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Key Lessons from the *BCE* Decision

The Supreme Court of Canada (SCC) released the long-awaited reasons for its decision in the *BCE Inc. v. 1976 Debentureholders* case on December 19, 2008. The SCC reaffirmed its decision in *Peoples Department Stores Inc. (Trustee of) v. Wise* that the directors' fiduciary duty is owed to the corporation, and not any particular constituency, thereby rejecting a "Revlon" duty to maximize shareholder value in change of control transactions.

Although the SCC said that directors "may" but are not required to give consideration to the interests of a range of stakeholders, including shareholders, employees, suppliers, creditors, consumers, governments and the environment, the practical effect of the SCC's decision is that directors will need to assess a range of interests when exercising their business judgment. This is because the SCC:

- characterized the fiduciary duty of directors as a "broad, contextual concept";
- made it clear that the oppression remedy, with its focus on fair treatment, is highly relevant to understanding the nature of the fiduciary duty;
- noted that "[t]he corporation and shareholders are entitled to maximize profit and share value, to be sure, but not by treating individual stakeholders unfairly"; and
- found that "the duty of the directors to act in the best interests of the corporation comprehends a duty to treat individual stakeholders affected by corporate actions fairly and equitably".

Nevertheless, it is important to note that the SCC implicitly recognized the importance of shareholder interests in director decision-making. In the change of control context, market pressures and the reality that shareholder acceptance is critical to allowing a transaction to proceed mean that, in practice, directors will continue to make a central focus of their analysis whether a transaction offers the highest value reasonably available to shareholders, even as they consider the best interests of the corporation and the impact of the transaction on other stakeholders.

The SCC also strongly endorsed the business judgment rule, both in the language of the decision and, more importantly, in the substance of the decision, when it stated that "[p]rovided that, as here, the directors' decision is found to have been within the range of reasonable choices that they could have made in weighing conflicting interests, the court will not go on to determine whether their decision was a perfect one". The result is a board-friendly decision that provides directors with protection provided that they follow a proper process that takes into account the interests of affected stakeholders.

The decision also provides guidance on the threshold considerations for an oppression claim. The SCC found that in assessing a claim of oppression, a court must focus on

whether the evidence supports the claim that a stakeholder entitled to bring an oppression action had a reasonable expectation and, in turn, whether that reasonable expectation was violated as a result of conduct that amounted to “oppression”, “unfair prejudice” or “unfair disregard” of the relevant interest. The SCC stated that in considering such claims, courts should look at “business realities, not merely narrow legalities”. The SCC went on to note that the reasonable expectations of stakeholders, which are the “cornerstone of the oppression remedy”, are “objective and contextual” and to be assessed with reference to, among other things, general commercial practice, the nature of the corporation, the relationship between the parties, past practice, steps the claimant could have taken to protect itself, representations and agreements and the fair resolution of conflicting interests between corporate stakeholders.

Applying these principles to the case at hand, the SCC found that although the evidence supported a reasonable expectation that the directors, in making their decisions, would consider the position of the debentureholders, the evidence showed that the directors did consider their interests. Moreover, the evidence did not support a reasonable expectation on the part of the debentureholders that the directors would set as a transaction constraint that the trading value of the debentures had to be preserved. Notwithstanding the broad, contextual discussion of the board’s fiduciary duty and the oppression remedy, the SCC found no grounds to disturb the trial judge’s approval of the directors’ business judgment that the transaction was in the best interests of the corporation and did not violate the reasonable expectations of the debentureholders in all the circumstances.

The SCC’s decision will be helpful to directors in considering not only change of control situations but, more broadly, corporate actions in general. The decision reminds directors and their advisors of the importance of a deliberate and robust process and maintaining a complete and accurate record. Corporations should also be mindful of their statements and actions in instances where these might be taken to create reasonable expectations for particular stakeholders (a concept that the SCC defines expansively), lest disgruntled parties subsequently seek to bring actions alleging that they are stakeholders entitled to bring a claim and that their reasonable expectations have not been adequately considered in connection with particular corporate decisions.

