

**THE BCE LITIGATION:
PRINCIPLES OF CORPORATE LAW REAFFIRMED**

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ABA BUSINESS LAW FALL MEETING

**Washington, D.C.
November 21-22, 2008**

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THE BCE LITIGATION: PRINCIPLES OF CORPORATE LAW REAFFIRMED

by Kent E. Thomson, Maryse Bertrand and Jordan Vaeth¹

1. INTRODUCTION

The proposed \$51.7 billion privatization of BCE Inc. ("BCE") by a consortium of private equity buyers is the largest change of control transaction in Canadian history and the largest leveraged buyout transaction ("LBO") in the world. Perhaps not surprisingly, this transaction gave rise to extensive, high stakes "real time" litigation that proceeded at a lightning pace between October 2007 and June 2008, including a lengthy trial before the Superior Court of Québec and appeals before the Québec Court of Appeal (the "QCA") and the Supreme Court of Canada (the "SCC").

A group of institutional debentureholders of Bell Canada, BCE's wholly owned subsidiary, sought to block the completion of this transaction. They claimed that the transaction would reduce the credit ratings of their debentures from investment grade to junk bond status, and diminish the current market value of their bonds by well over \$1 billion.

This is unquestionably one of the most high profile and closely watched transactions in Canadian history, and gave rise to extensive media coverage and legal commentary from one coast of Canada to the other.

As explained more fully hereafter, the trial judge in the Québec Superior Court found in favour of BCE and rejected the claims asserted by the debentureholders. A unanimous five judge panel of the QCA reversed the decision of the trial judge, however, and held that the transaction could not proceed. Less than one month later a unanimous seven judge panel of the SCC reversed the decision of the QCA, restored the decision of the trial judge, and enabled BCE and the private equity buyers to take steps to complete the transaction.

While detailed reasons for the decision of the SCC are not yet available, the decision appears to support the established view in Canada that, in the context of a change of control transaction, directors of a public company discharge their duties by taking reasonable steps to maximize shareholder value, while respecting the contractual and legal obligations of the company and its subsidiaries.

This paper discusses the decisions at each level of court and the legal concepts that were relevant to the proceedings, namely the statutory oppression remedy, the plan of arrangement provisions of the *Canada Business Corporations Act* (the "CBCA") and the duties of directors of Canadian public companies. The paper closes with practice tips for directors faced with the prospect of supervising and completing change of control transactions.

¹ The authors and their colleagues at Davies Ward Phillips & Vineberg LLP acted as corporate and litigation counsel to BCE and Bell Canada in respect of the transaction and litigation described herein. The views expressed in this paper are those of the authors and not of BCE. This paper was prepared for presentation at the 2008 Fall Meeting of the Business Law Section of the American Bar Association in Washington DC.

2. THE FACTS

(a) Earlier Efforts to Enhance Shareholder Value

BCE's Board undertook a number of initiatives to strengthen and refocus BCE in the years preceding the transaction as both BCE's Board and shareholders were disappointed in the performance of the Company's share price. BCE, the largest communications company in Canada with landline, cellular and internet services, was facing increasing competition from cable and other phone companies.

In the fall of 2006, BCE's Board reviewed various strategies to enhance shareholder value, including a substantial share repurchase, converting to an income trust, and the possibility of a privatization or LBO transaction. On October 11, 2006, BCE announced its intention to convert into an income trust. That plan was quashed just a few weeks later, however, when the Government of Canada announced substantial changes to the rules surrounding the taxation of income trusts. Shares of BCE, already considered undervalued, dropped in response.

(b) Private Equity Interest

With the income trust option eliminated, BCE hit the radar screens of a number of leading private equity firms as a possible LBO candidate. Though larger than any previous LBO target, BCE fit the classic profile for an LBO transaction, having a solid business franchise and steady cash flows that could be used to service the additional debt that an LBO would entail. In the buoyant credit markets prevailing at that time, LBO transactions were growing dramatically in size, with private equity firms having raised multi-billion dollar funds that needed to be invested and with banks willing to underwrite increasingly large debt commitments.

While rumours had circulated publicly (including reports in the *Globe and Mail*, a national Canadian newspaper) as far back as 2000 that BCE could be the target of an LBO, in November 2006 BCE began receiving overtures from private equity firms such as Kohlberg Kravis Roberts & Co. ("KKR") and the \$106 billion Ontario Teachers' Pension Plan ("Teachers") concerning a possible privatization of BCE. Importantly, Teachers' was BCE's largest shareholder, holding more than 5% of its outstanding shares, and for several years had been considering ways to maximize the value of its sizeable investment in BCE.

BCE resisted repeatedly all of these overtures, preferring to focus instead on the execution of its business plan that included the then pending sale of its Telesat subsidiary, which would bring BCE \$3 billion in cash in December 2007.

Although BCE repeatedly told the private equity suitors that it was not interested in pursuing an LBO transaction, the interest of KKR in privatizing BCE was leaked to the press and on March 29, 2007, a front-page story in the *Globe and Mail* announced that KKR was stalking BCE. Thereafter, articles appeared in the mainstream and business press throughout Canada on virtually a daily basis concerning the likelihood that BCE would become the target of an LBO transaction. Moreover, on April 9, 2007, Teachers' filed a Schedule 13D report with the U.S. Securities and Exchange Commission informing the market that it had changed its investment intent with respect to BCE from "passive" to "active." In so doing, Teachers' put BCE in play and made it clear that it was seriously considering a change of control transaction involving

BCE. Thereafter, the Board of BCE decided that it should take active steps to carefully manage any change of control transaction that might emerge.

(c) The Strategic Review and Auction Process

The need to take proactive steps to carefully manage the ensuing auction process was particularly acute in BCE's case (as opposed to a typical change of control transaction) due to foreign ownership restrictions in Canada that require BCE to be majority Canadian owned and controlled. Because of BCE's size, there was a real risk that a single bidder would be able to lock up a large enough proportion of the Canadian capital available for investment in a privatization transaction involving BCE that it would not be possible for a competing bidding consortium to emerge, thus severely limiting BCE's ability to generate an auction and maximize the value of the Company's shares in a sale transaction. For these reasons, one of the first objectives of the Board of BCE was to assemble a bidding consortium that could compete with Teachers'. To this end, BCE signed non-disclosure and standstill agreements with KKR and several large Canadian pension funds that permitted them to conduct due diligence. These agreements, among other things, prohibited consortium members from partnering with any other party (such as Teachers' and other sources of Canadian equity) without BCE's consent.

In addition to exploring a possible LBO and supervising a competitive auction process, BCE's Board initiated an exhaustive strategic review process that examined alternatives for enhancing shareholder value, including share buybacks, divestitures, and strategic combinations (such as with Telus, a national telecommunications company also providing wireless, landline and internet services). To supervise the strategic review and auction process, the Board established a Strategic Oversight Committee (the "SOC"), which was composed of four of the Company's independent Directors.

With the announcement of BCE's strategic review and auction process and the market's perception that an LBO was a likely outcome, the market prices for Bell Canada's debentures dropped swiftly on concerns that the addition to BCE's capital structure of substantial debt associated with the completion of an LBO would have a material negative impact on the credit ratings of Bell Canada. Shortly following the announcement, several institutional debentureholders of Bell Canada began writing letters to BCE and members of the SOC expressing their concerns about a possible LBO and the effect that such a transaction would have on their investments in Bell Canada's debentures.

The strategic review and auction process proceeded, in its later stages, in the context of rapidly deteriorating credit markets that could easily have foreclosed the opportunity to proceed with a sale of BCE if the process had not been completed by late June 2007. Three offers were submitted at the end of the process: by Cerberus Capital Management L.P.; by a consortium including KKR and the Canadian Pension Plan Investment Board; and by the Teachers' consortium that was composed of Teachers' Private Capital, Providence Equity Partners LLC and Madison Dearborn Partners, LLC. All were sophisticated private equity groups. Although Telus had participated earlier in the auction process, it ultimately bowed out shortly before bids were due, and no "strategic" industry participant submitted an offer. Significantly, all three offers contemplated borrowing billions of dollars to buy the shares of BCE. None of these offers contemplated redeeming Bell Canada's debentures at issue in the ensuing proceedings.

Moreover, all of these offers would have reduced the credit ratings of the debentures to below investment grade and resulted in a substantial decline in the current market value of those debentures.

On June 29, 2007, the Board concluded that the private equity option was the best option available to the Company to maximize shareholder value. It accepted the offer from the Teachers' consortium and entered into a Definitive Agreement providing for the acquisition of all of BCE's common shares for \$42.75 per share, and all of BCE's preferred shares at a series of stipulated prices (the "Transaction"). The purchase price represented a premium to the common shareholders of BCE of more than 40 percent, or approximately \$10 billion, relative to the undisturbed price of BCE's common shares in the period before BCE was put in play by Teachers'.

(d) The Litigation

In August 2007, BCE commenced a proceeding in the Québec Superior Court under section 192 of the CBCA to implement the Transaction by way of a court supervised plan of arrangement. In essence, the proposed plan required all shareholders of BCE to tender their shares at the prices proposed by the Teachers' consortium. The typical plan of arrangement structure requires both a shareholder vote and a court order confirming that the arrangement is "fair and reasonable" to the parties whose rights are being arranged (in this case, the shareholders of BCE). The plan of arrangement structure was utilized for the purpose of ensuring that all BCE shareholders (including those opposed to the Transaction) would be required to exchange their shares for the consideration offered by the purchaser in a single-step transaction. The plan of arrangement provisions of the CBCA are explained more fully below.

