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Fair To Whom?

The Quebec Court Of Appeal's Decision In The Matter Of The Proposed Arrangement Concerning BCE Inc.

On May 21, 2008, the Quebec Court of Appeal ruled in favour of a group of debentureholders of Bell Canada Inc. ("**Bell Canada**"), a wholly-owned subsidiary of BCE Inc. ("**BCE**"), who had challenged the proposed acquisition of BCE through a plan of arrangement by a consortium led by Ontario Teachers' Pension Plan Board.[1] In a unanimous five judge decision overturning an earlier decision of the Quebec Superior Court, the court found that the proposed plan of arrangement was not "fair and reasonable" to all securityholders. In particular, the court found that the arrangement would provide substantial benefits to BCE shareholders while significantly adversely affecting the debentureholders. On June 2, 2008, the Supreme Court of Canada granted BCE leave to appeal the decision. The appeal is scheduled to be heard on June 17, 2008.

If the Supreme Court of Canada affirms the Quebec Court of Appeal's decision, the largest leveraged buy-out transaction in Canadian history will have to be restructured or will be at an end. The decision also has a number of implications for boards and their advisors.

In that regard, the court determined that the process undertaken by the strategic oversight committee of BCE, which was premised solely on maximizing value for shareholders (often referred to as the "Revlon" duty) while respecting the contractual obligations of the corporation and its subsidiaries, was "fatally vitiated".

The court ruled that at all times the directors owe their fiduciary obligation to the corporation; at no time do the directors have an overriding duty to act only in the best interest of the shareholders. As a result, the court expressly repudiated the principles enunciated in the US case *Revlon v. MAC Andrew & Orbes Holdings Inc.*[2] The court stated that, "In Canada, the directors of a corporation have a more extensive duty. This more extensive duty embodied in the statutory duty of care encompasses, depending on the circumstances of the case, giving consideration to the interests of all stakeholders, which, in this case includes the debentureholders".

The following bulletin examines some of the key findings of the court's decision and possible implications of the decision going forward.

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[1] Fasken Martineau DuMoulin LLP acts as co-counsel to the debentureholders.

[2] 506 A. 2d 173 (Del. Sup. Ct. 1986).

Background

The proposed acquisition of BCE emerged out of a much-publicized auction process conducted during the spring and early summer of 2007. The auction resulted in the proposed purchase of BCE by a consortium of investors in a transaction valued at approximately $51.7 billion. The transaction was structured as a leveraged buyout as a result of which Bell Canada would guarantee approximately $30 billion to be borrowed by the purchasing consortium to fund the acquisition of the BCE shares. As a result of the Bell Canada guarantee, it was argued by the debentureholders, who hold debentures totalling over $5 billion in principal amount of indebtedness, that if the arrangement were to be consummated then the risk of default under the debentures would be substantially increased and the debentures would lose their investment-grade status.

Certain of the debentureholders had the benefit of covenants in their respective indentures that would have effectively required debentureholder approval if the arrangement had constituted a "reorganization". The court dismissed the arguments of those debentureholders that such covenant provided them with approval rights in connection with the arrangement. Instead, the court ruled that the arrangement was not fair and reasonable, given the substantial favouring of shareholders' interests over those of the debentureholders and the failure of the board to even consider how the economic interests of the debentureholders might be attenuated. Given the court's finding concerning the fairness and reasonableness of the arrangement, the court did not address the debentureholders' arguments based on the oppression remedy.

Legal Principles Cited by the Court

In arriving at its conclusion, the court cited the following legal principles:

- The fact that the acquisition was structured as a court-approved plan of arrangement requires the court to assess whether the arrangement is fair and reasonable.

- Applying the principles enunciated by the Supreme Court of Canada in the 2004 decision of *Peoples Department Stores In. (Trustee of) v. Wise*[3], the court found that "at no time do the directors have an overriding duty to act only in the best interests of the shareholders and to ignore the adverse effect on the interests of the debentureholders".

- Any securityholder whose legal rights, reasonable expectations or economic interests are affected by an arrangement under the *Canada Business Corporations Act* has standing to contest it, even if such securityholder was not granted voting rights in respect of the arrangement and even if the arrangement would not alter the legal rights of the securityholder.

- The reasonable expectations of the debentureholders are not limited to the legal rights spelled out in the contractual terms of the indentures; however, those expectations, to remain reasonable, cannot run contrary to the express terms of the relevant contracts. In assessing the reasonableness of expectations, the court will have regard to public statements made by a corporation.

[3] [2004] 3 S.C.R. 461.