The decision also deals with several technical issues relating to plans of arrangement under the CBCA. The SCC clarified the test for determining whether an arrangement is fair and reasonable. This determination involves two inquiries: first, whether the arrangement has a valid business purpose; and second, whether it resolves the objections of those whose rights are being arranged in a fair and balanced way. Importantly, the SCC stressed that the determination as to whether a plan of arrangement is substantively and objectively fair and reasonable is to be made by reference to the “legal rights” that are being arranged and, absent “extraordinary circumstances”, directors need not structure a transaction to accommodate those “whose legal rights remain intact but whose *economic interests* may be prejudiced”. The SCC decided that the reduction in the trading value of the debentureholders’ securities did not, without more, constitute an extraordinary circumstance.

A more detailed analysis follows below.

BACKGROUND

The *BCE* case concerned a challenge by a group of Bell Canada debentureholders to the proposed acquisition of BCE by a consortium headed by the Ontario Teachers' Pension Plan Board through a \$52 billion arrangement under section 192 of the CBCA.

The arrangement, which will not proceed as a condition to closing requiring a solvency opinion was not satisfied, was to have been financed in part through BCE's assumption of an additional \$38.5 billion in debt, of which \$30 billion was to have been guaranteed by Bell Canada. The debentureholders objected to the arrangement on the grounds that it would diminish the trading value of their debentures by an average of 20 percent, while conferring a premium of approximately 40 percent of the market price to holders of BCE common shares.

The Quebec Superior Court approved the arrangement as fair and reasonable under the CBCA and dismissed the debentureholders' claim for oppression. The Quebec Court of Appeal found that the arrangement had not been shown to be fair and reasonable and held that a final order approving the transaction could not be issued. On June 20, 2008, the SCC overturned the Court of Appeal's decision, with reasons to follow.

THE DEBATE CONCERNING DIRECTORS' DUTIES IN CHANGE OF CONTROL TRANSACTIONS

The Court of Appeal's decision raised considerable uncertainty as to the scope of directors' duties in a change of control transaction. This was because cases decided in Ontario, such as *Maple Leaf Foods Inc. v. Schneider Corp.* and *CW Shareholdings Inc. v. WIC Western International Communications Ltd.*, had previously found that when dealing with change of control transactions, a board of directors is bound to seek the best value reasonably available to shareholders in the circumstances. However, in these cases the courts were asked to speak to a board's duties when faced with

competing take-over bids for the corporation, but had not faced a situation where they were asked to speak to the appropriate balance between the interests of different classes of security holders in the context of a plan of arrangement.

Basing its analysis on the SCC's decision in *Peoples Department Stores Inc. (Trustee of) v. Wise*, the Court of Appeal found that as they considered competing proposals for the company, the BCE directors were required to consider the interests and reasonable expectations of the debentureholders. The Court of Appeal stressed that these interests and expectations were not to be understood as limited solely to the rights set out in the contract governing the terms of the debentures. The Court of Appeal suggested that the board had focused its attention on which offer was best for shareholders, but that in doing so it had failed to consider adequately the adverse impact that the arrangement would have on debentureholders' interests, which included the economic value of their investment. The Court of Appeal found that because BCE had not advanced evidence that it had considered the adverse impact the transaction would have on debentureholders' economic interests, BCE had not discharged its burden to establish that the arrangement was fair and reasonable.

The Court of Appeal's decision surprised many both because it did not embrace the proposition that maximizing shareholder value was the Board's principal objective in a change of control transaction and because of its conclusion that the transaction could not proceed. The decision also put particular emphasis on the proposition that Canadian law on fiduciary duties in this context was not the same as the law in Delaware. Cases such as *Revlon Inc. v. MacAndrews & Forbes Holdings Inc.* and *Unocal Corp. v. Mesa Petroleum Co.* had made it clear that when effecting a change of control transaction involving a Delaware corporation, that jurisdiction's law is that the directors have a

duty to get the best price for shareholders. Moreover, *Revlon* had stated explicitly that concern for non-shareholder interests was inappropriate when an auction among active bidders is in progress. Although Ontario case law had made clear that *Revlon* was not the law in Canada, in the sense that it is not necessary to conduct an auction in connection with a change of control transaction, many understood the lesson of the Ontario cases to be that directors are under a duty to maximize shareholder value in these circumstances.

