with few productive returns.⁵⁴¹ She argues that the labour movement has to work in coalition with other social movement actors to press for changes in investment criteria and practices that “secure jobs, communities, and retirement income.”⁵⁴² Ghilarducci suggests that a universal pension plan in which investments are managed by a public board “could create such criteria by providing adequate pensions and by incorporating employment and community effects when calculating the rate of return of a particular investment.”⁵⁴³ She provides few details about the mechanisms for selecting the board, or how such a universal system would be structured.

Stanford suggests a more comprehensive set of financial and regulatory reforms and programs designed to encourage investment in real productivity, and to encourage more democratic and social management of capital,⁵⁴⁴ including capping the foreign content investment limit for RRSPs and RPPs at 20 percent.⁵⁴⁵ Of interest in terms of institutional investors’ activities, particularly for those interested in promoting

⁵⁴¹ *Labor’s Capital*, *supra* note 40 at 132.

⁵⁴² *Ibid.*

⁵⁴³ *Ibid.*

⁵⁴⁴ See generally *Paper Boom*, *supra* note 20 at c. 14 & 16.

economically targeted investing, is his proposal for a more public system of venture capital investing “in which the need of the broader community for capital accumulation and job-creation explicitly motivated the chain of economic activity which culminates in a new investment in some real venture.”⁵⁴⁶ Private financial institutions including registered pension funds would be required to deposit a percentage of their assets in a “public venture investment bank.” Stanford suggests that this percentage could be a relatively small share of their total assets – “perhaps up to one-half of one percent, ... phased in over several years.”⁵⁴⁷ He estimates that this would create an initial capital fund of \$12 – 15 billion.⁵⁴⁸ The Bank of Canada could provide additional credit which would fluctuate with the economy. Governments, pension funds (private and public) and individuals could all invest in the bank.⁵⁴⁹

The investment bank would allocate investments through two types of development council, community and sectoral, which would identify economic and social needs as well as the resources available in the area, and then work to develop ventures that would utilize these resources in meeting the identified needs. The investment bank would be run on a non-profit basis. However, projects that are invested in would have to meet a basic rate of return threshold to cover the interest paid to the investment bank’s

⁵⁴⁵ *Ibid.* at 334-36. *Paper Boom* was published before the federal government’s 2000 budget when the limit was increased to 30 percent.

⁵⁴⁶ *Ibid.* at 397.

⁵⁴⁷ *Ibid.* at 398.

⁵⁴⁸ *Ibid.*

⁵⁴⁹ Stanford suggests that they receive interest on their deposits that is two or three percentage points above the rate of inflation. As he points out, this would be less than what would be received on deposits at other financial institutions. *Ibid.* at 399. It might be difficult for pension plans, in the absence of changes to fiduciary duties of loyalty and prudence, to make such investments.

investors. They would also have to provide social returns such as jobs, taxes, utilization of materials from local or national suppliers, or meet social needs such as affordable housing or environmental protection.⁵⁵⁰ Stanford argues that the public investment system will not only result in increases in real productivity that meet needs not adequately addressed by private investors, but over time it would build local and national capacities for citizens to exercise greater control over the economy:

One morning the citizens of a community or even a whole country would wake up and realize they were in charge of their own economic destiny: they now possessed the institutional strength, the financial resources, and the entrepreneurial experience and capabilities with which to oversee the continued accumulation of real capital and the continued qualitative and quantitative development of the economy.⁵⁵¹

While Stanford does not focus only on pension funds in his proposals, both Deaton and Blackburn suggest that expansion of the public pension system is an important means to establishing social control over corporations and capital. Deaton suggests that the expansion of the public pension system and the implementation of an investment strategy that focuses on investing pension funds in the public interest in a socially productive manner could be part of a process that socializes capital and contributes to a transition from socialism to capitalism. "Because the pension system has increasingly organized and socialized the flow of savings and investment at a macro-economic level in modern capitalist economies, it has become a potential instrument for the accumulation and direction of capital under public control at the state level."⁵⁵²

⁵⁵⁰ *Ibid.* at 400.

⁵⁵¹ *Ibid.* at 411-12.

⁵⁵² Deaton, *supra* note 44 at 349. See generally c. 10.