The Transaction was approved by over 97% of the votes cast by the shareholders of BCE. Indeed, out of more than 615,000 shareholders and 800 million shares outstanding, BCE received only one valid notice of dissent, from a single shareholder holding 4,588 common shares.

Even though the proposed plan of arrangement did not alter or arrange their legal rights, twelve institutional holders of Bell Canada debentures filed contestations to oppose it. In October 2007, they also commenced oppression proceedings against BCE and Bell Canada alleging that their rights and interests as creditors of Bell Canada had been unfairly prejudiced or disregarded. They sought Orders preventing the completion of the Transaction. Finally, at the instigation of these debentureholders, the trustees under two of Bell Canada's trust indentures commenced proceedings seeking a declaration that clause 8.01 of those trust indentures conferred upon the trustees the right to veto the proposed plan of arrangement.

(e) The Québec Superior Court

All of these proceedings were heard together in a lengthy "real time" trial that proceeded on a highly expedited basis before Justice Joël Silcoff in Montréal. Prior to trial, the parties conducted several weeks of out-of-court cross-examinations of numerous deponents who had sworn affidavits in respect of the plan of arrangement and oppression proceedings. The trial itself commenced on December 3, 2007 and was completed on January 31, 2008. It involved thousands of pages of exhibits and affidavits, the examination of more than 30 witnesses,

including 11 experts, in excess of six thousand pages of compendia (containing summaries of the thousands of pages of exhibits and extracts of affidavits and transcripts) and in excess of one thousand pages of written arguments supported by more than 25 volumes of authorities.

In judgments released on March 7, 2008, the trial judge approved the plan of arrangement, dismissed the oppression proceedings, and held that the plan of arrangement did not require the approval of the trustees under Bell Canada's trust indentures. All proceedings were determined in BCE's favour.²

The trial judge found that the plan of arrangement is "substantively fair and reasonable to the contesting debentureholders"³ and, further, that "the best interests of both BCE and Bell Canada, as well as those of its shareholders, are and will be served by the implementation of the Plan of Arrangement and the Definitive Agreement".⁴

The trial judge also found as a fact that the debentureholders of Bell Canada were well aware or should have been aware that BCE could be the subject of an LBO, and that if this were to occur the credit ratings and current market value of the debentures of Bell Canada would be affected adversely. They were also well aware of the risks associated with purchasing debentures pursuant to trust indentures, such as those of Bell Canada, that did not contain change of control or ratings protection covenants, and willingly assumed those risks, made unfounded assumptions that these risks would not materialize or were complacent with respect to them. The trial judge found that, in the circumstances, the debentureholders of Bell Canada had no reasonable expectation that the Board of BCE would "reject a transaction that maximized shareholder value on the basis of any negative impact on them".⁵

(f) The Québec Court of Appeal

The debentureholders appealed the trial judgments to the QCA 10 days later, on March 17, 2008. The QCA heard the appeal on an expedited basis during the week of April 28 and rendered its decision on May 21, 2008.

The QCA did not disturb the trial judge's finding that the plan of arrangement is in the best interests of both BCE and Bell Canada. Nor did the QCA overturn the trial judge's findings that the transaction is not oppressive to the debentureholders of Bell Canada and does not breach the terms of Bell Canada's trust indentures. However, the QCA overturned the trial judge's finding that the plan of arrangement is fair and reasonable. In doing so, the QCA focused on whether the proposed plan of arrangement was "fair and reasonable" to the debentureholders of Bell Canada rather than to the shareholders of BCE. The QCA imposed upon the Board of BCE a duty to go beyond respecting the contractual rights and reasonable expectations of the debentureholders of Bell Canada, namely to attempt to alleviate or attenuate any economic harm they might suffer as

² *BCE Inc. (Arrangement relatif à)*, [2008] Q.J. No. 1788 at paras. 7 and 171 (S.C.) [*Arrangement Judgment*].

³ *Arrangement Judgment, supra* at para. 161.

⁴ *Aegon Capital Management Inc. c. BCE Inc.*, [2008] Q.J. No. 1790 at para. 203 (S.C.) [*Oppression Judgment*].

⁵ *Oppression Judgment, supra* at para. 199.

a result of the Transaction. The test applied by the QCA for the approval of plans of arrangement differed from the test other courts in Canada had previously recognized, and in so doing treated the debentureholders of Bell Canada, whose rights are not being arranged or altered by BCE's plan of arrangement, on an equal footing with shareholders and holders of other equity-based rights of BCE whose rights are being arranged by the proposed plan of arrangement.

Prior to the QCA judgment, well-established practice and law in Canada provided guidance as to how directors of public companies should proceed when faced with change of control transactions. The SCC, however, had yet to decide a plan of arrangement case, and had never determined the duties of directors of public companies when faced with a change of control transaction. The decision of the QCA conflicted with decisions of other Canadian courts, including the Ontario Court of Appeal, and introduced a high degree of uncertainty into transactions of this nature, particularly in circumstances where the interests of shareholders do not coincide with those of other stakeholders, including creditors. Moreover, the decision of the QCA offered little or no direction to directors and other market participants as to how to resolve such competing interests.

(g) The Supreme Court of Canada

On May 22, 2008, one day after the QCA released its decision, BCE brought a motion before the SCC for an order expediting its imminent application for leave to appeal from the decision of the QCA, as well as expediting the appeal itself in the event that leave was granted. Recognizing the urgency of the case, on May 26, 2008 the SCC granted the requested order and established a highly expedited schedule. One indication of the degree of attention that the Court gave to the matter is that the expediting order was signed by seven justices of Canada's highest court.

Leave to appeal was granted on June 2, 2008, and the appeal was argued before a panel of seven justices of the SCC on June 17, 2008.

BCE argued at the SCC that in the context of a change of control transaction, directors of public companies discharge their fiduciary duties and act in their company's best interests by taking reasonable steps to maximize shareholder value while respecting the contractual rights and other legal obligations of the company and its affiliates. BCE submitted that the discretion of a board to consider the interests of diverse stakeholders, including creditors, should not be converted into a mandatory obligation to seek to protect those interests, as imposed by the QCA. Furthermore, BCE argued that the Board did, in fact, consider both the rights and interests of the debentureholders of Bell Canada, and explicitly considered their reasonable expectations. The Board considered the terms of Bell Canada's trust indentures as well as the content and context of the prior "public company" statements of BCE and Bell Canada (including the numerous warnings that accompanied those statements) and concluded that no reasonable debentureholder of Bell Canada could or should have expected to receive benefits that went beyond those that were provided for in the trust indentures at issue. In the circumstances, the Board of BCE exercised reasonably and properly its informed business judgment in concluding that it would have been inappropriate and unfair to confer upon the debentureholders of Bell Canada benefits that went beyond both their contractual rights and reasonable expectations, at the direct expense of the shareholders of BCE.

BCE also addressed before the SCC the question of whether, in determining if a proposed plan of arrangement is fair and reasonable, courts are required to consider the economic interests of parties whose legal rights are not altered or arranged by the proposed plan. BCE submitted that the proper approach for the court to take, and the approach that other Canadian courts have consistently taken, is to consider the fairness of the plan of arrangement from the perspective of those parties whose legal rights are being altered or arranged by the plan of arrangement in question. BCE also argued that even if this were not the case, the plan of arrangement effecting this particular transaction is fair and reasonable to the debentureholders of Bell Canada.

On June 20, 2008, three days after the appeal was argued, the SCC unanimously set aside the decision of the QCA and affirmed the trial judge's approval of the plan of arrangement. The Court reserved its reasons, which will be released at a later date, yet to be announced. The SCC's reasons will be of fundamental importance to Canadian public companies and their directors, as well as to shareholders, creditors and other corporate stakeholders.

3. THE LAW

(a) The Oppression Remedy

The oppression remedy is provided for in the CBCA, as well as in the corporate statutes of most Canadian provinces, and provides a court with broad based discretionary remedial powers if it determines that corporate conduct has been oppressive, unfairly prejudicial to, or has unfairly disregarded the rights or interests of a complainant.

Sections 241(2) of the CBCA sets out the grounds upon which the oppression remedy will be granted:

Grounds

(2) If, on an application under subsection (1), the court is satisfied that in respect of a corporation or any of its affiliates

(a) any act or omission of the corporation or any of its affiliates effects a result,

(b) the business or affairs of the corporation or any of its affiliates are or have been carried on or conducted in a manner, or

(c) the powers of the directors of the corporation or any of its affiliates are or have been exercised in a manner

that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of any security holder, creditor, director or officer, the court may make an order to rectify the matters complained of.

Over the years, Canadian courts have held that whether or not a particular course of conduct is deemed "fair" or "unfair" is dependent upon the reasonable expectations of a complainant. The oppression remedy protects only those expectations of a complainant that are legitimate and objectively reasonable. For these reasons, the oppression remedy cannot be invoked to permit a complainant to impose its "wish list" or unilateral expectations on the corporation.

