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# Directors' Duties After *BCE*: Supreme Court of Canada Decides

By James C. Tory and John Cameron

The Supreme Court of Canada released its reasons for decision in the *BCE* case in December 2008. The reasons have been awaited by Canadian M&A practitioners with a mix of eagerness and anxiety. Eagerness, because the case offered a perfect vehicle for the Court to provide much-needed guidance on the difficult question of directors' duties in the context of change-of-control transactions. Anxiety, because the Court's most recent foray into the realm of directors' duties – its decision in the *Peoples* case – raised as many questions as it answered.

Although the Court's decision to allow the BCE transaction to proceed (which was announced in June 2008, shortly after the case was argued) was the expected result, the recently released reasons reject the duty to maximize shareholder value in the context of change-of-control transactions (the so-called Revlon duty derived from Delaware jurisprudence) in favour of a nebulous duty to treat all affected stakeholders fairly, commensurate with "the corporation's duties as a responsible citizen." By requiring the directors to consider the interests of all stakeholders, the effect of the Court's decision may be that the directors become legally accountable to no one – immunizing directors' substantive decisions from legal attack provided that they get their process right and can make a plausible business case on the basis of their view of the best interests of the corporation. As a result of the *BCE* decision, stakeholders seeking to challenge a directors' decision in the courts will need to focus on the process whereby the decision was made, rather than on the substance of the decision.

## Background

In June 2007, BCE announced that it had entered into an agreement with an investor group led by Teachers' Private Capital, Providence Equity Partners Inc. and Madison Dearborn Partners Inc. The agreement was reached following a process led by a special committee of BCE's board that defined its objective as maximizing shareholder value while respecting bondholders' contractual rights.

Under the agreement between BCE and the investor group, the investors proposed to acquire all the outstanding shares of BCE at a price of C$42.75 per common share, a 40% premium for BCE's common shareholders. The parties agreed that the acquisition – the largest leveraged buyout in Canadian history – would proceed as a plan of arrangement under the *Canada Business Corporations Act*.

The agreement contemplated the addition of a substantial amount of new debt for which Bell Canada, BCE's wholly owned subsidiary, would be liable as guarantor. In anticipation of this transaction, the market value of Bell Canada's bonds fell about 20%, or C$1 billion. The Bell Canada bondholders opposed the transaction, asserting,

To discuss these issues, please contact the authors.

For media calls, please contact Stuart Wood, Director, Marketing & Business Development, 416.865.8205.

To contact us, please email info@torys.com.

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among other things, that the proposed plan of arrangement should not be approved by the Court at the fairness hearing that was part of the arrangement process because the plan was not fair and reasonable in light of its adverse effect on their interests. The trial court dismissed all of the bondholders' claims and approved the plan. The Court of Appeal reversed this decision, holding that BCE had failed to establish that the plan was fair and reasonable. The Supreme Court of Canada, in turn, reversed the Court of Appeal decision and allowed the transaction to proceed. In fact, the transaction did not proceed for other reasons.

## The Issue

The fundamental issue in the case was the scope of the BCE directors' duties in the context of this LBO transaction in which the shareholders' interest – obtaining the highest price possible for their shares – conflicted with the bondholders' interest – maintaining the credit rating and value of their bonds. Was it sufficient for directors, in discharging their duties, to maximize value for shareholders while respecting the contractual rights of the bondholders, as BCE submitted? Or were the directors required to consider the broader economic interests of the bondholders and to give those interests some weight, as the bondholders submitted?

## Key Elements of the Decision

The Supreme Court of Canada, in its reasons, gives an overview of directors' duties, considers the interests that are protected under the oppression remedy, and discusses the test for approval of a plan of arrangement.[1] The Court's discussion of arrangements is of obvious importance for transactions like the BCE transaction that are done by way of plan of arrangement; however, the Court's analysis of directors' duties and of oppression is the most significant aspect of the reasons since the analysis applies to corporate decision-making generally and is not limited to a particular form of transaction.

On directors' duties and the oppression remedy, the Court has reaffirmed the "stakeholder" model of directors' duties that the Court had endorsed in *Peoples* and that was relied on by the bondholders in this case. According to this approach, acting with a view to "the best interests of the corporation" requires directors to consider the interests of all stakeholders and not to equate the interests of the corporation with the interests of shareholders alone. The Court has thereby conclusively rejected the "shareholder primacy" model derived from Delaware jurisprudence, according to which the directors' duty in a change-of-control situation is to maximize shareholder value. However, while largely accepting the bondholders' view of the directors' duties, the Court ruled against the bondholders because they did not have a reasonable expectation to anything more than the contractual rights enshrined in the trust indenture under which their bonds were issued.

In the Court's words:

- 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 equitably and fairly. There are no absolute rules and no principle that one set of interests should prevail over another. In each case, the question is

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[1] The Court confirms that a plan of arrangement can be used to alter the legal rights of securityholders if the arrangement is fair and reasonable – i.e., the arrangement must have a valid business purpose and the objections of those whose legal rights are being arranged must be resolved in a fair and balanced way. In the Court's words, "Whether these requirements are met is 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."