Blackburn argues that control over pension funds “joins up with other, even larger, questions concerning the shape and direction of society as a whole,”⁵⁵³ and he provides a detailed pension reform proposal that is part of a larger strategy to socialize production by socializing investment mechanisms in “The New Collectivism: Pension Reform, Grey Capitalism and Complex Socialism.”⁵⁵⁴ He advocates for the gradual creation of a radical pension fund regime through the socialization of the private pension fund system by means of a variety of measures including: increased beneficiary and other stakeholder group representation on pension fund boards of trustees; government regulatory changes clarifying pension surplus ownership; clarification of pension plan trustees’ fiduciary duties to include consideration of “long-term, collective and inter-generational benefit-holder interest;”⁵⁵⁵ increases in the minimum level of retirement income guaranteed by the state; universal membership in private pension funds with the state contributing for those not employed in waged labour or able to contribute; legislative requirements that standards of ethical and social responsibility be incorporated into pension investment decisions; and tax, and other incentives applied only to contributions to pension plans which use socially responsible investment criteria in making their investments.⁵⁵⁶

The ultimate goal of these measures is the creation of a new pension regime – a public system funded through pension funds controlled by a number of social and

⁵⁵³ “New Collectivism”, *supra* note 11 at 4-5.

⁵⁵⁴ *Ibid.*

⁵⁵⁵ *Ibid.* at 23.

⁵⁵⁶ *Ibid.* at 32-33.

regional organizations and regulated by the state. For example, an individual's contributions, whether from the state, employer or him or herself would be deposited in a "social account" and invested in three to five registered pension funds of his or her choice. The registered pension funds would have to meet government established ethical and social criteria.

Blackburn does not really articulate why his pension fund regime is built on a range of registered pension funds, rather than one centralized public fund. Presumably the range of funds allows for greater citizen involvement in investment decision-making at a more local or regional level, and ultimately greater socialization of production. It may also be a strategic approach given the proliferation and popularity of mutual funds in recent years.

On retirement the individual would receive the state guaranteed pension through the social account. Blackburn suggests that the pension be set at no less than 50 percent of average earnings.⁵⁵⁷ Any shortfall from the investments in the registered pension funds would be provided by the government through a redistributive levy on the funds that perform well.⁵⁵⁸ This is a rough sketch of how such a system could function, and Blackburn acknowledges that the administration, as well as the types of progressive

⁵⁵⁷ CPP pensions are 25 percent of average earnings to a current maximum of \$9,465 per year. Given that Blackburn proposes that the state contribute to the social account on behalf of those not employed in waged labour or who are unable to contribute, one assumes that he also envisions an equitable calculation of "average earnings" for these individuals.

⁵⁵⁸ "New Collectivism", *supra* note 11 at 42-45.

changes needed would vary from state to state depending on the structure of their social systems.⁵⁵⁹

While this too may appear to be simply another method of regulating capitalism, with more input from government and social organizations such as unions, Blackburn argues that he is proposing something more radical - a way out of "grey capitalism."⁵⁶⁰ He argues that while his proposals take grey capitalism as their starting point and are designed to address the problems discussed above by making use of pension funds as "a tool of macroeconomic regulation that is peculiarly adapted to conditions of globalization,"⁵⁶¹ his proposals also provide an incremental means to socialize private pension provision by "creating a funded public and mutual sector which can act as [a] powerful influence within the economy as a whole" and together with the public and co-operative sector establish a new form of political economy.⁵⁶² He suggests that these measures will create an "economically active citizenry" who, once they are collectively involved in holding, investing and controlling capital property through their retirement investments, will start to explore or question the "limits of capitalism as a social regime."⁵⁶³

Both Sweden's recent reforms to its public pay-as-you-go pension system, and Australia's mandatory occupational pension scheme have some similarities with

⁵⁵⁹ *Ibid.* at 43-44. Unger's proposals for example are targeted to developing countries and are designed to reduce nation-states' reliance on foreign capital and investment.

⁵⁶⁰ As noted earlier, Blackburn defines 'grey capitalism' as "a new financial regime of accumulation based on the salience of pension funds in Britain and the United States, a model now spreading to many other countries." *Ibid.* at 5.

⁵⁶¹ R. Blackburn, "Reply to Henri Jacot" (2000) 1 *New Left Rev.* 130 at 132 [hereinafter "Reply to Jacot"].

⁵⁶² "New Collectivism", *supra* note 11 at 48.