The broad powers available to a court to remedy oppressive conduct are set out in section 241(3) of the CBCA:

Powers of court

(3) In connection with an application under this section, the court may make any interim or final order it thinks fit including, without limiting the generality of the foregoing,

- (a) an order restraining the conduct complained of;
- (b) an order appointing a receiver or receiver-manager;
- (c) an order to regulate a corporation's affairs by amending the articles or by-laws or creating or amending a unanimous shareholder agreement;
- (d) an order directing an issue or exchange of securities;
- (e) an order appointing directors in place of or in addition to all or any of the directors then in office;
- (f) an order directing a corporation, subject to subsection (6), or any other person, to purchase securities of a security holder;
- (g) an order directing a corporation, subject to subsection (6), or any other person, to pay a security holder any part of the monies that the security holder paid for securities;
- (h) an order varying or setting aside a transaction or contract to which a corporation is a party and compensating the corporation or any other party to the transaction or contract;
- (i) an order requiring a corporation, within a time specified by the court, to produce to the court or an interested person financial statements in the form required by section 155 or an accounting in such other form as the court may determine;
- (j) an order compensating an aggrieved person;
- (k) an order directing rectification of the registers or other records of a corporation under section 243;
- (l) an order liquidating and dissolving the corporation;
- (m) an order directing an investigation under Part XIX to be made; and
- (n) an order requiring the trial of any issue.

(i) "Unfair" Prejudice or Disregard

A complainant is only entitled to an oppression remedy if its rights or interests have been "unfairly" prejudiced or disregarded.⁶ Prejudice alone will not entitle a complainant to a remedy. There is an inherent tension between the rights or interests of shareholders and those of creditors. Put as simply as possible, corporate decisions often prejudice the interests of certain stakeholders

⁶ *Brant Investments Ltd. v. Keeprite Inc.* (1991), 3 O.R.(3d) 289 at 306 (C.A.) [*Brant*].

but such prejudice will not normally be unfair.⁷ The Ontario Court of Appeal recognized in the seminal case of *Brant Investments v. KeepRite Inc.* that it may be in the best interests of the corporation that directors: "act other than in the best interests of one of the groups protected by the oppression provisions in the C.B.C.A."⁸

"Unfairly disregard" means to ignore, pay no attention to or treat the interests of a complaining securityholder as being of no importance.⁹ In *Brant*, the Ontario Court of Appeal stated: "[o]f course, there may be many situations where the rights of minority shareholders have been prejudiced or their interests disregarded, without any remedy being appropriate. The difficult question is whether or not their rights have been prejudiced or their interests disregarded 'unfairly'."¹⁰

(ii) Bad Faith

Although bad faith is not a necessary element of an oppression action, the Ontario Court of Appeal in *Brant* in considering the comparable provision of the *Ontario Business Corporations Act* stated that as a practical matter, "there will be few cases where there has not been some 'want of probity' on the part of the corporate actor where a remedy pursuant to s. 234 will be appropriate".¹¹

(iii) Reasonable Expectations

As stated above, the concept of "reasonable expectations" lies at the heart of the oppression remedy. Not all expectations of corporate stakeholders are reasonable, and the reasonableness of the expectations in question must be determined on an objective basis.¹² Conversely, the subjective beliefs or intentions or understandings of a complainant cannot be used as a foundation for a viable oppression claim unless the objective test of reasonableness is satisfied.¹³

Relevant to the BCE litigation was the difference between debentureholders and shareholders of public companies and how their reasonable expectations start from different premises. Shareholders typically have no form of contract with the public companies they invest in. This is particularly so when their equity investments are made in the secondary markets, rather than pursuant to a prospectus or offering memorandum of the public company. Debentureholders, by contrast, typically purchase debentures that have been issued pursuant to detailed, carefully prepared trust indentures that delineate with precision the rights and obligations of the issuers of

⁷ Markus Koehnen, *Oppression and Related Remedies* (Toronto: Thomson Carswell, 2004) at 82 [Koehnen].

⁸ *Brant*, *supra* at 301.

⁹ *Piller Sausages & Delicatessens Ltd. v. Cobb International Corp. et al.* (2003), 35 B.L.R. (3d) 193 (Ont. S.C.J.), *aff'd* (2003), 40 B.L.R. (3d) 88 (Ont. C.A.).

¹⁰ *Brant*, *supra* at 306.

¹¹ (1991), 3 O.R. (3d) 289 at 311.

¹² *Maple Leaf Foods Inc. v. Schneider Corp.* (1998), 42 O.R. (3d) 177 at 201 (C.A.).

¹³ *820099 Ontario Inc. v. Harold E. Ballard Ltd.* (1991), 3 B.L.R. 113 at para. 129 (Ont. Gen. Div.), *aff'd* (1991) 3 B.L.R. (2d) 113 (Ont. Div. Ct.). See also *Gazit (1997) Inc. v. Centrefund Realty Corp.*, 8 B.L.R. (3d) 81 at para. 85 (S.C.J.).

the debentures as well as the parties that purchase those debentures. This can be particularly important if, as in Bell Canada's case, the trust indentures pertain to debentures with maturities of up to 60 years. Covenants in trust indentures can have an ongoing impact on the day-to-day operations of the issuers throughout the period in which the debentures remain outstanding.

While the debentureholders argued that certain representations of Bell Canada regarding its investment grade credit rating were specifically designed to give comfort to and be relied on by investors, BCE argued that the reasonable expectations of debentureholders are limited to the payment of interest and principal when due in accordance with the trust indentures and compliance with other covenants in the trust indentures. This was particularly so in this case where the representations in question were subject to numerous express written warnings, including Safe Harbour Notices, to the effect that these representations might cease to apply if circumstances changed in the period after the representations were made. The changed circumstances specified in the warnings included, among other things, transactions that BCE or Bell Canada might become embroiled in. Unlike equity holders who, in exchange for taking on greater risk than debtholders, expect to earn a profit and to have a degree of control over the management of the company through voting rights, debtholders have no reasonable expectation of exerting control over the activities of the company in a manner that extends beyond, or conflicts with, rights provided for in the trust indentures or other agreements of the issuers in question.

In this regard, the expectations of debentureholders in Canada are essentially the same as the expectations of bondholders in the United States:

certain fundamental characteristics of long-term debt financing which distinguish it from equity financing should be considered. In general, funds needed for financing private corporate enterprises are obtained in exchange for interests of two essentially different kinds: (1) those of the "equity" owners or shareholders, whose securities represent certain rights of ownership, control and profit accompanied by a relatively greater risk of loss, and (2) those of the "lenders", **who classically forego control and profit in return for periodic payments (interest and often sinking fund) without regard to profits and for repayment of principal at a fixed date, ahead of the equity owners.**

The most obvious and important characteristic of long-term debt financing is that the holder ordinarily has not bargained for and does not expect any substantial gain in the value of the security to compensate for the risk of loss. This is not true of a debt security which is convertible into an equity security, and it is not entirely true of a debt security purchased for much less than its principal amount. With these exceptions, however, the significant fact, which accounts in part for the detailed protective provisions of the typical long-term debt financing instrument, is that the lender (the purchaser of the debt security) can expect only interest at the prescribed rate plus the eventual return of the principal. Except for

possible increases in the market value of the debt security because of changes in interest rates, the debt security will seldom be worth more than the lender paid for it, provided he bought it at approximately its face amount. It may, of course, become worth much less. Accordingly, the typical investor in a long-term debt security is primarily interested in every reasonable assurance that the principal and interest will be paid when due.¹⁴ (emphasis added)

In *Fox v. MGM Grand Hotels, Inc.*, MGM's bondholders had filed a complaint relating to a loss of market value of their MGM bonds following a spin-off by MGM of its film business to its shareholders that had the effect of reducing MGM's assets by approximately 50%. In addressing the bondholders' complaints about the loss in value of their bonds, the court stated:

[A] corporate creditor, like any other unsecured creditor, runs the risk that his debt may not be paid because of a decline in the general business climate, because of poor management by the debtor, or disaster to the debtor from fire¹ or theft. **He does have a right not to have the debtor deliberately act for the purpose of impairing the creditor's legitimate business expectations. But those expectations are only that the debt, with interest, will be paid when due. He has no enforceable right to have the market value of his debt unimpaired, so long as he is paid interest and principal when due.**¹⁵(at p. 527) (emphasis added)

(iv) The Effect of a Trust Indenture on Reasonable Expectations

Throughout the litigation referred to above, BCE's position was that the comprehensive and highly detailed trust indentures of Bell Canada constituted the code that the parties had agreed and understood would govern their relationship. As a result, the trust indentures formed the primary and most important source of the reasonable expectations of the debentureholders, determined on an objective basis. Moreover, although it was theoretically possible for the debentureholders of Bell Canada to have reasonable expectations that went beyond those that found expression in the trust indentures, they could not have reasonable expectations that conflicted with the express terms of these trust indentures, and there was no proper evidentiary basis to ground reasonable expectations that did, in fact, go beyond those provided for in the indentures of Bell Canada. BCE emphasized repeatedly that where a contractual relationship exists between the complaining security holder and the company, the security holder's reasonable expectations are much narrower than those of a shareholder who has not had an opportunity to negotiate protections for him or her self.¹⁶

¹⁴ American Bar Foundation, *Commentaries on Model Debenture Indenture Provisions* in 1971 at pp. 1-2).

¹⁵ (1982) 137 Cal. App. 3d 524; 187 Cal. Rptr. 141; 1982 Cal. App. LEXIS 2115, (Court of Appeal of California, Second Appellate District, Division Four).

