

# Update

## Corporate Securities Law

January 2009

### The Supreme Court Releases Reasons in the BCE Litigation Some Comfort, but Unclear Guidance for Canadian Boards

#### The Background

In late-December 2008, the Supreme Court of Canada (the “**Court**” or the “**SCC**”) released the written reasons for its decision earlier in the year to approve the plan of arrangement by which the proposed acquisition of BCE Inc. (“**BCE**”) was to proceed. For reasons unrelated to the issues that the Court had considered at the hearing of this matter in June, 2008 the proposed acquisition had been terminated just prior to the release of the SCC’s reasons.

The reasons set out a flexible blueprint that may help to guide directors in their decision-making process in the context of change of control transactions. Although the Court’s decision does not provide boards of directors and their advisors with a clear roadmap to this decision-making or as to the discharge of their fiduciary obligations, its strong affirmation of the “business judgment rule” – the principle that courts should generally defer to, and not second-guess, the reasonable business judgment of boards of directors – should provide comfort for directors.

#### The Litigation

The crux of the litigation was the opposition by debentureholders of Bell Canada (a wholly-owned subsidiary of BCE) to the proposed acquisition

of BCE by a group of purchasers including Teachers’ Private Capital (the private investment arm of the Ontario Teachers Pension Plan), affiliates of Providence Equity Partners Inc. and Madison Dearborn Partners LLC and Merrill Lynch Global Private Equity. The acquisition, which was to be completed pursuant to a plan of arrangement, had been opposed by the debentureholders because the debt to be incurred to finance the acquisition would reduce the rating and trading value of their bonds.

The debentureholders’ core complaint was that their interests had not been fairly and properly considered. Their challenge was made on two bases. The debentureholders claimed that:

- the proposed acquisition was “oppressive” entitling them to relief under the “oppression remedy” pursuant to the Canada Business Corporations Act (the “CBCA”), and
- the plan of arrangement should not have been approved by the trial judge as “fair and reasonable”, which is a requirement for the implementation of a plan.

In June, the SCC decided that the proposed acquisition was not oppressive of the debentureholders’ interests and that the proposed plan of arrangement was fair and reasonable.

#### The Issues

The Court’s reasons focus on four issues:

- the elements of claims for oppression under the CBCA (which would apply in substance to claims for oppression under the OBCA and other business statutes in Canada as well),
- the scope of directors’ fiduciary duties,
- the statutory framework for approving plans of arrangement, and what makes an arrangement “fair and reasonable”, and
- the “business judgment rule.”

## The Oppression Remedy

The “oppression remedy” is a broadly cast statutory remedy under certain Canadian corporate statutes that provides courts with a wide range of remedial powers where a claimant’s interests have been oppressed, unfairly prejudiced or unfairly disregarded. The Court set out a two-pronged analysis to establish oppression, involving an assessment of:

- the “reasonable expectations” of the claimant, and
- “oppression”, “unfair prejudice” or “unfair disregard” of such reasonable expectations,

both elements of which must be established by the claimant.

### *Reasonable Expectations*

Because an assessment of a claimant’s reasonable expectations is necessarily fact-specific, the SCC did not articulate a rigid rule for defining, or exhaustive list of, reasonable expectations. However, the Court enumerated several factors that may be relevant in determining whether a stakeholder’s expectations are reasonable: 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 by and between the parties and, significantly in the context of the proposed acquisition of BCE, the fair resolution of conflicting interests between corporate stakeholders. Although the debentureholders did not allege that the BCE board had breached its fiduciary duties, the SCC focused on those fiduciary duties in detail (as outlined below) in the context of the oppression remedy on the basis that stakeholders should reasonably expect directors to discharge their fiduciary duties.

### *Oppression, Unfair Prejudice or Unfair Disregard*

The second prong of the oppression analysis involves consideration of whether, in failing to meet a reasonable expectation, a party’s conduct amounts to “oppression”, “unfair prejudice” or “unfair disregard”. Merely because an expectation is found to be reasonable does not necessarily mean that, if unmet, the expectation will establish a valid oppression claim.