Court's Findings Regarding BCE's Decision-Making Process

As applied to the decision-making process undertaken by the BCE board and its strategic oversight committee, the court made the following key findings:

- Besides considering the contractual rights flowing from the trust indentures, the BCE board should have considered the interests (including reasonable expectations and economic interests) of the debentureholders. While the debentures themselves did not include any covenant that their investment grade status would be maintained, the reasonable expectations of the debentureholders were informed in part by various public statements (or "representations") made to the investment community by BCE and Bell Canada over the years. In these various statements, BCE and Bell Canada demonstrated a commitment to maintaining investment grade ratings for the debentures. The court also noted that these statements enhanced Bell Canada's ability to sell long term debt on the market. Even BCE's own expert witness on the bond market "confirmed that such assurances … are factors that debentureholders rely on in making their investment decisions".

- The successful bidder originally proposed a tax-driven amalgamation that would have required approval of the debentureholders due to certain covenants in the debenture indentures. At BCE's insistence, the arrangement transaction was restructured during the negotiation process such that approval by the debentureholders under the indentures would not be required. In that regard, the court found that the arrangement, as structured, did not provide the debentureholders with any formal approval rights.

- Despite various approaches by the debentureholders to meet with BCE during the auction process, these approaches were refused and no meetings were ever held. The court cited the trial judge's finding that the BCE board had concluded that its overriding duty was to maximize shareholder value, while respecting only the strict contractual obligations of BCE and its subsidiaries and without regard to the reasonable expectations and economic interests of the debentureholders.

- BCE's strategic oversight committee did not take into consideration the adverse financial impact of the potential transaction on the debentureholders and no detailed analysis was made by the committee of the costs and benefits of the transaction insofar as it affected the securityholders other than the shareholders.

- Having regard to the finding of the trial judge that the arrangement adversely affected the interests of a class of securityholders (debentureholders), it was incumbent on the BCE board to consider the interests of the debentureholders with a view to examining whether it was possible to attenuate all or some of the adverse effects.

- The court found that BCE failed to discharge the onus on it to demonstrate that the arrangement, as structured, was fair and reasonable.

The court concluded that the BCE board acted in good faith; however, the flawed process undertaken by the board led the court to conclude that the board's decision was no longer entitled to the deference otherwise due by virtue of the business judgment rule.

The Decision-Making Process Endorsed by the Court of Appeal

The court noted that when a board undertakes an analysis of the treatment of the various securityholders, the interests of those securityholders are not necessarily of the same weight. It is up to the board to consider the relative weight and importance of the various interests and in its best business judgement to structure an arrangement that takes into account, and to the extent reasonably possible satisfies, the interests of the various securityholders.

The court stated that, "As between obtaining the highest price for the shareholders and the elimination of all adverse effects on the debentureholders it might be possible, through accommodation or compromise, to reach a solution that is fair and reasonable; one that is in the best interests of the corporation and that gives proper consideration to the interests of the shareholders and the debentureholders, taking into account all the circumstances, including the relative weight of their interests".

Potential Implications of the Court of Appeal's Decision

The Quebec Court of Appeal's decision has a number of potential implications for boards and their advisors.

- It is unclear whether the court's findings apply only to court-approved arrangements, in which a court must decide that the transaction is fair and reasonable.

- Given the broad range of stakeholders, it is not difficult to envision challenges to plans of arrangements in the future by affected groups other than securityholders. A board should be mindful whether choosing a plan of arrangement over a take-over bid would provide a platform for disaffected stakeholders in which the corporation would bear the onus of proving fairness; whereas the class of persons who may bring oppression claims may be more limited and the complainant would bear the burden of proof and the significantly greater expense of initiating and conducting an oppression proceeding.

- While the oppression remedy requires a board to have at all times fair regard to the interest of securityholders, the oppression standard is not as demanding as the fairness standard for plans of arrangement. The higher fairness standard applies to an arrangement because an arrangement requires court discretion to sanction and enable what otherwise could not be accomplished practicably under the corporate statute.

- As one part of its assessment of the interests of various stakeholders in a plan of arrangement, boards may ask their financial advisors to expand the scope of their fairness opinions to address fairness, from a financial point of view, to some or all affected securityholders, in addition to shareholders. In that regard, BCE's position might conceivably have been strengthened had the board obtained a fairness opinion from its financial advisors as to the fairness of the arrangement, from a financial point of view, to the debentureholders. The board's advisers also might be asked how the transaction could be practicably restructured to attenuate adverse effects to securityholder and other stakeholder interests. Similar considerations also may apply where a board needs to assess competing bids, as is the case during an auction process.

- The decision makes clear that public statements by senior officers may legitimately be used to buttress claims by securityholders as to their reasonable expectations. Public companies

should evaluate prior public statements to determine whether any such statements should be updated, corrected or changed, particularly if a transaction that may affect the interests of securityholders is contemplated. Public companies also should take into consideration what expectations may be established by virtue of any future public statements.

For more information about this bulletin, or any other matter, please do not hesitate to contact us.

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