THE SUPREME COURT OF CANADA'S VERDICT ON THE DEBATE

In its decision, the SCC affirmed its holding in *Peoples* that the directors' fiduciary duty is to act in the best interests of the corporation. The SCC opened its analysis by setting out what it views as important guiding principles. It held that "[t]he fiduciary duty of the directors is a broad, contextual concept. It is not confined to short-term profit or share value. Where the corporation is an ongoing concern, it looks to the long-term interests of the corporation. The content of this duty varies with the situation at hand".

The SCC reiterated a proposition put forward in *Peoples* to the effect that in considering what is in the best interests of the corporation, directors may look to the interest of, among others, shareholders, employees, suppliers, creditors, consumers, governments and the environment to inform their decisions. But the SCC was at pains to stress that there is no fiduciary duty owed to any one of these sets of stakeholders and that the directors' duty is instead to act in the corporation's best interests. Importantly, the SCC also reaffirmed the business judgment rule, noting that courts should give appropriate deference to the business judgment of directors who take into account these ancillary interests, so long as the directors' decision lies within a range of reasonable alternatives.

Informed by case law on the statutory oppression remedy, in the context of

discussing conflicting stakeholder interests, the SCC also stated that "the duty of the directors to act in the best interests of the corporation comprehends a duty to treat individual stakeholders affected by corporate actions fairly and equitably". This statement suggests that in some circumstances directors **must** (and not simply may) consider the impact of change of control transactions and other corporate decisions on affected stakeholders to ensure that they are treated fairly, even though the SCC noted elsewhere in its decision that it **may** be appropriate (although not mandatory) for directors to consider the impact of corporate decisions on particular groups of stakeholders. Where stakeholders' interests conflict, the SCC noted that "[t]here is no principle that one set of interests – for example the interests of shareholders – should prevail over another set of interests. Everything depends on the particular situation faced by the directors and whether, having regard to that situation, they exercised business judgment in a responsible way".

Turning to the "*Revlon* line" of cases from Delaware, the SCC specifically refused to endorse the proposition that shareholder interests should prevail over those of other stakeholders in change of control transactions, noting again that "the duty of directors cannot be confined to particular priority rules, but is rather a function of business judgment of what is in the best interests of the corporation, in the particular situation it faces".

THE OPPRESSION REMEDY

The SCC noted that the Court of Appeal had been incorrect to subsume its analysis of the plaintiffs' oppression remedy claim in its analysis of whether the arrangement was fair and reasonable. The SCC stated that the oppression remedy and arrangement provisions of the CBCA involved different questions and impose different burdens on the plaintiff and the corporation. The SCC held that in assessing a claim of oppression, a court must answer two questions: (1) Does the

evidence support the reasonable expectation asserted by the claimant? and (2) Does the evidence establish that the reasonable expectation was violated by conduct falling with the terms “oppression”, “unfair prejudice” or “unfair disregard” of a relevant interest?

The SCC stated that in considering such claims, courts should look at “business realities, not merely narrow legalities”. The SCC went on to note that the reasonable expectations of stakeholders, which are the “cornerstone of the oppression remedy”, are “objective and contextual” and to be assessed with reference to, among other things, general commercial practice, the nature of the corporation, the relationship between the parties, past practice, steps the claimant could have taken to protect itself, representations and agreements and the fair resolution of conflicting interests between corporate stakeholders.

The SCC stated that the debentureholders asserted two alternative expectations. The first was that they had a reasonable expectation that the BCE directors would protect their economic interests as debentureholders in Bell Canada by putting forward a plan of arrangement that would maintain the investment grade trading value of their debentures. The second was that the directors would consider their economic interests in maintaining the trading value of the debentures.

Affirming the trial judge’s findings, the SCC concluded that the debentureholders did not have a reasonable expectation that the investment grade rating of their debentures would be maintained. Among other reasons, the SCC noted that leveraged buyouts were not unusual or unforeseeable, and that trust indentures can include change of control and credit rating covenants, which were not negotiated for in this case. In addition, the debentureholders included some of Canada’s largest and most reputable financial institutions, pension funds and insurance companies, who could have negotiated for these protections.