### *The Debentureholders’ Claim*

Within this framework, the SCC determined that the debentureholders had a reasonable expectation that the directors would consider their position in making their decisions. However, the Court stated that the debentureholders did not have a reasonable expectation in the circumstances that the board would take steps to ensure that the rating or market value of the debentures would be maintained, and concluded that the debentureholders’ interests had been considered, the contractual terms of the debentures would be met, and that the claim for oppression should fail.

## Fiduciary Duties

Under applicable corporate law the directors have a duty to act in the best interests of the corporation. How this duty is interpreted and applied generally, and particularly in the context of a change of control transaction, has been the subject of much analysis and commentary.

There is a well-known line of American cases that stands for the proposition that, in the context of a change of control transaction, boards of directors have an obligation to maximize *shareholder* interests (known as the “Revlon duty”). By contrast, the SCC stated that the directors’ fiduciary duty is to act in the best interests of the *corporation*, not primarily in the interests of any one group of stakeholders. In considering what is in the best interests of the corporation, directors may have to consider the interests of a broad array of stakeholders to inform their decisions, including – but not necessarily limited to – shareholders, creditors, employees, consumers, governments and the environment. This is amplified by the Court’s statement that the directors are required to act in the best interests of the corporation *viewed as a good corporate citizen*, implying consideration of the interests of stakeholders beyond just investors.

This concept does not provide a clear roadmap as to how to deal with conflicting stakeholder interests. However, as noted below, the Court’s endorsement of the “business judgment rule” provides comfort that a determination by the

board, based on an independent, considered and fair analysis of the interests of the corporation and its various stakeholders, generally will not be disturbed by the courts.

## The Elements of Approving a Plan of Arrangement

The Court's decision also addressed the requirement that a plan arrangement must be "fair and reasonable." The Court stated that to be "fair and reasonable" an arrangement must:

- have a valid business purpose, and
- resolve in a fair and balanced way the objections of those whose legal rights are being arranged.

The onus is on the corporation to show the arrangement is fair and reasonable (in contrast to the oppression remedy in which the onus is on the party alleging oppression).

### *Fair and Balanced Resolution*

An analysis of whether an arrangement is a fair and balanced resolution of conflicting interests is a fact-specific exercise. The Court provided a list of factors that might be considered, including:

- whether a majority of securityholders voted for the arrangement,
- if no vote has occurred, whether an intelligent and honest business person, as a member of the class concerned and acting in his or her own interest, might reasonably approve the plan,
- the proportionality of the compromise between various securityholders, the securityholders' positions before and after the arrangement and the impact on various securityholders' legal rights, and
- the reputation of the directors and advisors who endorse the arrangement, the presence of a fairness opinion and the access of shareholders to dissent and appraisal remedies.

Of particular significance in the context of BCE, the Court found that the debentureholders' interests – beyond their legal rights – did not need to be considered by the directors of BCE or the Court in determining whether the arrangement was fair and reasonable. The SCC stated that, in

the context of an arrangement, such interests would be considered only in "extraordinary circumstances" (though it did not elaborate on the meaning, or provide any examples of, such circumstances).

## The "Business Judgment Rule"

In the context of its discussion of each the oppression remedy, fiduciary duties and the plan of arrangement, the Court emphasized that directors are not to be held to a standard of perfection. Boards can therefore take comfort in the Court's clear statements that, so long as the directors' decisions are within the range of reasonable choices and having addressed their minds to the relevant considerations, courts should not second-guess or substitute their views.

## The Future

The SCC's decision provides general guidance on certain basic legal principles that are relevant to a range of corporate initiatives and circumstances. However, it leaves unanswered questions as to how conflicting stakeholder interests are to be balanced. Though the endorsement of the "business judgment rule" provides comfort to directors, it remains to be seen how directors will reconcile conflicting interests and define the best interests of the corporation and how courts will respond.

Please contact any member of Goodmans corporate securities team should you wish to discuss this decision further:

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