Blackburn's proposals. They also illustrate some of the difficulties that will be encountered in moving towards the "new collectivism" envisioned by Blackburn. Reforms in Sweden included the allocation of two percent of pension contributions into government-administered, personal retirement accounts.⁵⁶⁴ These are defined contribution accounts and the funds are invested in a variety of market instruments.⁵⁶⁵ Individuals can "invest in up to five domestic or international funds that are registered to do business in Sweden."⁵⁶⁶ While a government agency acts "as a clearinghouse to direct the contributions to the participating funds,"⁵⁶⁷ the individual chooses the funds. The state's role in regulating the funds is limited to ensuring that "they operate within the limits of good practice."⁵⁶⁸ There do not appear to be any limits on foreign investment, or the imposition of investment criteria such as economically targeted investing.

These reforms have moved the Swedish public pension system from a defined benefit system to a hybrid one with elements of defined benefit and defined contribution systems.⁵⁶⁹ Over time, people's pension entitlement will become more individualized. First, because under the reforms to the public system, an individual's pension benefit will be based on average lifetime earnings. Prior to the reforms, pension benefits were based

⁵⁶³ "Reply to Jacot", *supra* note 561 at 132.

⁵⁶⁴ J. Myles & P. Pierson, "The Comparative Political Economy of Pension Reform" in P. Pierson, ed., *The New Politics of the Welfare State* (Oxford: Oxford University Press, 2001) 305 at 319.

⁵⁶⁵ *Ibid.* at 319. See also A. Sunden, "How Will Sweden's New Pension System Work" (2000) No. 3 *Center for Retirement Research at Boston College Issues in Brief*.

⁵⁶⁶ Sunden, *ibid.* at 9.

⁵⁶⁷ L. Fox & E. Palmer, *Pension Reform in Europe in the 90's and Lessons for Latin America* (Santiago: United Nations, 2001) at 26.

⁵⁶⁸ *Ibid.* at 25.

⁵⁶⁹ For a detailed overview of the changes to the Swedish system see Sunden, *supra* note 565; Working Group on Pensions, *Pension Reform in Sweden: A Short Summary* (Stockholm: Ministry of Health and

on the best fifteen years of earnings out of a minimum thirty years of employment. And secondly, some people's contributions to the personal retirement accounts will be more successful in the market than others. As a former Director of Sweden's National Social Insurance Board commented: "[t]he risk for an inadequate benefit level stemming from an uneven flow of incomes over a lifetime will be switched from the state to the individual."⁵⁷⁰ Some commentators have suggested that rather than moving towards a new collectivism for investment decision-making, these reforms "[open] the door to much larger individuation of benefits in the future."⁵⁷¹

It is important to place these reforms within the context of the larger debate in Sweden over the social control of corporations which has its roots in proposals introduced by Rudolf Meidner in 1975-76. These proposals were designed to "change the ownership structure of the Swedish economy through collective profit-sharing by way of wage-earner funds"⁵⁷² and would have ultimately socialized corporations. Meidner proposed that corporations issue new shares equal to about 20 percent of profits. The shares would be held by wage-earner funds controlled by workers through their unions, and the corporations would use the working capital to increase investment. Over time, the growth of the funds would increase workers' influence on corporate decision-making, and part of the earnings of the funds would be distributed to the public pension system. The

Social Affairs, 1994); O. Settergren, "The Automatic Balance Mechanism of the Swedish Pension System" (May 2001) [unpublished preliminary draft, on file with the author].

⁵⁷⁰ K.G. Scherman, "The Future of Social Security for this Generation and the Next," Prepared Testimony Before the U.S. House of Representatives Ways and Means Committee, Social Security Subcommittee at 5.

⁵⁷¹ Myles & Pierson, *supra* note 564 at 320.