¹⁶ *Alberta (Treasury Branches) v. SevenWay Capital Corp.*, 50 B.L.R. (2d) 294 (Alta. Q.B.) aff'd 8 B.L.R. (3d) 1 (Alta. C.A.); *Goldhar v. J.M. Publications Inc.*, 13 B.L.R. (3d) 181 (Ont. S.C.J.); *Working Ventures*

In *Casurina Ltd. Partnership Ltd. v. Rio Algom Ltd.*,¹⁷ the Ontario Court of Appeal made it clear that the oppression remedy is not broad enough to afford a sophisticated institutional debentureholder with additional rights beyond those provided for in the trust indenture under which the debentures were issued. *Casurina* held convertible debentures issued by Rio Algom under a Trust Indenture. Rio Algom was the target in a successful takeover. Immediately following the completion of the takeover, Rio Algom's shares were de-listed. This was done for the purpose, and with the intended effect, of negating the conversion rights associated with the convertible debentures and constituted an event of default under the Trust Indenture which entitled Rio Algom to redeem the convertible debentures at par. *Casurina* argued that because of the oppressive conduct of Rio Algom and its directors in triggering the event of default, it was not limited to its contractual remedy under the Trust Indenture based on the default, but rather was entitled to be compensated for the loss of the conversion privilege. The Court of Appeal upheld the trial decision and concluded that the reasonable expectations of the debentureholders of Rio Algom did not extend beyond the rights contained in that Company's Trust Indenture.¹⁸

Similarly, courts in the United States have repeatedly and consistently held that bondholders do not have rights beyond those contained in the trust indenture under which the bonds in question were issued.¹⁹ In the seminal case of *Metropolitan Life Ins. v. RJR Nabisco*, bondholders alleged that the leveraged buyout of RJR Nabisco violated a duty of good faith and fair dealing because the transaction reduced the credit ratings of RJR Nabisco debt to below investment grade. In finding that the bondholders were not entitled to a remedy, the Court held that it would not "permit an implied covenant to shoehorn into an indenture terms plaintiffs now wish had been included."²⁰

In *RJR Nabisco* the bondholders raised many of the same arguments that the debentureholders made in the BCE litigation, including that RJR Nabisco "consistently reassured its bondholders" that it would "maintain RJR Nabisco's preferred credit rating". In its reasons, the Court cited various assertions made in the bondholders' Amended Complaint which included:

that the LBO 'undermines the foundation of the investment grade debt market...,' that, although 'the indentures do not purport to limit dividends or debt ... such covenants were believed unnecessary with blue chip companies...,' that 'the transaction contradicts the premise of the investment grade market...,' and finally, that 'this buy-out was not contemplated at the time the debt

Canadian Fund Inc. v. Angoss Software Corp. [2000] O.J. No. 4537 (S.C.J. [Commercial List]); *Levy-Russel Ltd. v. Shieldings Inc.* [1998] O.J. No. 3932 (Gen. Div.); *Katz v. Oak Indus. Inc.*, 508 A.2d 873, 879 (Del. Ch. 1986).

¹⁷ (2004), 40 B.L.R. (3d) 112 (Ont. C.A.).

¹⁸ *Casurina Partnership Ltd. v. Rio Algom Ltd.* (2004, 40 B.L.R. (3d) 112 at para. 33 (C.A.), application for leave to the S.C.C. dismissed, [2004] S.C.C.A. No. 105.

¹⁹ *Metropolitan Life Ins. v. RJR Nabisco, Inc.*, 716 F. Supp. 1504 (S.D.N.Y. 1989) [*RJR Nabisco*]; *Hartford Fire Ins. Co. v. Federated Dep't Stores, Inc.*, 723 F. Supp. 976 (S.D.N.Y. 1989); *Katz v. Oak Indus. Inc.*, 508 A.2d.

²⁰ *RJR Nabisco*, *supra* at 1519.

was issued, contradicts the premise of the investment grade ratings that RJR Nabisco actively solicited and received, and is inconsistent with the understandings of the market...which plaintiffs relied upon.²¹ (citations removed)

In rejecting the bondholders' claims the Court stated:

At the heart of the present motions lies plaintiffs' claim that RJR Nabisco violated a restrictive covenant – not an explicit covenant found within the four corners of the relevant bond indentures, but rather an *implied* covenant of good faith and fair dealing – not to incur the debt necessary to facilitate the LBO and thereby betray what plaintiffs claim was the fundamental basis of their bargain with the company. The company, plaintiffs assert, consistently reassured its bondholders that it had a "mandate" from its Board of Directors to maintain RJR Nabisco's preferred credit rating. Plaintiffs ask this Court first to imply a covenant of good faith and fair dealing that would prevent the recent transaction, then to hold that this covenant has been breached, and finally [*1508] to require RJR Nabisco to redeem their bonds.

...RJR Nabisco defends the LBO by pointing to express provisions in the bond indentures that, *inter alia*, permit mergers and the assumption of additional debt. These provisions, as well as others that could have been included but were not, were known to the market and to plaintiffs, sophisticated investors who freely bought the bonds and were equally free to sell them at any time. Any attempt by this Court to create contractual terms *post hoc*, defendants contend, not only finds no basis in the controlling law and undisputed facts of this case, but also would constitute an impermissible invasion into the free and open operation of the marketplace.

For the reasons set forth below, this Court agrees with defendants. **There being no express covenant between the parties that would restrict the incurrence of new debt, and no perceived direction to that end from covenants that are express, this Court will not imply a covenant to prevent the recent LBO and thereby create an indenture term that, while bargained for in other contexts, was not bargained for here and was not even within the mutual contemplation of the parties.**²² (emphasis added, footnotes excluded)

²¹ *RJR Nabisco, supra* at 1519.

²² *RJR Nabisco, supra* at 1507-08.

The Court quoted at length from documents produced by the bondholders in the course of the litigation. These documents were quite similar to documents produced in the BCE litigation and highlighted the risks to bondholders of leveraged buy-outs and the steps bondholders could take to protect themselves. These included negotiating (and paying for) protective covenants in trust indentures.

In light of the knowledge that could be imputed to the bondholders based on these documents, the Court concluded that the expectations of bondholders, determined on an objective basis, were fundamentally inconsistent with their claim that they had a reasonable expectation that RJR Nabisco would maintain an investment grade rating on its bonds.²³

The Court emphasized the importance to its decision of the market's expectations, the evolution of those expectations, and the Court's reluctance to interfere with a freely struck bargain between sophisticated market participants:

The sort of unbounded and one-sided elasticity urged by plaintiffs would interfere with and destabilize the market. And this Court, like the parties to these contracts, cannot ignore or disavow the marketplace in which the contract is performed. Nor can it ignore the expectations of that market – expectations, for instance, that the terms of an indenture will be upheld, and that a court will not, *sua sponte*, add new substantive terms to that indenture as it sees fit. The Court has no reason to believe that the market, in evaluating bonds such as those at issue here, did not discount for the possibility that any company, even on the size of RJR Nabisco, might engage in an LBO heavily financed by debt. That the bonds did not lose any of their value until the October 20, 1988 announcement of a possible RJR Nabisco LBO only suggest that the market had theretofore evaluated the risks of such a transaction as slight.

...The Court recognizes that the market is not a static entity, but instead involves what plaintiffs call 'evolving understanding[s]', ... Just as the growing prevalence of LBO's has helped change certain ground rules and expectations in the field of mergers and acquisitions, so too it has obviously affected the bond market, a fact no one disputes. ... To support their argument that defendants have violated an implied covenant, plaintiffs contend that, since the October 20, 1988 announcement, the bond market has 'stopped functioning'. ... **They argue that if they had 'sold and abandoned the market [before October 20, 1988], the market, if everyone had the same attitude, would have disappeared.'** ... **What plaintiffs term 'stopped functioning' or 'disappeared', however, are properly seen as natural responses and**

²³ *RJR Nabisco, supra* at 1514.

adjustments to market realities. Plaintiffs of course do not contend that no new issues are being sold, or that existing issues are no longer being traded or have become worthless.

To respond to changed market forces, new **indenture provisions can be negotiated, such as provisions that were in fact once included in the 8.9 percent and 10.25 percent debentures implicated by this action. New provisions could include special debt restrictions or change-of-control covenants. There is no guarantee, of course, that companies like RJR Nabisco would accept such new covenants; parties retain the freedom to enter into contracts as they choose.** But presumably, multi-billion dollar investors like plaintiffs have some say in the terms of the investments they make and continue to hold. And, presumably, companies like RJR Nabisco need the infusions of capital such investors are capable of providing.²⁴ (emphasis added, citations excluded)

The reasoning in *RJR Nabisco*²⁵ has been applied consistently in other U.S. decisions involving claims by bondholders arising from the completion of change of control transactions. In *Revlon*²⁶ for example, the Court emphasized the important duty directors owe to maximize shareholder value when faced with an imminent change of control transaction. The Court found that the board of Revlon had breached its duties to shareholders by taking steps to protect the value of certain Notes and stated:

This brings us to the lock-up with Forstmann and its emphasis on shoring up the sagging market value of the Notes in the face of threatened litigation by their holders. Such a focus was inconsistent with the changed concept of the directors' responsibilities at this stage of the developments. The impending waiver of the Notes covenants had caused the value of the Notes to fall, and the board was aware of the noteholders' ire as well as their subsequent threats of suit. The directors thus made support of the Notes an integral part of the company's dealing with Forstmann, even though their primary responsibility at this stage was to the equity owners.

...

Instead, obtaining the highest price for the benefit of the stockholders should have been the central theme guiding director

²⁴ *RJR Nabisco*, *supra* at paras. 50-52.

