The Fiduciary Duty of Boards

Look up the statute (Act of a legislative body) that your corporation was incorporated under. At the very top of the section outlining directors’ duties and liabilities, you will find this:

A director must act honestly, in good faith, in the best interests of the corporation.
(Canada Business Corporations Act 2010)

This is the fundamental legal, or statutory, duty of board members. It is called the duty of loyalty, or more commonly, the fiduciary duty.

“Fiduciary” is an old English word (from the Latin for “faith” and “trust”). It means a trustee—someone who looks after the business and affairs of someone else, a beneficiary.

But a fiduciary is a special kind of trustee. A fiduciary is a trustee who looks after the business and affairs of a beneficiary who is disadvantaged, who is not capable of looking after their own business and affairs. Examples would be an orphan child, or a mentally challenged adult.

A fiduciary has a higher standard of loyalty and care than any other person under the law, since there is no way for their beneficiary to know how good a job they are doing, whether they are being faithful and diligent, or robbing them blind.

That is how to think of your duty as a board member.

You are a fiduciary, a trustee looking after the business and affairs of a beneficiary who can’t look after their own business and affairs, the corporation.

The corporation is a helpless child.

It has no way of knowing how good a job you are doing as its trustee, whether you are being faithful and diligent, or robbing it blind.

The corporation is a helpless child because it is a legal fiction.

In British law, which extends to most English-speaking countries and beyond, we treat the corporation as a person.

As a person, the corporation has a birth, it has a life, it has a purpose, and it will have a death. Corporate law is written to enable this, the orderly birth, life, purpose and death of corporations.

We treat corporations as a person under the law for practical reasons. It lets corporations do things, like buy and sell property, own assets, borrow money, launch ships and expeditions, take risks. Corporations can sue, and be sued, just like people. Corporations can sell their business, merge, wind down or declare bankruptcy.

But of course corporations aren’t really persons at all. They are treated as if they are persons, but they have no mind of their own, no heart or soul.

That’s the board’s role.
The board is the “directing mind of the body corporate”. In a very real way, the board is the mind, heart and even soul of the corporation.

By acting in the best interests of the corporation, the board takes into account the competing self-interests of principals, agents and other stakeholders, but at the end of the day sets the direction and priorities of the corporation in its own [the corporation’s] interests, as stewards and trustees.

In Canada, the 2008 Supreme Court decision in the BCE vs. Bondholders case gives the definitive interpretation for members of boards of directors in Canada. Here are its key principles: (Galway and Gans 2008) (BCE Inc. v. 1976 Debentureholders 2008)

1. Directors must consider the best interest of the corporation;
2. Where the corporation is ongoing, directors should be looking to the long-term interests of the corporation, which duty will vary with the situation at hand;
3. Fiduciary duty includes the duty to treat individual stakeholders affected by corporate actions equitably and fairly;
4. In considering what is in the best interest of the corporation, directors may look at the interests of shareholders, employees, creditors, consumers, governments, and the environment to inform their decision;
5. In each case directors must act in the best interests of the corporation in a fair manner commensurate with the corporation’s duties as a responsible corporate citizen;
6. There is no principle in Canada that one set of interests, for example the interests of shareholders, should prevail over another set of interests;
7. Where conflicting interests arise, and where it is impossible to please all stakeholders, it will be irrelevant that the directors rejected alternative transactions that were no more beneficial than the chosen one; and
8. It is a function of business judgment as to what is in the best interests of the corporation in any particular situation.

This decision is the clearest articulation and confirmation of the principles-based governance system that Canada has chosen to adopt. Even in times of governance failure, Canada has resisted the urge to rush into a rules-based governance system such as that chosen by the United States.

For those of us who view principles-based systems as ultimately superior (that is to say, more effective) than rules-based systems, this Supreme Court ruling is like a breath of fresh air in a very stuffy room.

If you accept a position as a board member in Canada, you are accepting appointment as guardian of a helpless child, the corporation. Not only must you act in this helpless child’s best interests, to guard its welfare and sustain it over the long term, but you also must decide what those best interests are. Your primary tool is your own experience and wisdom, your judgment. You are entitled to, in fact must, take into account the interests and views of everyone else in the helpless child’s life. However, you must not let any one of their interests prevail over the others. You listen, you weigh, you deliberate as a collective group of guardians, you agree on what is in the child’s best
interest, then you act on it. Then you watch over the child’s welfare, and go through the whole process again, and again. And each time, you may weigh the competing interests slightly differently, to benefit the child over its lifetime.

This is both an incredibly empowering and frustrating position to be in. Board members in Canada and other countries with similar fiduciary duties to the corporation are given wide latitude by the law to use their judgment. Yet some individuals are wired in a way that they find this incredibly frustrating – they have low tolerance for ambiguity, and would much prefer a simple rule that says, when X happens, do Y. To have to listen to and weigh conflicting interests, without a clear weigh scale, can be really stressful.

If you have low tolerance for ambiguity, and/or have trouble saying “no” to people all the time, then you may want to reconsider whether board service is your true calling. For board service necessarily involves subordinating your own interests, compromising among conflicting and often implicit interests of others, then having the confidence to direct and control, to govern, the corporation. Sounds a lot like being a parent, or guardian.

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