⁵⁷² Minns, *supra* note 11 at 44.

wage-earner funds were predicted to accumulate approximately 49 percent of the equity in Swedish corporations over a five-year period.⁵⁷³

The Meidner Plan generated intense opposition from employers who lobbied strenuously against its adoption. The system ultimately introduced through legislation in 1984 was significantly less radical than that envisioned by Meidner. Five funds were established which could purchase existing shares (rather than new ones) or provide loans to start new businesses with the funds raised from a 0.2 percent payroll tax and a 20 percent profits tax.⁵⁷⁴ Interest on the investments would be transferred to the public pension system.⁵⁷⁵ While worker representatives made up the majority on the board of directors of each fund, the boards were prohibited from active involvement in corporate management, and could only hold 8 percent of the equity shares in any company. “By the end of 1990, the accumulated funds amounted to only 3.5 percent of the total value of Swedish company shares quoted on the Stockholm stock exchange.”⁵⁷⁶

As Minns points out, the fate of the Meidner Plan “reveals the political difficulty of increasing social ownership for explicitly ‘socialist’ ends.”⁵⁷⁷ In terms of the recent reforms to the public pension system in Sweden, John Myles and Paul Pierson argue that the introduction of individual accounts was a concession by the Social Democrats to the conservative opposition parties in order to “reach an all-party agreement.”⁵⁷⁸

⁵⁷³ *Ibid.* at 45.

⁵⁷⁴ Deaton, *supra* note 44 at 318; *Ibid.*

⁵⁷⁵ Deaton, *ibid.*

⁵⁷⁶ Minns, *supra* note 11 at 45.

⁵⁷⁷ *Ibid.* at 53.

⁵⁷⁸ Myles & Pierson, *supra* note 564 at 320.

In Australia, employers are required to contribute to employee's individual defined contribution pension accounts which are invested in mutual funds chosen by the employer.⁵⁷⁹ Created in 1992, this system was the outcome of negotiations between the labour movement and the government in which labour agreed to wage reductions in exchange for mandatory occupational pension plans composed of fully portable defined contribution accounts.⁵⁸⁰ While the labour movement has some involvement in the administration and regulation of the occupational pension schemes, including equal representation on the Boards Directors of industry funds, they do not appear to have significant involvement in investment decision-making, since during the negotiations, the labour movement agreed to:

the delegation of control to private financial institutions, ... who have amassed an army of 'service providers' – 'asset consultants', administrators, custodians, and investment managers – to share in the fees. ... [T]he unions did set up their own financial consultancy company, ... their own trustee advisory and educational structure, and have agreed deals with the largest insurance companies to bring down the price of administration, and held an annual Conference of Major Superannuation Funds which has now become an Australian institution.⁵⁸¹

Recent statistics indicate that industry funds cover approximately 30 percent of Australian workers, while the vast majority (49 percent) are covered by retail superannuation funds.⁵⁸² Although industry funds are not-for-profit, facilitate fund

⁵⁷⁹ If the fund manager has more than one fund, the employee can choose which of these funds his or her money will be invested in. Fox & Palmer, *supra* note 567 at 27.

⁵⁸⁰ Myles & Pierson, *supra* note 564 at 316. See also Minns, *supra* note 11 at 48-49. Australian Council of Trade Unions, "Fact Sheet on Superannuation" (2002) online: Australian Council of Trade Unions <<http://www.actu.asn.au>>.

⁵⁸¹ Minns, *ibid.* at 49. See also Myles & Pierson, *ibid.* at 317.

⁵⁸² Productivity Commission, *Superannuation Industry (Supervision) Act 1993 and Certain Other Superannuation Legislation*, Draft Report (Canberra: Commonwealth of Australia, 2001) at Table 1, p. XIV.

portability from employer to employer, and work to reduce fund administration fees, they do not appear have investment policies that differ from other superannuation funds in terms of, for example, real investment, job creation or economically targeted investment.⁵⁸³

As the Australian Council of Trade Unions' (ACTU) states:

The ACTU's interest is in ensuring that superannuation funds fulfill their prudential responsibilities, including by seeking high returns balanced by appropriate risk, and by ensuring that administration and investment costs are brought to as low levels as possible consistent with providing adequate levels of service.⁵⁸⁴

Australian workers bear all the risks inherent in defined contribution pension plans, and there is no redistribution between funds or between workers as envisioned by Blackburn's scheme.

Analysis of the reforms in Sweden and Australia points to the need to examine the vision underlying pension fund reform proposals in order to critically assess their transformative possibilities. While the proposals discussed in this section may appear to merely take the moderate reforms proposed by pension fund activists a step further, they all have a vision of more public, democratic and social systems of regulating corporations and the allocation of capital. They also address the criticism that proposals aimed at corporate and market reform should target all investors, not just occupational pension plans. As well, Unger, Ghilarducci and Blackburn's proposals all illustrate the potential

⁵⁸³ Australian Council of Trade Unions, "Industry Funds Forum? Super!" (2002) online: Australian Council of Trade Unions <<http://www.actu.asn.au>>.

