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Lessons learned: Alberta Court refuses to approve plan of arrangement

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In a decision with important considerations for market practice with respect to the treatment of dissent rights, fairness opinions and corporate governance in private company sale transactions, the Court of King's Bench of Alberta blocked Pathway Health Corp.'s (TSXV:PHC) (Pathway) acquisition of HEAL Global Holdings Corp. (HEAL) and The Newly Institute Inc. (Newly). Despite the fact that the proposed plan of arrangement was approved by 100% of the votes cast by Newly's shareholders, and the Court acknowledging that failure to approve the arrangement would impede the continued existence of Newly, the Court found that the arrangement was not fair and reasonable.

This decision reinforces the following:

- The importance of providing clear and prominent disclosure of dissent rights if there are unique or extenuating circumstances that may affect the ability of dissenting shareholders to exercise their rights under the applicable corporate statute, particularly in the context of a distressed company sale.
- The value of a fairness opinion, particularly when there is a reasonable probability of disputes respecting valuation, and
- The importance of establishing a special committee, as well as the need for detailed disclosure of key judgments made in the course of reviewing and approving the transaction.

Summary

Pathway, Newly and HEAL entered into an arrangement agreement on March 31, 2023 whereby Pathway would acquire all of the common shares of Newly (the Newly Shares), other than the Newly Shares held by HEAL, and all of the common shares of HEAL pursuant to a plan of arrangement under section 193 of the *Business Corporations Act* (Alberta) (the Arrangement).

The Arrangement was approved by 100% of the votes cast by shares and options represented at the special meeting of securityholders held on May 30, 2023. Prior to the

meeting, dissent notices were received from a group of shareholders representing 10.5% of Newly Shares (the Dissenting Shareholders). Certain other non-dissenting shareholders, holding 3% of Newly Shares, opposed the arrangement at the final order hearing following the shareholder vote on several grounds, including:

1. The Newly board of directors failed to obtain an independent fairness opinion and conduct a sufficient process to evaluate and assess the Arrangement, and
2. The Arrangement, together with Newly's financial position, prevented the Dissenting Shareholders from voting against the Arrangement and receiving fair value for their shares under applicable law.

The Court primarily relied on the Supreme Court of Canada's decision in *BCE Inc. v. 1976 Debentureholders* for final order approval of a proposed plan of arrangement. In determining that the Arrangement was not "fair and reasonable", the Court ascribed particular weight to the following factors:

- Newly became insolvent during the Arrangement as a result of (i) its obligation to pay Dissenting Shareholders fair value for their shares and (ii) a convertible loan set to mature shortly after the first scheduled final order hearing.
- Newly did not receive an independent fairness opinion, despite objections raised regarding the valuation method used, as well as the deemed share price being significantly undervalued relative to several transactions completed prior to the Arrangement, and
- Newly did not form a special committee and, while its CEO properly recused himself from the resolution approving the Arrangement, Newly's two independent directors had only served on the board for eight months prior to the hearing, and no evidence was submitted as to the materials or level of review conducted prior to such approval.

Importantly, the Court acknowledged that the Arrangement was necessary to the ongoing operations of Newly. However, despite this conclusion, the Court was unwilling to approve the final order due to the prejudicial effect it would have on certain security holders.

Shortly following the decision, Pathway announced the resignation of its executive management team and board of directors, in large part due to its inability to produce sufficient revenue or raise capital to support its obligations. Newly entered into a non-binding term sheet to provide for, among other things, debt restructuring and forbearance.

Takeaways

The Court's decision has the following takeaways:

Dissent Rights. Most corporate statutes in Canada prohibit a company from paying fair value to dissenting shareholders for their shares if the company is insolvent, in which case the dissenting shareholders can elect to have their full rights as a shareholder restored. If a financially distressed company proposes to complete an arrangement, it would be prudent to provide clear and plain disclosure to shareholders of the possibility that circumstances could change during the interim period such that the company may become insolvent and be legally prohibited from paying fair value.

Disclosure should be tailored to the unique circumstances of the deal. While this may be considered an extenuating situation, it stands as an example of how strict compliance with applicable corporate statutes may not be enough to establish that a proposed arrangement is fair and reasonable. This decision also raises important questions about the structuring of a plan of arrangement to ensure that dissenting shareholders are not – or not perceived to be – prevented by a technicality from exercising their right to vote against the transaction.

Fairness Opinions. This decision reinforces the importance of obtaining a fairness opinion to, among other things, provide comfort to the court and shareholders that the board has considered the fairness and reasonableness of the proposed arrangement on the basis of objective criteria. This is particularly true in instances where the target company did not form a special committee or conduct a broad sales process prior to entering into the arrangement agreement, and where there are prior transactions that could reasonably call into question the negotiated deal price. While a fairness opinion is not an "insurance policy", courts have consistently held it to be a helpful indicator that a transaction is "fair and reasonable".

Special Committee. While not legally required in Canadian private company acquisition transactions, this decision reinforces the usefulness of establishing a special committee early in a sales process to guide boards when designing and implementing procedures in connection with material conflict of interest transactions. This is particularly important for transactions that have aspects of insider or related party transactions.

Board Independence. The Court raised concerns regarding the independent directors "short history with the Company" and the lack of "information as to the support provided to the independent directors in their consideration of the Arrangement". It is important to establish in the shareholder disclosure that independent directors had an informed basis for approving the transaction.

This decision serves as a reminder that whether an arrangement satisfies the "fair and reasonable" will be determined based on a holistic view of factors. Approval by shareholders is typically afforded significant weight, but may not be determinative if, as the Court found in this case, shareholders are not offered a "real" right to dissent and shareholders are not provided with sufficient comfort (by obtaining a fairness opinion or through the board's decision process) that the deal price reflects fair value.

We will continue to monitor how courts deal with future arrangements and whether this decision results in any changes to market practice