



Supreme Court of Canada Releases Reasons for its BCE Decision

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On December 19, 2008, the Supreme Court of Canada (SCC) released reasons for its decision in the matter of *BCE Inc. v. 1976 Debentureholders*. In its decision, the SCC reaffirmed its determination in *Peoples Department Stores Inc. (Trustee of) v. Wise* that the director's fiduciary duty is owed to the corporation, and not to stakeholders or any particular group of stakeholders, even in change of control situations.

Background

In *BCE*, certain Bell Canada debentureholders opposed a proposed acquisition of all of the issued and outstanding shares of BCE by a consortium of purchasers including the Ontario Teachers Pension Plan by way of a \$52 billion plan of arrangement under the *Canadian Business Corporations Act* (CBCA). The acquisition was to be financed, in part, through the assumption of \$38.5 billion in debt, the vast majority of which was to be guaranteed by Bell Canada, a BCE subsidiary. The guarantee of such debt was to result in the loss of investment grade status of Bell Canada's outstanding debentures and would materially diminish the trading price of such debentures. The debentureholders challenged the plan of arrangement on the grounds that it was oppressive and failed to meet the "fair and reasonable" test required for court approval required of a CBCA plan of arrangement.

The Quebec Superior Court approved the plan of arrangement as fair and dismissed the debentureholders claim for oppression. The Quebec Court of Appeal overturned the Superior Court's decision, concluding that the arrangement was not fair and reasonable and held that that it should not have been approved. The Court of Appeal held that the directors had not only the duty to ensure that the debentureholders' contractual rights would be respected, but also to consider whether the adverse impact on debentureholders' economic interests could be alleviated. Since the Court of Appeal found that the CBCA requirement that an arrangement be fair and reasonable had not been met, the court found it unnecessary to consider the debentureholders' oppression claim.

In a unanimous decision, the SCC overturned the Court of Appeal's decision.

Supreme Court Decision

Oppression Remedy

The SCC held that the oppression remedy focuses on harm to the legal and equitable interests of a wide range of stakeholders affected by oppressive acts of a corporation or its directors and that the remedy gives a court a broad jurisdiction to enforce not just what is legal but what is fair. The SCC further indicated that oppression is also fact specific, and that what is just and equitable is to be judged by the reasonable expectations of the stakeholders in the context and in regard to the relationships at play.

In assessing a claim of oppression, the SCC determined that 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 within the terms "oppression", "unfair prejudice" or "unfair disregard" of a relevant interest? For the first question, the SCC provided certain factors to be considered in determining whether a reasonable expectation exists, including: 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 conflicts between corporate stakeholders. For the second question, the SCC indicated that a claimant must show that the failure to meet the reasonable expectation involved unfair conduct and prejudicial consequences.

Where conflicting interests arise, the SCC determined that it falls to the directors of the corporation to resolve them in accordance with their fiduciary duty to act in the best interests of the corporation and that this duty comprehends a duty to treat individual stakeholders affected by corporate actions equitably and fairly. The SCC determined that there are no absolute rules and no principle that one set of interests should prevail over another and that in each case, the question is whether, in all the circumstances, the directors acted in the best interests of the corporation, having regard to all relevant considerations, including - but not confined to - the need to treat affected stakeholders in a fair

manner, commensurate with the corporation's duties as a responsible corporate citizen.

In BCE, the SCC held that the debentureholders did not establish that they had a reasonable expectation that the directors of BCE would protect their economic interests by putting forth a plan of arrangement that would maintain the investment grade trading value of their debentures. The trial judge concluded that this expectation was not made out on the evidence, given the overall context of the relationship, the nature of the corporation, its situation as the target of a bidding war, the fact that the claimants could have protected themselves against reductions in market value by negotiating appropriate contractual terms, and that any statements by Bell Canada suggesting a commitment to retain investment grade ratings for the debentures were accompanied by warnings precluding such expectations. The SCC further acknowledged that under the business judgment rule, deference should be accorded to the business decisions of directors acting in good faith in performing the functions they were elected to perform. While the SCC found that the evidence, objectively viewed, supported a reasonable expectation that the BCE directors would consider the position of the debentureholders in making their decisions on the various offers under consideration, it was apparent to the SCC that the directors had considered the interests of debentureholders, and concluded that while the contractual terms of the debentures would be honoured, no further commitments could be made. The SCC found that this fulfilled the duty of the directors to consider the debentureholders' interests and did not amount to "unfair disregard" of the interests of debentureholders.