⁵⁸⁴ Australian Council of Trade Unions, "ACTU Submission to the Superannuation Working Group (February 2002) at 2, online: Australian Council of Trade Unions <<http://www.actu.asn.au>>.

importance of merging the private and public pension systems into a universal system in order to better effect social control of corporations and capital allocation.

This emphasis on the creation of a universal pension system is particularly interesting in light of the labour movement's initial opposition to the development of occupationally based pension plans in favour of a universal system. Moreover a universal public system addresses Deaton's concern identified earlier about the stratification created within the labour movement between those with occupational pension plans, and those workers who must rely on their own savings and the residual public pension system.⁵⁸⁵ This suggests that pension fund activists might want to focus renewed attention on the possibilities for corporate and market regulation that a universal public system creates.

Recent changes to Canada's public pension system indicate that this too may not be without its challenges. In 1997, with the passage of the *Canada Pension Plan Investment Board Act*, the federal government created an arms-length board, the Canada Pension Plan Investment Board (the "Board"), to oversee the investment in the market of surplus CPP assets that are transferred to it.⁵⁸⁶ The Board has allocated management of these assets to investment managers at private financial institutions and there are few investment parameters. For the first three years investment had to be passive and a maximum of 30 percent of the fund could be invested outside of Canada.⁵⁸⁷ In 1999

⁵⁸⁵ See also *Labor's Capital*, *supra* note 40 at 161.

⁵⁸⁶ *Canada Pension Plan Investment Board Act*, S.C. 1997, c. 40.

⁵⁸⁷ At the moment all of the fund is invested in equities because of the funds already invested in provincial government loans. *Pensions Under Attack*, *supra* note 3 at 199.

active management of half of the fund was permitted.⁵⁸⁸ Active investment of the entire fund will likely be permitted in 2003.⁵⁸⁹

Eventually the CPP Fund is predicted to be the largest pension fund in Canada. Although some suggest that the creation of the fund and its investment in the market represents “creeping socialization,”⁵⁹⁰ the governance and management of the fund by the private sector and the limited restrictions on its investments suggest this is not the case. The Board’s directors are appointed by federal Minister of Finance in consultation with the participating provinces and the Board’s own nominating committee. The legislation does not require that there be representation from other groups such as the labour movement, current retirees, or other social movement actors.⁵⁹¹ The Board’s recently published *Investment Statement*,⁵⁹² a consolidation of a number of its investment policies and guidelines, does not contain any investment criteria related to social, political, or economically targeted investing. Moreover, in its *Social Investing Policy*,⁵⁹³ the Board indicates that it will “not give preference to or consider as ineligible for investment the securities of any issuer based on non-investment criteria.”⁵⁹⁴

Mary Condon argues that in choosing to rely on market returns rather than other workers for pension provision “a move away from a commitment to collective

⁵⁸⁸ Condon, *supra* note 3 at 100 n13.

⁵⁸⁹ *Pensions Under Attack*, *supra* note 3 at 199.

⁵⁹⁰ Myles & Pierson, *supra* note 564 at 320.

⁵⁹¹ *Canada Pension Plan Investment Board Act*, *supra* note 586, s. 10(4).

⁵⁹² Canada Pension Plan Investment Board, *Investment Statement* (Toronto: 10 April 2002), online: Canada Pension Plan Investment Board <<http://www.cppib.ca>>.

⁵⁹³ Canada Pension Plan Investment Board, *Social Investing Policy* (Toronto: 6 March 2002), online: Canada Pension Plan Investment Board <<http://www.cppib.ca>>.

⁵⁹⁴ *Ibid.* at 2.

responsibility for pension provision has definitely taken place.”⁵⁹⁵ And Townson points out that the creation of the investment board and the shift to investing funds in the market represented a compromise to those who advocated private savings accounts or opting out of the public plan.⁵⁹⁶ She suggests this compromise may ultimately lead to renewed pressure for the abolition of the CPP and the creation of a system of individual savings accounts in its place.⁵⁹⁷

Conclusion

This chapter has reviewed the possibilities for the investment strategies pursued by pension fund activists to lead to significant or transformative shifts in corporate and market regulation. For a variety of reasons, legal and practical, it does not appear that strategies such as shareholder activism including proxy voting, investment screening, and economically targeted investing, will lead to significant changes, particularly if they are pursued by individual pension funds, acting on their own.