²⁵ *RJR Nabisco*, *supra*; *Hartford Fire Ins. Co. v. Federated Dep't Stores, Inc.*, 723 F. Supp. 976 (S.D.N.Y. 1989); *Katz v. Oak Indus. Inc.*, 508 A.2d. (Del. Ch. 1986).

²⁶ *Revlon Inc. v. MacAndrews & Forbes Holdings*, Fed. Sec. L. Rep. (CCH) P92, 525 (Del. 1986) [*Revlon*].

action. Thus, the Revlon board could not make the requisite showing of good faith by preferring the noteholders and ignoring its duty of loyalty to the shareholders. **The rights of the former already were fixed by contract.** *Wolfensohn v. Madison Fund, Inc.*, Del. Supr., 253 A.2d 72, 75 (1969); *Harff v. Kerkorian*, Del. Ch., 324 A.2d 215 (1974). **The noteholders required no further protection, and when the Revlon board entered into an auction ending lock-up agreement with Forstmann on the basis of impermissible consideration at the expense of the shareholders, the directors breached their primary duty of loyalty.**²⁷ (emphasis added)

Although there is no oppression remedy *per se* in the United States, the U.S. courts have analysed cases involving bondholder rights in leveraged buyout transactions on the basis of an implied covenant of fair dealing and fairness. Similar concepts lie at the heart of the oppression remedy in Canada.²⁸

(v) Corporations Are Permitted to Change Publicly Pronounced Financial Policies

Changing financial policies were relevant in the BCE litigation because the debentureholders argued that BCE's public company statements about maintaining investment grade credit ratings and low levels of leverage prevented BCE from participating in the LBO. They maintained that these statements created a reasonable expectation on the part of the debentureholders that BCE would not take on the levels of debt associated with the LBO.

BCE argued that, in appropriate circumstances, corporations are permitted to change publicly stated business plans and financial strategies. Security holders can have no reasonable expectation that a corporation will not change a publicly pronounced strategic direction or stated financial policy in the face of changes in its competitive environment or in the face of a change of control transaction. This is particularly so where, as in this case, BCE rebuffed all approaches made to it concerning a possible privatization, and was put in play involuntarily by its largest shareholder. BCE relied upon, among other things, the recent Ontario case of *Greenlight Capital Inc. v. Stronach*, in which the Ontario Superior Court held that corporations are entitled to change publicly pronounced business plans and strategies to respond to unanticipated developments so long as such changes are believed to be in the best interest of the corporation:

With respect to a change in business plans or strategies as a result of a change in market conditions or unforeseen developments, the only reasonable expectation of shareholders is that a board and committees of a board will act honestly and

²⁷ *Revlon*, *supra* at 146-147.

²⁸ *First Edmonton Place Ltd. v. 315888 Alberta Ltd.*, (1988), 40 B.L.R. 28 (Alta. Q.B.) at 57; *Koehnen*, *supra* at 78.

in good faith with a view to the best interests of the corporation
and exercise care, diligence and skill.²⁹ (emphasis added)

Similarly, in *Alberta (Treasury Branches) v. SevenWay Capital Corp.* the Alberta Court of Appeal dismissed the plaintiff's claim that a change in the nature of the defendant corporation's business from agribusiness to a speculative telecommunications business was oppressive.³⁰

"Safe Harbour" statements routinely made by public companies in respect of forward looking statements under Canadian and U.S. securities law expressly contemplate that companies may change their publicly stated business strategies, financial policies and prospects.³¹

(b) Plans of Arrangement

An arrangement is, in essence, a contract between a corporation and one or several class(es) of corporate stakeholders that, when approved, is imposed by court order. As the contract proposed by the corporation, if approved by the Court, is binding upon all the "arranged" parties irrespective of whether they consented to the Plan of Arrangement or not, the *CBCA* requires corporations seeking to impose such a contract by Court order to meet certain statutory conditions and satisfy the court at a "fairness hearing" that the proposed arrangement is fair and reasonable to those whose rights are being "arranged". The purpose of a plan of arrangement is to effect a change in a corporation's structure that it is not practicable to accomplish under other provisions of the *CBCA*. In making an order approving a plan of arrangement under section 192 of the *CBCA*, the Court must be satisfied that:

- 1) all statutory requirements have been fulfilled, namely:
 - a) the proposed Arrangement is an "arrangement" as defined in section 192(1) of the *CBCA*;
 - b) the corporation applying to the Court is not insolvent within the meaning of section 192(2); and
 - c) it is not practicable for the corporation to effect a fundamental change in the nature of the Arrangement under any other provision of the *CBCA*;
- 2) the Arrangement is put forward in good faith; and

²⁹ *Greenlight Capital Inc. v. Stronach* (2006), 22 B.L.R. (4th) 11 at para. 103 (Ont. S.C.J.), currently under appeal.

³⁰ *Alberta (Treasury Branches) v. SevenWay Capital Corp.* (2000) 8 B.L.R. (3d) 1 (Alta. C.A.) at paras. 33-34.

³¹ See for example, National Policy 51-201 – Disclosure Standards (July 12, 2002), 25 O.S.C.B. 4492. See also: The Securities and Exchange Act of 1934 § 21(e), 15 U.S.C. § 78u(e)(1). Section 21E of The Securities Exchange Act of 1934 defines "forward-looking statement" to mean, among other things, "a statement containing a projection of revenues, income (including income loss), earnings (including earnings loss) per share, capital expenditures, dividends, **capital structure**, or other financial items" and "a statement of the plans and objectives of management for future operations, including plans or objectives relating to the products or services of the issuer". (emphasis added).

3) the Arrangement is fair and reasonable.³²

In an oppression case, the burden of proof lies squarely with the party claiming oppression to demonstrate unfairness, in the manner described above. By contrast, in a plan of arrangement case, the burden rests with the party seeking approval to demonstrate that the "fair and reasonable" test has been satisfied. The company seeking approval must put forward the arrangement, establish that the statutory requirements have been fulfilled, and that the proposed arrangement is, at least, *prima facie* fair and reasonable. Once those elements are established, the burden then shifts to those opposing the plan of arrangement.³³

In a case such as BCE, the corporation must demonstrate that the transaction in question fits within the definition of the term "arrangement" in section 192(1) of the CBCA, which reads as follows:

192. (1) In this section, "arrangement" includes

(a) an amendment to the articles of a corporation;

(b) an amalgamation of two or more corporations;

(c) an amalgamation of a body corporate with a corporation that results in an amalgamated corporation subject to this Act;

(d) a division of the business carried on by a corporation;

(e) a transfer of all or substantially all the property of a corporation to another body corporate in exchange for property, money or securities of the body corporate;

(f) an exchange of securities of a corporation for property, money or other securities of the corporation or property, money or securities of another body corporate;

(f.1) a going-private transaction or a squeeze-out transaction in relation to a corporation;

(g) a liquidation and dissolution of a corporation; and

(h) any combination of the foregoing.

The Transaction involved the exchange of the common and preferred shares of BCE for cash and thus fell within section 192(1)(f).

The second element of the test requires that the corporation is solvent.

Section 192(2) of the CBCA provides that:

(2) For the purposes of this section, a corporation is insolvent

(a) where it is unable to pay its liabilities as they become due; or

³² *Re St. Lawrence & Hudson Railway Co.* [1998] O.J. No. 3934 at paras. 12-13.

³³ *Koehnen, supra* at 195.

(b) where the realizable value of the assets of the corporation are less than the aggregate of its liabilities and stated capital of all classes.

This aspect of the test was not an issue for BCE. There was no allegation that BCE was insolvent.

The practicability question requires the applicant to prove that it is not practical to proceed under other provisions of the CBCA in effecting the arrangement in question. There is no requirement to establish that it would be impossible to proceed under other provisions of the CBCA.³⁴ Section 192(3) of the CBCA states:

Application to court for approval of arrangement

(3) Where it is not practicable for a corporation that is not insolvent to effect a fundamental change in the nature of an arrangement under any other provision of this Act, the corporation may apply to a court for an order approving an arrangement proposed by the corporation.

In BCE's case, resort to the arrangement provisions of the CBCA was required because the Transaction is dependent upon the Purchaser acquiring all of the Shares of BCE and eliminating all of the Options or other equity based rights issued by BCE in a single transaction. This result can only be achieved by a court supervised plan of arrangement. In addition, the Transaction is dependent upon the completion of a number of interrelated and sequenced corporate transactions relating to tax planning, and it is essential that no element of the Arrangement occur unless there is certainty that all will occur within the strict time frames provided for and in the correct sequence. The only practical way to achieve the required certainty in a timely manner was through an arrangement under section 192 of the *CBCA*.

(i) The Arrangement is put Forward in Good Faith

A plan of arrangement will be considered to be put forward in good faith if it has been brought forward to provide the shareholders with as good a deal as possible under the circumstances, and if the shareholders have been given an opportunity to cast their votes concerning the proposed plan.

This aspect was not an issue in BCE and the trial judge held that "[t]he uncontradicted evidence supports BCE's contentions that the Plan of Arrangement is the result of an extensive, complex strategic review and auction process, whose overriding objective was to maximize shareholder value, while respecting the corporation's legal and contractual obligations."³⁵

(ii) The Arrangement is Fair and Reasonable

In considering the fairness of an arrangement, courts apply a "business judgment" test which looks to the approval given by the "intelligent and honest business person, as a member of the class concerned".³⁶ In applying this test the Court does not consider third parties whose rights

³⁴ *St. Lawrence, supra* at para. 18.

