

The Ethical Imperative for Board Decision-making Processes

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Ensuring that officers and board members of private and public-sector corporations, government-agencies, and not-for-profit organizations do not further their own private interests when participating in decision-making processes is one of the fundamental challenges of any good governance system. Decisions that re-direct resources toward serving board members' private interests can: decrease corporate revenues and share value (for a private or publicly traded corporation); waste the public's money (for a public-sector corporation or government-agency), and; waste money that is difficult to raise (for a not-for-profit organization).

When officers and board members are exposed as having taken part in decisions in which they have a private interest, it can also undermine trust in private and public-sector corporations (and sometimes also share value), and trust in agencies and not-for-profit organizations.

Officers and board members of all these entities are required by law to disclose conflicts of interest and recuse themselves from participating in decisions that affect their private interest(s).¹ However, the definition of what constitutes a "private interest" and a "conflict of interest" varies.

In addition, especially for private sector corporations and not-for-profit organizations, the conflict-of-interest rules are essentially self-regulating. Even in the public sector, no enforcement agency is actively checking to ensure officers and board members are not furthering their private interests (or the interests of others in return for some type of benefit).

My doctoral research project addresses, in part, the question: What is the best-practice model system for ensuring officers and board members of private

¹ For example, see: *Canada Business Corporations Act* (R.S.C., 1985, c. C-44), section 120; *Conflict of Interest Act* (S.C. 2006, c. 9, s. 2), sections 4 and 6, and; *Canada Not-for-profit Corporations Act* (S.C. 2009, c. 23), section 141.

and public-sector corporations, agencies, and not-for-profit organizations do not take part in decisions in which they have a private interest? Answering this question involves answering the following sub-questions:

1. What is the best-practice definition of “conflict of interest” for each entity?;
2. What are best-practice disclosure and recusal rules for each entity?
3. What is a best-practice enforcement system for the disclosure and recusal rules, including the penalties for violations of the rules, for each entity, and;
4. Should the rules and enforcement system address the phenomenon of “unconscious bias” in decision-making that has been raised by psychologists.²

I have been examining domestic Canadian and international research by legal, political science and behavioural psychology scholars and practitioners to develop the model system of best-practice rules and enforcement measures. I am examining not only enforcement measures that include incentives and disincentives based on the standard theory approach (i.e. chance of being caught x penalty x ability to bear penalty = effective penalty) but also behavioural psychology approaches (i.e. training, education, nudging). I am attempting to develop a model system that will establish a culture of ethical behaviour for each entity.

In terms of rules, one of the key questions posed by various domestic and international standards is whether to prohibit taking part in decisions only when a decision-maker has a real, direct conflict of interest or whether the prohibition should also apply to apparent, potential or indirect conflicts of interest?³ Another key question is whether the prohibition should apply only to financial conflicts or also to non-financial conflicts? And another key question is whether the prohibition should apply to the interests (financial or non-financial) of family members, and if so only immediate family or also extended family? A final key question is whether the prohibition should apply to the interests (financial or non-

² Dan Ariely, *The (Honest) Truth about Dishonesty: How We Lie to Everyone – Especially Ourselves* (HarperCollinsPublishers: London [2013]).

³ Organisation for Economic Co-operation and Development (OECD), *OECD Guidelines for Managing Conflict of Interest in the Public Service*, online: (2003)

financial) of friends, and if so only close friends or also acquaintances or associates.

In terms of enforcement systems, one of the key questions I am exploring is what is an “independent” enforcement agency? Many enforcement agencies are claimed to be “independent” but actually lack key characteristics of independence in terms of the appointment process, security of tenure and/or funding. For example, the federal Conflict of Interest and Ethics Commissioner is chosen by the Cabinet even though the Ethics Commissioner enforces a law that applies to Cabinet ministers, and the Cabinet also determines the Ethics Commissioner’s annual budget.⁴

Another key issue I am examining is the discretion and accountability of enforcement agencies in areas such as:

- Are they required to investigate and rule publicly on all complaints?
- Are they required to impose some penalty for all violations?
- Are all their decisions subject to judicial review by the courts?

In terms of penalties, most domestic and international standards focus on the standard theory approach to enforcement measures.⁵ However, growing evidence from behavioural psychologists reveals that these approaches are not effective because humans are not rationally self-interested economic beings when it comes to cheating, and instead cheat to the extent that they can still maintain a good self-image.⁶ Those who cheat don’t focus on the possibility of getting caught or a potential penalty because they have rationalized that their cheating is justified.⁷

⁴ Democracy Watch has filed a challenge of the Trudeau Cabinet’s appointment of the new federal Ethics Commissioner on the basis that the Cabinet was in a conflict of interest in making the appointment. See details at: <<http://democracywatch.ca/democracy-watch-files-lawsuits-challenging-trudeau-cabinets-appointments-of-new-ethics-commissioner-and-lobbying-commissioner>>.

⁵ United Nations Office of Drugs and Crime, *United Nations Convention Against Corruption*, online: (2004) (Vienna International Center, V.04-56160) <<http://www.unodc.org/unodc/it/treaties/CAC/index.html>>.

⁶ Ariely, *supra* note 2.

⁷ Lenny Mendonca “Not everything has a price,” (2016) 14(4) *Stanford Social Innovation Review* 69.

As a result, I am gathering evidence concerning best-practice systems that include other incentives and disincentives based on behavioural psychology clinical studies, and other similar approaches, including approaches that attempt to address unconscious biases.⁸ I am unsure at this point whether attempting to address unconscious biases will lead me to recommend measures to ensure diversity in the membership of boards of private and public sector entities (such as quotas) as the only means of ensuring a diversity of viewpoints in decision-making.⁹

Overall, as you can see from the above, I am examining whether Canada's current systems require ethical, merit-based decisions to the extent that it is possible to require human beings to make ethical, merit-based decisions.

In both the private and public-sector spheres, that means decisions that are honest and evidence-based, made by decision-makers who are not tainted by conflicts of interest or other biases. In the public sector sphere, that also means decisions that take into account voter concerns based on the fundamental democratic principle of one-person, one-vote, both in terms of how decision-makers are chosen, and who can have influence over decision-makers.¹⁰ And in the private sector sphere, that also means decisions that take into account the concerns of investors and shareholders (or members or supporters of non-profit organizations).

My final challenge is to develop recommendations for changes that are practical – that don't unduly slow decision-making or make it unworkable in other ways.

⁸ Maurice E. Stucke, "In Search of Effective Ethics & Compliance Programs," online: (2014) 39 *Journal of Corporation Law* 769 University of Tennessee Legal Studies Research Paper No. 229 <<http://ssrn.com/abstract=2366209/>>.

⁹ Bjorn Lindhal, "Norway's female boardroom quotas: what has been the effect?" *Nordic Labour Journal*, May 21, 2105.

¹⁰ Robert A. Dahl, "What Political Institutions Does Large-Scale Democracy Require?" *Political Science Quarterly*, (2005) 120(2) 187. Robert A. Dahl, *On Political Equality* (Yale University Press, Princeton, NJ [2006])