Government regulatory intervention could certainly help facilitate the implementation of these strategies, but many of the interventions proposed by pension fund activists such as mandatory worker representation on various pension fund investment decision-making bodies; requiring pension funds to report on the extent to which their investment policies consider social, environmental and ethical criteria, or to

⁵⁹⁵ Condon, *supra* note 3 at 94.

⁵⁹⁶ *Pension Under Attack*, *supra* note 3 at 200-201. Myles and Pierson argue that major cuts to CPP benefits were only prevented through the opposition of the Quebec government working with the social democratic governments in power in British Columbia and Saskatchewan. Myles & Pierson, *supra* note 564 at 320. While Condon suggests that although some of the more radical and regressive proposals were not implemented, “the price that was paid for maintaining benefits and access to benefits was ... the ‘marketization’ of the CPP.” *Ibid.* at 92.

implement value-added accounting procedures; or the creation of an ETI infrastructure, are ultimately modest reform proposals that will temper rather than transform capital and corporate management.

The more radical regulatory changes suggested such as legislatively expanding fiduciary duties of loyalty and prudence to include consideration of the effect of investment decisions on all plan members and the economy generally, raise questions about why pension funds should be the only institutional investors singled out for such regulatory intervention. As well, a focus on facilitating these pension fund activist strategies, even if they are extended to other types of individual and institutional investors, is not likely to lead to more democratic and social systems of corporate regulation as the strategies fail to fully confront the corporation as a social institution.

The last section of this chapter considered some alternative reform proposals that attempt to do this. Of particular importance to the labour movement is the emphasis that many of these strategies place on expanding or utilizing public pension systems to invest capital in the broad public interest, and to gradually turn corporations and markets into democratically and socially regulated institutions, the goal of many labour movement pension fund activists. The experiences in Sweden, Australia, and with recent creation of the Canada Pension Plan Investment Fund suggest that this may be politically difficult to do. On the other hand, a number of factors including the limited potential of current pension fund activist strategies; the relatively positive experience of the Caisse, which invests Quebec's public pension funds; and the labour movement's historical support for

⁵⁹⁷ *Pensions Under Attack, ibid.*

an expanded public pension system; suggest that this avenue for change should not be ignored.

CONCLUSION

... pension arrangements ... incorporate the key elements of political economy: power, capital accumulation, industrial relations, politics and social transformation. The pension issue is volatile because it represents the historical conjuncture where the interest of capital, labour and the state collide and simultaneously affect the interest of all key segments and institutions of society: the elderly, workers, unions, the industrial and finance sectors, and the state.⁵⁹⁸

Property rights and the legitimacy of market rates of return are the foundations of a capitalist economy. If the pension fund system, the system of capital accumulation by means of workers' forced savings, continues to be governed by these rules, the system will function on terms favorable to the most powerful interests in the economy.⁵⁹⁹

Pension funds, the funds held in trust to support occupational pension plans, represent significant funds of capital. Together with other institutional investors such as mutual funds and hedge funds they have become important actors in financial markets – nationally and internationally. They have significant holdings in national and transnational corporations. They are also deeply implicated in the financial instability of global financial markets, and free market globalization.

Pension funds are generated from two sources: the contributions of, or on behalf of, workers; and the investment returns from the pooled contributions. They provide retirement pensions to workers who are generally unionized members of the labour movement. This movement has a history of working to limit many of the excesses of capitalist accumulation through collective bargaining, and participation in the political process to promote a broad range of state regulatory programs such as worker health and safety, unemployment insurance, and universal public pension programs. It has also been

⁵⁹⁸ Deaton, *supra* note 44 at 2.

an active force in the emerging global civil society as part of a coalition of social movement actors working to re-orient or temper the effects of global capitalism and neoliberalism.

Yet, pension fund members have watched as the pension funds from which they will receive retirement income have been invested in corporations that use non-union labour, or have poor labour-management relations, violate environmental, labour or human rights, lay off unionized labour, or move production to another region or country. And they found they had little or no ability to affect these decisions, or to advocate for investment decisions with collateral benefits such as job creation, the provision of social services or the creation of other economic benefits.