³⁵ *Arrangement Judgment, supra* at para. 147.

³⁶ *St. Lawrence, supra* at para. 27.

are not being arranged. For example, a plan of arrangement which involves a change of control, such as the one proposed by BCE, will often also have an economic impact on various parties whose legal rights are not being arranged by Court order. These include a corporation's employees, creditors, suppliers, customers and competitors. The fact that a person's economic interests are affected, however, does not give that person standing to contest the fairness of the arrangement at a "fairness hearing". Nor does it give that person a right to approve an arrangement by voting, as a separate class or even together with other classes, which could amount to veto rights.

In considering whether an arrangement that alters the rights of shareholders is fair and reasonable courts have held that the business judgment of the shareholders (those whose rights are being arranged) as reflected in the shareholder vote is the best evidence of the fairness and reasonableness of the proposed arrangement.³⁷ As stated above, BCE's shareholders approved the Transaction by a vote of over 97%.

The plan of arrangement provisions in the *CBCA* offer a "flexible approach to the resolution of corporate problems between companies and their shareholders".³⁸ They allow a corporation to change its security holders' legal rights, even without their consent, and to carry out complex restructurings.

The issue raised by the debentureholders of Bell Canada was not one of standing *per se*, meaning the right to be heard. Rather, the issue concerned the identity of the parties whose interests are relevant to a fairness analysis in respect of a plan of arrangement. As the trial judge put it when conducting his fairness analysis in this case, the question is "fairness to whom?"³⁹

The trial judge in BCE granted the debentureholders standing to contest the plan of arrangement despite the fact that their legal rights were not being arranged or altered. In doing so, he relied upon the Policy Statement concerning plans of arrangement issued by the Director under the *CBCA* concerning the manner in which fairness hearings should be conducted (the "Policy").⁴⁰

The trial judge considered the effect of the Transaction on the debentureholders. Because the debentureholders were not oppressed and there were no contractual limitations in the trust indentures of Bell Canada precluding BCE from implementing an arrangement of this nature, he

³⁷ *Re. St. Lawrence & Hudson Railway Co.*, [1998] O.J. No. 3934 at para. 27 (Gen. Div.) [*St. Lawrence*].

³⁸ *Re. Olympia & York Developments Ltd.* (1993), 102 D.L.R. (4th) 149 at 162 (Ont. Gen. Div.) [*Olympia & York Arrangement*]. While Justice Blair's decision in *Olympia & York Arrangement* was decided under the arrangement provisions of the *Ontario Business Corporations Act* and not the *CBCA*, this passage was adopted by Justice Farley in *Re Fairmont Hotels & Resorts Inc.*, [2006] O.J. No. 5591 at para. 5 (S.C.J.), a case decided under the *CBCA*.

³⁹ *Arrangement Judgment, supra* at para. 133.

⁴⁰ Industry Canada (Corporation Canada), Policy concerning Arrangements under section 192 of the *CBCA*, policy statement 15.1, November 7, 2003 [*Policy*]. The *Policy* states that, at a minimum, all security holders whose legal rights are affected by a proposed arrangement are entitled to vote on the arrangement. The *Policy* also states that it may be appropriate in cases where a proposed arrangement fundamentally alters the security holders' investment, whether economically or otherwise, that the right to vote on the arrangement should be provided to these security holders. The Director is the person appointed by the Minister of [Industry](#) to exercise the powers allocated to the Director in the *CBCA*.

held that there was no reason to stretch the permissive language in the CBCA to grant the debentureholders the right to vote on the arrangement.⁴¹ The trial judge also relied on the Policy, which states that in determining whether holders of debt securities should have the right to vote on a plan of arrangement, the trust indenture or contractual instrument creating such securities should normally be determinative.⁴²

On appeal, the QCA held that the Directors of BCE and the trial judge both erred by considering the issue of fairness in relation to compliance with the legal rights of the debentureholders of Bell Canada, as enumerated in that Company's trust indentures, rather than in relation to their interests. The QCA held that the Board of BCE did not consider the reasonable expectations of the debentureholders in deciding to proceed with the Transaction, and did not consider the impact the Transaction would likely have upon them.

The QCA relied on *Re Canadian Pacific Ltd.*,⁴³ and *Re Alabama, New Orleans, Texas & Pacific Junction Railway Co.*⁴⁴ in support of its reasoning. In both cases, however, the contesting party's legal rights were being arranged or altered. In *Canadian Pacific (1996)*, the plan that was originally proposed would have altered the legal rights of the consolidated debenture stock ("CDS") holders by giving the company the right to redeem its outstanding CDS. *Alabama Railway* concerned an insolvent company, and its creditors were required under the plan to release their security, which the Court characterized as a "scheme of confiscation". The plan of arrangement in BCE has no such effects on the legal rights of the debentureholders.

BCE argued successfully in the SCC that there were a number of problems with the QCA's findings, including that they were contrary to the evidence and to the findings of the trial judge. The evidence established that the Board did, in fact, consider very carefully the reasonable expectations of the debentureholders as well as the manner in which they had been and would be affected by the Transaction. Moreover, BCE argued that as a matter of law the proper focus in a plan of arrangement case of this nature had to be on the manner in which the Transaction impacted on the shareholders of BCE, rather than on the non-legal "interests" of debentureholders of Bell Canada.

BCE relied on a long line of Canadian and English authorities to argue that only the legal rights of parties being arranged ought to be considered in deciding whether to approve a plan of arrangement. In *PetroKazakhstan Inc. v. Lukoil Overseas Kumkol B.V.*,⁴⁵ for instance, the court overruled a complaint by the company's joint venture partner (Lukoil) that the arrangement, if

⁴¹ *Arrangement Judgment, supra* at para. 166.

⁴² Policy Statement, s. 3.10.

⁴³ [1996] O.J. No. 2412 (Gen. Div.), aff'd [1998] O.J. No. 3699 (C.A.) [*Canadian Pacific (1996)*].

⁴⁴ [1891] 1 Ch. 213 (C.A.) [**Alabama Railway**].

⁴⁵ [2005] A.J. No. 1415 (Alta. Q.B.) [*PetroKazakhstan*].

approved, would result in a breach of the parties' joint venture agreement. Lukoil's objections were judged irrelevant.⁴⁶

In *Re Telewest Communications plc (No. 2)*,⁴⁷ an insolvent company sought approval of an arrangement under the English *Companies Act* that would have cancelled the company's bonds in exchange for 98.5% of the company's equity. The Chancery Division dismissed the objections of various shareholders on a number of grounds, including the fact that "the scheme is not proposed between Telewest and its members [*i.e.*, shareholders]".⁴⁸

This approach to the approval of plans of arrangement is well-established and consistent with basic principles of corporate law. Over 60 years ago, the English Court of Appeal recognized in *Greenhalgh v. Arderne Cinemas Ltd.* that a security holder's consent to a corporate change is only required to the extent that its legal rights (as opposed to economic interests) are affected.⁴⁹ The reasoning in this case has been adopted in Canada,⁵⁰ and is consistent with cases such as *PetroKazakhstan*.

The Debentureholders in the BCE litigation relied on the unreported 1998 decision of the English Chancery Division in *Re BAT Industries plc*.⁵¹ That case involved an asset spin-off implemented while the corporation was defending U.S. tobacco lawsuits.

The judge in *BAT Industries* held that he was entitled to consider the objections of the U.S. plaintiffs even though they were not parties to the plan of arrangement at issue in that case. He held, however, that the fact that the objectors were not parties to the arrangement had "relevance when I come to consider whether to sanction the scheme".⁵² Indeed, he approved the plan. The factors considered by the judge in approving the plan included: "the Court's primary concern under [the relevant arrangement statute] is between the Company and its members"; the objectors were actually complaining of a step taken after the arrangement, rather than the arrangement itself; the purpose of the arrangement was not to prejudice the objectors; the objectors had no enforceable claims against the company at the time of the approval hearing; and the board of the company had considered the objectors' contingent claims in recommending the plan to the shareholders and was satisfied that in the period following the implementation of the plan of arrangement, the company would continue to be able to satisfy its obligations.⁵³

⁴⁶ *PetroKazakhstan*, *supra* para. 51; see also *Re Gentra Inc.*, [1993] O.J. No. 2078 at para. 35 (Gen. Div.) [*Gentra*]; *Re Big Bear Exploration Ltd.* (2000), 258 A.R. 338 (Q.B.) [*Big Bear*]; *Samos Investments Inc. v. Pattison* (2000), 3 B.L.R. (3d) 283 (S.C.), *aff'd* (2000), 12 B.L.R. (3d) 181 (C.A.) [*Samos*].

⁴⁷ [2005] 1 B.C.L.C. 772 (Ch. D.) [*Telewest*].

⁴⁸ *Telewest*, *supra* at p. 782.

⁴⁹ *Greenhalgh v. Arderne Cinemas Ltd.*, [1946] 1 All E.R. 512 at 517-18 (C.A.); see also *White v. Bristol Aeroplane Co. Ltd.*, [1953] 1 All E.R. 40 at 44 (C.A.).

⁵⁰ *Re Trend Management Ltd.* (1977), 3 B.C.L.R. 186 at 192 (S.C.).

⁵¹ [unreported], September 3, 1998 (Ch. Div) [*BAT Industries*].

⁵² *BAT Industries*, *supra* at p. 6.