Plan of Arrangement

With respect to the approval of a statutory plan of arrangement, the SCC held that the approval process is to focus on whether the arrangement, viewed objectively, is fair and reasonable and that to approve a plan of arrangement as fair and reasonable, courts must be satisfied that (a) the arrangement has a valid business purpose, and (b) the objections of those whose legal rights are being arranged are being resolved in a fair and balanced way. Whether these requirements are met is to be determined by taking into account a variety of relevant factors, 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.

In BCE, the SCC found a material distinction to exist between the focus on legal rights under arrangement

approval and reasonable expectations under the oppression remedy, and that where "the oppression remedy is grounded in unfair treatment of stakeholders, the arrangement procedure focuses on legal rights in their strict sense". While the SCC did indicate, however, that this general rule does not preclude the possibility that in "extraordinary circumstances" interests that are not strictly legal should be considered, the SCC concluded that "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". Since only the debentureholders' economic interests were affected by the proposed transaction, not their legal rights, and since the debentureholders did not fall within an exceptional situation where non-legal interests should be considered, the debentureholders did not constitute an affected class such that "the trial judge was correct in concluding that the debentureholders should not be permitted to veto almost 98 percent of the shareholders who approved the plan of arrangement simply because the trading value of their securities would be affected".

Directors' Duties in Change of Control Transactions

With the BCE decision, the SCC expressly affirmed its determination in *Peoples* that the directors' fiduciary duty is to act in the best interests of the corporation, stating that "[t]he fiduciary duty of the directors to the corporation 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". In considering what is in the best interests of the corporation, the SCC stated that directors may look to the interests of shareholders, employees, creditors, consumers, governments and the environment to inform their decisions. It should be noted that the SCC reaffirmed the application of the business judgment rule in such instances, indicating 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.

The SCC then indicated that while directors, acting in the best interests of the corporation, may be obliged to consider the impact of their decisions on various stakeholders, the SCC explicitly stated that in cases (such as BCE) where the interests of the various stakeholders do not coincide, "it is important to be clear that the directors owe their duty to the corporation, not to stakeholders, and that the reasonable expectation of stakeholders is simply that

the directors act in the best interests of the corporation”.

In looking at the series of Delaware corporate takeover cases referred to as the *Revlon* line of cases which indicate that shareholder interests should prevail over those of other stakeholders in change of control transactions, the SCC noted that “the *Revlon* line of cases has not displaced the fundamental rule that the duty of the 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”.

Conclusion

The BCE decision evidences the SCC’s determination not to adhere to the proposition that shareholder interests should prevail over those of other stakeholders in change of control transactions and should provide some guidance in structuring the process by which directors are to reach their decisions regarding change of control transactions. Clearly, the SCC has indicated that directors owe their fiduciary duty to the corporation and not to any one set of stakeholders. Directors are to look to the long-term best interests of the corporation and may consider a broad set of stakeholders, including shareholders, employees, creditors, consumers, government and the environment, commensurate with the corporation’s duties as a good corporate citizen.

The BCE decision forcefully reaffirms the business judgment rule, suggesting that courts should be giving sufficient deference to the determination of a board of directors that is properly informed and follows a fair and diligent process that considers whether and why a proposed transaction is in the best interests of the corporation and the impact of the proposed transaction on all stakeholders.

This update is intended as a summary only and should not be regarded or relied upon as advice to any specific client or regarding any specific situation.

If you would like further information regarding the issues discussed in this update or if you wish to discuss any aspect of this commentary, please feel free to contact us.

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