In response, there has been renewed interest in the past decade on the part of some members of the labour movement in more active involvement in pension fund investment decision-making as a strategy to achieve a number of goals including: influencing corporate management and practice; encouraging productivity, local and regional development and long-term growth and sustainability; creating new conceptions of “value” that include factors other than monetary return; and transforming capital by gaining greater social and democratic control over it. Labour movement pension fund activists have pursued four main strategies to do this: greater representation on pension plan boards of trustees, investment committees and pension fund advisory bodies; shareholder activism including proxy voting, investment screening and economically targeted investing. This thesis has sought to examine the transformative potential of these

⁵⁹⁹ *Labor's Capital*, *supra* note 40 at 132.

strategies in light of pension law and corporate law principles and practice. It has also looked at some of the more practical limitations of the strategies.

In terms of pension law, pension fund activists have argued that pension funds are owned by workers because they represent their deferred wages, and these ownership rights entitle them to a greater involvement in pension fund investment decision-making. Pension law however, is unclear about whether pensions are deferred wages, who owns the funds, and when they own it. Justifying pension fund activism on the basis of “ownership rights” also means that pension fund activists fail to explore the possibilities that flow from the facts that pension funds have many “owners” and “beneficiaries” – legal or otherwise.

While pension fund activists have sought to use pension fund investment strategies to challenge traditional monetary conceptions of value, trust law fiduciary duty principles make it clear that while investment criteria other than market rate of return can be considered when making investment decisions, market rates of return must be the paramount investment criteria. This reveals an important limitation of the application of traditional trust law principles to pension fund regulation. This is that trust law standards of prudence were created to regulate the investment of income derived from an initial allocation of capital to a trust, and do not properly account for the fact that pension trust funds receive two streams of income: ongoing income from contributions by employers and/or employees, and the income from fund investments.

In terms of corporate law, pension fund activist strategies are built on assumptions about corporate “ownership”, and the powers that their position as shareholders brings to

pension funds and other institutional investors. Yet as we saw in chapter four, the uncertainty in corporate law about the legal nature of the share, which mediates the relationship between the shareholder and the corporation, the nature of shareholding, and the contradictions that exist within modern corporate law between separate corporate personality doctrine on the one hand and shareholder ownership “rights” on the other all raise questions about the transformative potential of pension fund activist strategies that are built on these assumptions.

In the absence of government regulatory action that encourages these investment strategies, or expands fiduciary duties of loyalty and prudence to permit consideration of factors other than rate of return when making investment decisions, pension fund activist strategies are at best moderate reform strategies, particularly as it appears that a relatively small number of pension funds with more politically active members are currently pursuing these strategies. And, while these strategies may be more effective on a larger scale if more pension funds pursue them, particularly if combined with other local, national and global activities such as consumer boycotts, purchasing campaigns, the development of meaningful corporate codes of conduct, and political campaigns against exploitative working conditions, human rights violations and environmental degradation, together they will only achieve incremental change. They will not fundamentally democratize or socialize the ownership and control of capital.

Pension fund activists have not fully explored the possibilities created by the fact that pension funds have many “owners” and “beneficiaries” – legal or otherwise. Nor have their strategies adequately considered the suggestion that the uncertainties of

corporate law make completing the separation of the corporation from the shareholder, and creating democratic and social systems of corporate regulation, a more appropriate and meaningful political project. In short, they have not challenged the limitations of pension law and corporate law with strategies that recognize the corporation and markets as social institutions that should be democratically and socially regulated.

One strategy for doing this appears to be utilizing the public pension system, particularly by expanding a funded public pension system, and democratizing the fund investment decision-making process. The labour movement historically opposed the expansion of an occupationally based pension system, and favoured an expanded, universal public pension system. The recent creation of the Canada Pension Plan Fund means that the CPP Fund will eventually be the largest pension fund in the country. This development, coupled with the fact that a declining percentage of workers are covered by occupational pension plans, particularly defined benefit plans,⁶⁰⁰ suggests that the labour movement may want to focus greater attention on expanding the public pension system and gaining greater influence and control over the CPP Fund's investment practices as a means to encourage long-term productivity and sustainability and to socialize capital and corporations, while also improving the retirement income prospects for all Canadian workers.

⁶⁰⁰ Between 1991 and 1999, "the percentage of paid workers belonging to RPPs ... slipped from 45% to 41%." *Pension Plans in Canada*, *supra* note 6 at 5.

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