⁵³ *BAT Industries*, *supra* at pp. 8-9.

The as yet unreleased reasons of the Supreme Court of Canada should provide guidance as to how the legal rights of parties who are being arranged should be balanced against the economic interests of parties whose rights are not being arranged in evaluating the fairness of a plan of arrangement.

(c) Duties of Directors

The duties of directors of public companies when considering a change of control transaction were squarely in issue in the BCE litigation as the debentureholders argued that the Directors of BCE, who were also the Directors of BCE's wholly-owned subsidiary Bell Canada, could not approve the transaction in their capacity as Bell Directors because the transaction was not in the best interest of Bell Canada. The trial judge rejected this argument, however, and made an express finding that "the best interests of both BCE and Bell Canada, as well as those of its shareholders, are and will be served by the implementation of the Plan of Arrangement and the Definitive Agreement".⁵⁴

The leading Canadian case concerning directors' fiduciary duties is the decision of the Supreme Court of Canada in *Peoples Department Stores*.⁵⁵ *Peoples* arose in an insolvency context, in which the trustee in bankruptcy sought to impose personal liability on Peoples' directors in connection with transactions they authorized when the corporation was in the "vicinity of insolvency".

(i) The Fiduciary Duty

In *Peoples*, the SCC held that directors owe their statutory fiduciary duty exclusively to the corporation, rather than to any specific stakeholder or group of stakeholders. The SCC also recognized that, in determining the best interests of the corporation, it may be legitimate for directors to consider the interests of various stakeholders. The relevance of these interests varies depending on the circumstances of each case.⁵⁶

Further, in *Peoples* the SCC observed that the interests of one group of stakeholders may be of increased relevance in some circumstances.⁵⁷ The Court did not impose a mandatory duty upon directors to consider the interests of creditors (including debentureholders) in all circumstances, and did not hold that the interests of all stakeholders must be given equal weight at all times.

The *Peoples* decision has been seen as problematic to those espousing a *shareholder primacy* model of corporate governance. Because *Peoples* did not arise in a change of control context, the SCC did not reconcile their characterization of the fiduciary duty with the principle that directors of public companies have a duty to maximize shareholder value when faced with a change of control transaction.

⁵⁴ *Oppression Judgment, supra* at para. 203.

⁵⁵ *Peoples Department Stores Inc. (Trustee of) v. Wise*, [2004] 3 S.C.R. 461 [*Peoples*].

⁵⁶ *Peoples, supra* at 484-85.

⁵⁷ *Peoples, supra* at 482-85.

In the BCE litigation, the QCA extended *Peoples* to impose duties upon directors to consider, and arguably to protect (or at least seek to protect) the economic interests of creditors when proceeding with a change of control transaction. Specifically, the QCA required the board, in discharging its duties, to attempt to alleviate or attenuate any economic harm suffered by the Debentureholders as a consequence of the Transaction. No previous decision in Canada had recognized or imposed such a duty in the context of a change of control transaction.

(ii) The Duties of Directors in a Change of Control Transaction

Shareholders' interests are highly relevant in determining whether a particular change of control transaction is in the best interests of the corporation. It has been well-established law in Canada that when a change of control appears likely or inevitable (i.e., when the corporation is "in play"), the directors have a duty to take reasonable steps to maximize shareholder value.

In *Peoples*, the SCC adopted the reasoning of the Ontario Court of Appeal in *Maple Leaf Foods Inc. v. Schneider Corp.*,⁵⁸ one of the leading cases in Canada concerning the duties of directors in change of control transactions. In *Schneider*, the Ontario Court of Appeal concluded that when there is a change of control, directors act appropriately in seeking to achieve "the best value reasonably available to shareholders in the circumstances".⁵⁹

In *Ventas Inc. v. Sunrise Senior Living Real Estate Investment Trust*,⁶⁰ a case decided by the Ontario Court of Appeal more than two years after the decision in *Peoples*, the Court stated that there is "no doubt that the directors of a corporation that is the target of a takeover bid have a fiduciary obligation to take steps to maximize shareholder value in the process".⁶¹ The decision in *Ventas* was released by the Ontario Court of Appeal on March 23, 2007, fewer than three weeks before BCE was put in play by Teachers. *Ventas* stands for the proposition that directors have an obligation to maximize shareholder value when a change of control is imminent, while respecting the legal obligations of the company and its affiliates. This is the principle that the Board of BCE followed in supervising and administering the strategic review and auction process referred to above, and in taking steps to finalize and implement the Transaction.

In *CW Shareholdings Inc. v. WIC Western International Communications Ltd.*,⁶² the Ontario Superior Court concluded that where a corporation is "in play", the common law and statutory duties of directors are "to act in the best interests of the shareholders as a whole and to take active and reasonable steps to maximize shareholder value by conducting an auction".⁶³ The Court characterized this as the so-called "Revlon Duty", in reference to the decision of the Delaware Supreme Court in *Revlon*. Numerous other cases in Canada have similarly held that

⁵⁸ (1998), 42 O.R. (3d) 177 (C.A.) [*Schneider*].

⁵⁹ *Schneider*, *supra*, at 200.

⁶⁰ (2007), 85 O.R. (3d) 254 (C.A.) [*Ventas*].

⁶¹ *Ventas*, *supra* at 271-72.

⁶² (1998), 39 O.R. (3d) 755 (Gen. Div.) [*CW Shareholdings*].

⁶³ *CW Shareholdings*, *supra* at 768-69.

directors of public companies act in their corporation's best interests by taking steps to maximize shareholder value when the company is "in play" or for sale.⁶⁴

The consistency between maximizing shareholder value and advancing the best interests of the corporation was explained by Stephen H. Halperin and Robert A. Vaux as follows:

The rationale for the imposition of the *Revlon* duty on a board is that, once the directors have concluded that a change of control or sale of the company is inevitable, long-term strategic and business concerns are irrelevant since ... in the case of a change of control, the future strategy and synergies essentially will be out of the target shareholders' control and will reside principally with the acquiring party.

It is neither surprising nor controversial that the courts have adopted a form of *Revlon* duty in Ontario. Once it is apparent that the company is 'in play', shareholders have a reasonable expectation that the board will endeavor to maximize the value of their shares, as opposed to pursuing a transaction or a course of action that is notionally in the long-term 'best interests of the corporation'. The *Revlon* duty also partially addresses the conflict of interest that is inherent in the position in which directors and senior managers find themselves when their company is under attack. By imposing a clear and uncompromising obligation of the directors, the *Revlon* duty mitigates this conflict of interest.⁶⁵

These principles also form the foundation for the regulation of takeover bid or change of control transactions in Canada, reflected in the Canadian Securities Regulators' National Policy 62-202, which states:

"(2) The primary objective of the take-over bid provisions of Canadian securities legislation is the protection of the bona fide interests of the shareholders of the target company."

For all of these reasons, BCE's position throughout the litigation referred to above was that the duty of directors to maximize shareholder value in circumstances where a company is "in play" is merely a manifestation of a director's fiduciary duty to act in the best interests of the

⁶⁴ See, for example: *Gazit (1997) Inc. v. Centrefund Realty Corp.* (2000), 8 B.L.R. (3d) 81 at para. 69 (Ont. S.C.J.); *Olympia & York v. Hiram Walker* (1986), 59 O.R. (2d) 254 at 272 (Div. Ct.); *Benson v. Third Canadian General Investment Trust Ltd.* (1993), 14 O.R. (3d) 493 at 500 (Gen. Div.); *Casurina Limited Partnership v. Rio Algom Ltd.* (2004), 40 B.L.R. (3d) 112 at para. 27 (Ont. C.A.); *347883 Alberta Ltd. v. Producers Pipelines Inc.* (1991), 80 D.L.R. (4th) 359 at 399-402 (Sask. C.A.); *Pacifica Papers Inc. (Re)* (2001), 15 B.L.R. (3d) 249 at para. 30 (B.C.S.C.), aff'd 19 B.L.R. (3d) 63 (B.C.C.A.); See also *Koehnen, supra* at 285 and 293.

⁶⁵ "The Role of the Target's Directors in Unsolicited Control Transactions", *Critical Issues in Mergers and Acquisitions – Domestic and International Views, Papers Presented at the 6th Queen's Annual Business Law Symposium* (Kingston: Queen's University, 2000) at 109-14.

corporation. The fiduciary duty which, as the SCC recognized in *Peoples*, is better described as a "duty of loyalty", is designed to ensure that directors put the interests of the corporation ahead of their own. The duty to maximize shareholder value recognizes that in transactions of this nature there is a heightened risk that directors will act in their own self-interest to retain control of the company.

As recognized in *CW Shareholdings*, "in no other context is the conflict of interest [of directors] as serious as in the takeover situation".⁶⁶ The heightened risk of conflict arises because directors may be tempted, acting in their own self-interest, to authorize actions directed at frustrating a takeover bid while purporting to act in the best interests of the corporation. Not only is the maximization of shareholder value when a company is in play "not necessarily incompatible" with acting in the best interests of the corporation, as described by the trial judge,⁶⁷ it helps ensure that directors do indeed act in the best interests of the corporation in a change of control context that is rife with potential conflict.

U.S. and Canadian courts have consistently recognized the duty to take reasonable steps to maximize shareholder value, without adhering rigidly, or at all, to the original *Revlon* decision.

The decision of the SCC should clarify and provide authority from the highest court in Canada on the duties of directors in a change of control situation.