The SCC found that the debentureholders did have a reasonable expectation that their

economic interests would be considered by the directors, but that this expectation had in fact been fulfilled. The directors considered the interests of the debentureholders and concluded that while the contractual terms of the debentures would be honoured, no further commitments could be made. In making this determination, the directors took into account the fact that each of the three bids for BCE was leveraged and involved a substantial increase in Bell Canada’s debt. The directors also weighed the conflicting interests of the shareholders and the debentureholders, and made a reasonable decision in the circumstances as to what was in the best interests of the corporation.

It should be noted that the SCC’s pronouncements involved the CBCA’s oppression remedy provision which provides standing to certain stakeholders that are not provided standing to bring an oppression claim under all provincial business corporations acts. For example, under the *Business Corporations Act* (British Columbia) only shareholders may bring an oppression action. Moreover, the *Companies Act* (Quebec) does not currently include an oppression remedy provision. Accordingly, it is unclear to what extent directors’ duties under business corporations statutes other than the CBCA should be understood to involve a duty to treat individual stakeholders affected by corporate actions fairly and equitably. However, until the matter is clarified through further judicial pronouncements, it would be advisable for any Canadian board of directors to turn its mind to whether stakeholders affected by corporate actions are being treated fairly. Concerns about the implications of having to factor this into the board decision-making process should, however, be mitigated by the SCC’s affirmation of the business judgment rule, together with its application of that rule in this instance.

THE ARRANGEMENT APPROVAL PROCESS

The SCC made some important observations about the differences between the oppression remedy under section 241 of the CBCA and the approval process requirements for a plan of arrangement under section 192 of the CBCA.

The SCC stated that the oppression remedy is a broad and equitable remedy that focuses on the reasonable expectations of stakeholders, while the section 192 approval process focuses on whether the arrangement, objectively viewed, is fair and reasonable and looks primarily to the interests of the parties whose legal rights are being arranged. The SCC also noted that in an oppression proceeding, the onus is on the claimant to establish oppression or unfairness, while in a section 192 proceeding, the onus is on the corporation to establish that the arrangement is fair and reasonable.

The SCC noted that the distinction between reasonable expectations and legal rights is crucial. The oppression remedy “is grounded on unfair treatment of stakeholders, rather than on legal rights in their strict sense”. In “extraordinary circumstances”, the SCC found that non-legal interests may be considered in a section 192 application. As a general matter, though, “the fact that a group whose legal rights are left intact faces a reduction in the trading value of its securities would generally not, without more, constitute such a circumstance”. This observation will serve to dampen concerns that the Court of Appeal’s decision had raised about the advisability of using a plan of arrangement in circumstances where debt holders’ legal rights were respected but their economic interests risked being affected. That said, questions will remain about the implications of effecting a transaction using an arrangement rather than a take-over bid, since it provides a forum for disgruntled stakeholders to object to the transaction.

The SCC also set out the process for seeking approval of an arrangement under section 192 of the CBCA. The SCC found that the corporation bears the onus of satisfying the court that: (1) the statutory procedures have been met; (2) the application has been put forward in good faith; and (3) the arrangement is fair and reasonable. In doing so, the SCC clarified the test for determining whether an arrangement is fair and reasonable. This determination involves two inquiries: first, whether the arrangement has

a valid business purpose; and second, whether it resolves the objections of those whose rights are being arranged in a fair and balanced way. The SCC rejected the “business judgment test” that was used by courts in previous arrangements and which asked whether an intelligent and honest business person, as a member of the voting class concerned and acting in his or her own interest would reasonably approve the arrangement. The business judgment test was rejected for two reasons. First, the fact that the business judgment test and the business judgment rule are so similarly named leads to confusion. Second, the business judgment test does not provide any more information than the outcome of a vote on the arrangement, which is only one factor to be considered by a judge in determining whether it is fair and reasonable.