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."

- "The corporation and shareholders are entitled to maximize profit and share value, to be sure, but not by treating individual stakeholders unfairly. Fair treatment – the central theme running through the oppression jurisprudence – is most fundamentally what stakeholders are entitled to 'reasonably expect'."
- In this case, "it is apparent that the directors considered the interests of debentureholders, and concluded that while the contractual terms of the debentures would be honoured, no further commitments could be made. This fulfilled the duty of the directors to consider the debentureholders' interests and did not amount to 'unfair disregard' of the interests of debentureholders."
- "Provided 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 the perfect one."

## Implications

This decision explicitly rejects the view that the directors of a target company have an overriding duty to maximize shareholder value in a change-of-control transaction. However, having rejected that view of the duty of directors, the Court endorses the conduct of the BCE board, which defined its objective in precisely those terms subject only to satisfying contractual obligations to bondholders.

Although the Court has thereby sent an arguably mixed message, the decision makes one thing clear: the decisions of directors are to be given a high degree of deference. As long as directors get their process right, respect legal rights and have regard to the interests of all stakeholders affected by their decision, their balancing of conflicting stakeholder interests in determining the best interests of the corporation will be treated as a matter of business judgment not to be overturned by the courts unless it falls outside the range of reasonableness.

This highly deferential approach to director decision making reflects an insensitivity to the "omnipresent spectre of conflict" of which Delaware courts have been acutely aware in their analysis of directors' duties in a change-of-control context – the spectre of conflict arising from the fact that the directors' jobs as directors are normally on the line in that context. Consequently, in a change-of-control context, Delaware courts (i) impose a clear duty on directors to maximize shareholder value, for which directors can more easily be held accountable than a duty that allows directors to define the corporation's interests; and (ii) apply an "intermediate standard of review" under which director decisions receive less deference than under the normal business judgment rule.

Relying on the *BCE* decision, a target company board could attempt to justify a much more robust defence to a hostile bid than has hitherto been thought consistent with the directors' fiduciary duty. For example, a target company board could defend the continued deployment of a poison pill in the face of a highly leveraged offer that envisaged the bust-up of the target on the basis that the success of the offer, while value-maximizing for shareholders, was nonetheless contrary to the best interests of the corporation (which would cease to exist if the offer succeeded) and of non-shareholder constituencies (e.g., employees who could lose their jobs) who were entitled to "fair treatment" "commensurate with the corporation's duties as a responsible corporate citizen." It remains to be seen whether securities regulators, who have given primacy to the protection of target company shareholder interests in the regulation of takeover bids, will tolerate the sacrificing, by a target company board, of shareholder value in the name of fairness to other stakeholders.

Another open question is how the *BCE* decision will affect the treatment of preferred shareholders in LBOs. The *Carling O'Keefe* decision of Ontario's Divisional Court has stood in the way of leveraged transactions that had the effect of reducing the value of outstanding preferred shares. That decision was premised on (i) the directors' duty to act in the best interests of the corporation translating into a duty to act in the best interests of shareholders as a whole; and (ii) the holders of preferred shares being treated as shareholders for this purpose (despite the investment character of preferred shares often being more akin to debt securities than common share equity). In light of the *BCE* decision, the first premise of *Carling O'Keefe* is no longer valid – the interests of the corporation cannot be equated with the interests of shareholders as they were in *Carling O'Keefe*. If preferred shareholders are just one stakeholder group among many, with their interests subject to balancing along with the interests of others, there seems no reason in principle why, in considering a leveraged transaction, preferred shareholder interests should be entitled to any more consideration than the Bell Canada bondholder interests in this case. The fact that the transaction would reduce the value of preferred shares and debt securities should not be a conclusive objection to a transaction, in either case so long as share conditions and contractual rights are respected and the corporation keeps any promises it made to investors in related offering documents or otherwise.

Finally, while the Court requires directors to consider the interests of all stakeholders and to treat them fairly, it is clear that those requirements do not preclude directors from proposing a plan of arrangement which affects the legal rights of security holders.

## Advice for Directors

The *BCE* decision confirms the importance of the process whereby directors make their decisions. Key elements of that process include the following:

- Directors' decisions must continue to be made by non-conflicted directors.
- Directors must continue to obtain appropriate financial, legal and other advice.
- Directors must continue to ensure that they carefully consider all alternatives reasonably available to the corporation in the circumstances.
- Directors must be able to demonstrate that they have considered the reasonable expectations of all stakeholders and have not merely sought to maximize shareholder value without regard to other stakeholders' reasonable expectations.
- Despite the rejection of the Revlon duty, directors must tread very carefully in a change-of-control context if they decide to sacrifice shareholder value to satisfy creditor or other stakeholder expectations that have not been reflected in binding contracts or other promises made by the corporation.