(iii) No Duty to Protect the Economic Interests of Debentureholders

At the heart of the QCA's decision to vacate the order of the trial judge approving the Plan of Arrangement is the QCA's interpretation of *Peoples* as requiring directors, in order to satisfy their statutory duties under section 122 of the CBCA, to "structure an arrangement that takes into account, and to the extent reasonably possible, satisfies the interests of the various securityholders".⁶⁸

However, the SCC noted in *Peoples* that Canadian courts have long recognized the discretion enjoyed by directors in soundly managing the corporation.⁶⁹ In acting honestly and in good faith with a view to the best interests of a corporation that has been put in play, the directors may legitimately act other than in the best interests of particular stakeholders, including creditors. As stated above, this important principle was recognized almost two decades ago by the Ontario Court of Appeal in *Brant Investments Ltd. v. KeepRite Inc.*:⁷⁰

"Acting in the best interests of the corporation could, in some circumstances, require that a director or officer act other than in the best interests of one of the groups protected under s. 234 [of the CBCA]. To impose upon directors and officers a fiduciary duty to the corporation as well as to individual groups of

⁶⁶ *CW Shareholdings*, *supra* at 768-769

⁶⁷ *Oppression Judgment*, *supra* at para. 131.

⁶⁸ *BCE Inc. (Arrangement relatif à)*, [2008] Q.J. No. 4173 (C.A.) at para. 123.

⁶⁹ See for example: *Schneider*, *supra* at 199-200.

⁷⁰ (1991), 3 O.R. (3d) 289 at 301 (C.A.), *aff'g* (1987), 60 O.R. (2d) 737 (H.C.).

shareholders of the corporation, could place directors in a position of irreconcilable conflict..."

Accordingly, BCE argued that the discretion enjoyed by directors to consider diverse stakeholders, described by the SCC in *Peoples*, serves as a shield protecting directors from challenges by shareholders and other stakeholders to decisions made with a view to the best interests of the corporation. BCE argued that in converting a discretion to *consider* diverse interests into a mandatory obligation to seek to *protect* these interests, the QCA turned *Peoples* on its head. In effect, the QCA transformed a shield protecting directors from challenges to their good faith decisions into a sword that can be used by disgruntled stakeholders to challenge board decisions.

In reaching its decision, the QCA placed considerable reliance on a discussion by Rousseau and Desalliers⁷¹ of the possible impact of *Peoples* on Revlon Duties to maximize shareholder value in Canada. The authors mused that by recognizing that directors may consider the interests of stakeholders other than shareholders in fulfilling their duties to the corporation, the SCC may have created, by jurisprudence, the equivalent of "Constituency Statutes", such as those enacted in Pennsylvania and other U.S. States, and eliminated any application of Revlon Duties in Canada. Most observers, however, think it is unlikely that the SCC intended to effect such a sweeping change to Canadian corporate law as a by-product of an insolvency case that concerned the issue of whether directors owe statutory fiduciary duties and duties of care to creditors in circumstances where a company is operating in the vicinity of insolvency.

It is hoped that the reasons of the SCC will clarify whether directors have a broad discretion to consider certain stakeholder interests in particular situations, and whether the interests of some stakeholders may have more importance and relevance than those of others in a change of control situation.

4. EXPECTED AREAS OF CLARIFICATION IN THE REASONS OF THE SUPREME COURT OF CANADA

The BCE case is the most significant commercial law case to be considered by the SCC in years. The case presents the SCC with the opportunity to clarify its earlier decision in *Peoples* regarding the nature and scope of directors' fiduciary duties. By divorcing the fiduciary duty from the interests of shareholders and focussing on the statutory language of the CBCA that indicates that the duty is owed to "the corporation", critics have argued that the SCC has given directors and shareholders no yardstick against which the discharge by directors of their important duties can be measured.

More broadly, the BCE case gives the SCC its first opportunity to consider the duties of directors in the context of change of control transactions and the rights and expectations of shareholders and creditors in that context. Practitioners and scholars are curious as to whether the SCC will confirm what has emerged from Canadian provincial appeal courts as the standard for directors

⁷¹ S. Rousseau & P. Desalliers, *Les devoirs des administrateurs lors d'une prise de contrôle: étude comparative du droit du Delaware et du droit canadien* (Montréal: Éditions Thémis, 2007). Constituency Statutes generally permit, but do not require, directors to regard any particular corporate interest in considering the best interests of the corporation.

in a change of control context, namely that they take reasonable steps designed to maximize shareholder value. Some critics of the decision in *Peoples* have argued that the reasoning in that case gives directors the leeway (but not the obligation) to disregard shareholder wealth maximization.

Corporate practitioners are also anticipating that the SCC will reverse the QCA on the issue of whether directors have a "duty to consider" the contractual rights and reasonable expectations of creditors or other stakeholders when proceeding with a change of control transaction. One of BCE's arguments on appeal to the SCC was that the QCA made factual errors in its judgment regarding the extent to which the BCE Board considered the concerns of the bondholders and the effect of the transaction on Bell Canada bondholders. Thus, it is possible that the SCC reversed the QCA on the basis of important factual errors in the decision of the QCA, and/or because the QCA applied an incorrect standard of review. However, the questioning from the SCC justices during the appeal hearing suggests that the Court focussed on the question of whether directors owe such a duty to consider creditors in the first place and it is expected that the Court will clarify this question. Such clarification will be of keen interest to boards of directors and their advisors.

Another point that may be of interest in the SCC's reasons is whether a creditor has diminished expectations of protection in circumstances where the board had not sought out the transaction in question, but rather was "put in play" by external events. In BCE's case, arguments in defence of the transaction emphasized that Teachers' decision to cease being a passive investor and to consider a privatization transaction for BCE had essentially forced BCE to accept a shareholder value maximizing transaction that impacted adversely on the debentureholders of Bell Canada. If this context has bearing on the SCC's conclusions, the decision could be viewed as limiting the ability of boards to initiate transactions without considering the ramifications on other stakeholders.

The SCC is also likely to address in its reasons the nature of the rights of creditors of a corporation and the extent to which the directors of a corporation would be required, if ever, to afford to creditors protections that go beyond the terms of their contract with the corporation. The question of whether bondholders have reasonable expectations (*i.e.*, expectations that are deserving of protection) that go beyond the terms of their contract was central to the arguments made by both sides at the SCC. The reversal of the QCA's decision indicates that the SCC is unlikely to find extra-contractual protections for sophisticated creditors, such as bondholders, in circumstances where a corporation has negotiated a detailed contract governing the rights of the creditors.

The reasons of the SCC can and hopefully will provide greater clarity regarding the viability of plans of arrangement. The SCC is expected to comment on whether creditors whose rights are not being arranged have standing at a fairness hearing and, if they have standing, whether creditors or other stakeholders can expect more favourable treatment in a plan of arrangement because of the "fair and reasonable" test than their treatment in the context of a takeover bid that does not proceed by plan of arrangement where no such test must be satisfied. Even if the SCC's reasons do not touch on the standing issue, clarification of the rights of creditors (and other stakeholders) in an arrangement in which their legal rights are not being arranged will be of

assistance to corporations and lower courts in conducting fairness hearings for arrangements in the future.

5. PRACTICAL ADVICE FOR DIRECTORS

Few transactions in Canadian corporate history have been as closely watched, and as rigorously dissected, as this one. Virtually every step taken by the Board of BCE throughout the strategic review and auction process was subjected to prolonged and microscopic examination. In the end, the Board of BCE was vindicated. The Board members were diligent, thoughtful and extraordinarily careful at each step of the process. They were guided throughout by multiple sets of highly sophisticated financial and legal advisors. They documented carefully and thoroughly the various steps taken along the way as well as the various factors they considered in deciding to proceed with and implement the Transaction. The lessons learned from this case for directors faced with potentially contentious changes of control transactions include the following:

- a) obtain proper advice from sophisticated and experienced financial and legal advisors, and do so throughout the sale process;
- b) be careful and diligent throughout the process, including by considering alternatives and impacts;
- c) follow a proper, informed and sufficiently independent process that will permit the board to avail itself of the "business judgment rule" in the event that litigation arises;
- d) do not be afraid or reticent to question or debate contentious points or issues at the board level when they arise. A dialogue of this nature is healthy and indeed expected when members of a board are dealing with important and difficult matters, recognizing that many of the issues boards must face give rise to "judgment calls" in respect of which reasonable people acting in good faith can easily differ;
- e) document carefully the deliberations and decisions of the board, and the nature of the advice sought and received, preferably in well crafted Minutes of meetings, prepared by a highly capable corporate secretary contemporaneously with the meetings in question; and
- f) be prepared for challenges and be resilient. Boards faced with the prospect of proceeding with possibly contentious change of control transactions are almost certain to be criticized by those who are less well-informed than they are. Directors have a heavy burden in circumstances such as these, and must be resolute in their efforts to fulfill their important responsibilities.

6. CONCLUSION

The BCE Transaction is the largest, most high profile and closely watched transaction in Canadian history. It has impacted directly on hundreds of thousands of shareholders of BCE and debentureholders of Bell Canada situated throughout the country, and has had and likely will

have an important indirect impact on Canadian markets and observers of the Canadian corporate landscape, including directors, financial and legal advisors, law professors and commentators. There are important lessons to be learned from an extraordinary case of this nature, and we await eagerly the reasons of the SCC which will provide much needed answers to the many questions the litigation gave rise to.