A court must take into account a variety of relevant factors in determining whether an arrangement is fair and reasonable, including the necessity of the arrangement to the corporation’s continued existence, the approval, if any, of a majority of shareholders and other security holders entitled to vote, and the proportionality of the impact on affected groups. On a section 192 application, the court should refrain from substituting its views on what it considers the “best” arrangement, but must nevertheless conduct a careful review of the proposed transactions. The SCC’s decision does not, unfortunately, provide much detail on what it means when it suggests that the greater the necessity of the arrangement to the corporation’s continued existence, the more willing a court should be to approve it even though it may have a prejudicial impact on certain security holders. In this instance, the SCC simply concluded that it was clear to the trial judge that continuance of the corporation required acceptance of the arrangement, with its attendant consequences for the debentureholders.

Applying these principles to the case, the SCC concluded that the debentureholders’ economic interest in preserving the trading value of their bonds was not an interest that

the directors were required to consider in relation to the arrangement, since their legal rights were not being affected and this was not an exceptional situation where non-legal interests should be considered. Although not required, the SCC noted that it remained open to the trial judge to consider the debentureholders' economic interest in assessing whether the arrangement was fair and reasonable and affirmed the trial judge's conclusion that the arrangement addressed the debentureholders' interests in a fair and balanced way.

CONCLUSIONS

The SCC's decision not to embrace the proposition that a board of directors has a duty to focus first and foremost on shareholder interests in a change of control transaction will no doubt provoke reaction from some commentators, given the jurisprudence that had previously emerged from the Ontario courts and the influence of Delaware jurisprudence in considering how best to structure a board's decision-making process. However the SCC set out clear signposts in the *Peoples* decision and so it does not come as a surprise to see it affirming once again that boards owe their fiduciary duty to the corporation and not to any one set of stakeholders.

More novel perhaps is the SCC's proposition that, within the context of the CBCA at least, the duty of the directors to act in the best interests of the corporation comprehends a duty to treat individual stakeholders affected by corporate actions fairly and equitably. The proposition is a broad one and although it is made in the context of its CBCA oppression remedy analysis, the SCC did not speak in terms that suggest that it intended the statement to be limited in its application. It would therefore be advisable for any Canadian board of directors to turn its mind to whether stakeholders affected by corporate actions are being treated fairly.

At the same time, the SCC repeatedly affirmed in this decision the importance of the business judgment rule, suggesting that

courts should not be quick to second guess a board that has clearly considered whether and why a given transaction is in the best interests of the corporation and that has turned its mind to the impact of the transaction on all stakeholders that will be affected. Boards will therefore want to be mindful of the need to structure their decision-making processes so that they identify affected parties and assess the impact of the transaction on those parties.

The SCC's decision is a complex one that sets out important principles that will shape subsequent interpretation of the CBCA in general and its oppression and arrangement provisions in particular. The repeated references to stakeholders, the emphasis placed on the need to treat these stakeholders fairly, and the unexpected reference in the decision to the directors having a duty to act in the best interests of the corporation "viewed as a good corporate citizen" (words that do not appear in the CBCA), together with the constant focus on what is in the corporation's best interests, are all indications that the SCC rejects a purely shareholder-centric understanding of the duties of a board of directors. Instead, the SCC has spelled out a more complex vision that recognizes that boards have to balance many competing factors and interests when making decisions. The SCC is in turn clearly concerned to leave boards of directors the room needed to make difficult decisions and its affirmation of the business judgment rule represents an important counter-weight to the attention paid to stakeholders.

At the same time, it is important to note that the SCC implicitly recognized the importance of shareholder interests in director decision-making. In the change of control context, market pressures, the reality that shareholder acceptance is critical to allowing a transaction to proceed, and the fact that the oppression remedy is available to shareholders concerned that their reasonable expectations have not been adequately addressed, mean that, in practice, directors will continue to make a central focus of their analysis whether a transaction offers the highest value

reasonably available to shareholders, even as they consider the best interests of the corporation and the impact of the transaction on other stakeholders.

Lastly, it is worth reiterating that M&A practitioners will undoubtedly give renewed attention in upcoming transactions to the question when it is or is not best to make use of the arrangement procedure. The decision reminds practitioners that an arrangement may in certain instances inject incremental risk into a transaction – particularly in circumstances in which there are conflicting interests between corporate stakeholders or stakeholders and the corporation. It will continue to be important early on in the process to weigh the pros and cons of proceeding via a plan of arrangement as opposed to an alternate route, such as a take-over bid.

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