EXERCISING GOOD JUDGMENT: THE SUPREME COURT BACKS DIRECTORS IN BCE DECISION*

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In a highly anticipated, unanimous judgment, released on December 19, 2008, the Supreme Court of Canada ("**SCC**") provided guidance to corporate directors who, in the exercise of their fiduciary duty to corporations, find themselves torn between conflicting interests, particularly those of shareholders and creditors. However, directors' duties in specific factual contexts have yet to be worked out and the SCC has left open some intriguing questions for future interpretation.

Background

In June 2007, the directors of telecommunications giant BCE Inc. ("**BCE**") accepted an offer to purchase all of the company's shares at a 40% premium over the current market price. Nearly 98% of BCE's shareholders approved the transaction, which was to take place by way of a court-approved plan of arrangement under section 192 of the Canada Business Corporations Act (the "**CBCA**"). It would have been the largest leveraged buyout in Canadian history.

As the proposed arrangement involved a substantial increase to the debt load of BCE's subsidiary (and primary source of revenue), Bell Canada, it was opposed by Bell Canada debentureholders who held $7.2 billion in securities. The debentureholders alleged that the arrangement was neither fair nor reasonable, primarily because it would cause the debentures to lose their investment grade status and suffer a reduction in their trading value. The debentureholders also sought relief under the CBCA's oppression remedy.

Judicial History

The Quebec Superior Court approved the arrangement and dismissed the debentureholders' claim for oppression. However, the Quebec Court of Appeal (the "**QCA**") overturned the trial decision, on the grounds that the arrangement did not satisfy the requirement that arrangements must be fair and reasonable. Since the arrangement was found to be neither fair nor reasonable, the QCA found it unnecessary to consider the claim for an oppression remedy under section 241 of the CBCA.

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SCC's Decision

On June 20, 2008, the SCC reinstated the trial decision and, six months later, released reasons for its decision. The SCC disagreed with the QCA's conflation of the analyses for the oppression remedy as opposed to arrangements. The SCC treated the analyses separately, but found that the debentureholders' claims did not satisfy the legal tests under either remedy. In its discussion of the oppression remedy, the SCC also described the fiduciary duties that directors owe to the Canadian corporation.

1. The duty of directors

While Canadian courts generally observe the "business judgment rule" and defer to the good faith business decisions of corporate directors, they can scrutinize whether those business decisions satisfy the fiduciary duty owed by directors to a corporation. Uncertainty about how that duty relates to the interests of the corporation's various stakeholders, combined with the broad rights given to those stakeholders under the oppression remedy, has created a significant amount of litigation.

In its last major decision analyzing the fiduciary duties of corporate directors, *Peoples Department Stores Inc. (Trustee of) v. Wise*, [2004] 3 S.C.R. 461, 2004 SCC 68, the SCC held that, in carrying out their duty to act in the best interests of the corporation, it may be appropriate, although not mandatory, for directors to consider the impact of corporate decisions on shareholders or particular groups of stakeholders.

The Peoples decision appeared to diverge from a series of prominent Delaware corporate takeover cases that includes *Revlon Inc. v. MacAndrews & Forbes Holdings Inc.*, 506 A.2d 173 (1985). The Revlon line of cases has been understood to mean that directors should seek to maximize shareholder value when the corporation is "in play". With its decision in BCE, the SCC stressed the importance of analyzing the fiduciary duty of corporate directors in its context. According to the SCC,

> There is no principle that one set of interests — for example, the interests of the shareholders — should prevail over another set of interests. Everything depends on the particular situation faced by the directors and whether, having regard to that situation, they exercised business judgment in a responsible way.

Moreover, the SCC set out the positive duty of corporate directors in Canada as follows:

> …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 . . . In each case, the question is whether, in all the circumstances, the directors acted in the best interests of the corporation, having regard to all relevant considerations, including, but not confined to, the need to treat affected stakeholders in a fair manner, commensurate with the corporation's duties as a responsible corporate citizen.

2. Oppression remedy under section 241 of the CBCA

The oppression remedy provides the broadest remedy available to stakeholders following a breach of a director's duties. In its BCE decision, the SCC combined conflicting strands of jurisprudence by setting out a two-pronged test for establishing a stakeholder's entitlement to relief under the oppression remedy. A court must now assess (i) whether the evidence supports the reasonable expectation asserted by the claimant, and (ii) whether the evidence establishes that the reasonable expectation was violated by conduct falling within the terms "oppression", "unfair prejudice", or "unfair disregard" of a relevant interest.

The SCC listed a number of factors that would assist corporate directors in determining whether they have met the reasonable expectations of the corporation's stakeholders. These factors (which are described in greater length in the judgment) include general commercial practice, the nature of the corporation, the relationship between the parties, past practice, steps the claimant could have taken to protect itself, representations and agreements, and the fair resolution of conflicting interests between corporate stakeholders.

In its decision, the SCC emphasized the directors' duty to treat each stakeholder equitably and fairly, with a view to their legal rights, their past experiences, and the representations they may have received, as well as commercial norms and marketplace or organizational realities, particularly where there are conflicting interests between stakeholders.

The stakeholder must also establish wrongful conduct, causation and compensable injury amounting to "oppression", "unfair prejudice", or "unfair disregard" of a relevant interest in order to satisfy the second branch of the test for oppression.

The SCC concluded that the expectations of BCE's debentureholders were not reasonable. Neither BCE nor Bell Canada had made any unqualified representations concerning the investment-grade ratings of the debentures upon which the debentureholders could reasonably rely. The SCC also noted that the debentureholders had failed to negotiate contractual terms that would protect them from business risks associated with a change of control or fluctuations in debt load, or that would prevent Bell Canada from assuming new debt. Relying on the business judgment rule, the SCC concluded that "the corporation's best interest arguably favoured acceptance of the offer" and that, as BCE faced certain takeover, the directors had acted reasonably to create a competitive bidding process.

Finally, with respect to the second branch of the test for an oppression test, the SCC concluded that the directors considered the interests of the debentureholders, and ultimately decided that BCE could make no commitments beyond the contractual terms of the underlying trust indentures.

3. Plan of arrangement under section 192 of the CBCA

In overturning the decision of the QCA, the SCC distinguished the onus on the stakeholder to show a wrongful breach of its reasonable expectation under the oppression remedy from the onus on the corporation to show that a plan of arrangement under section 192 of the CBCA is fair and reasonable. This is in addition to the requirement that the statutory procedures for an arrangement have been met and that the application has been put forth in good faith.

The test for whether a proposed arrangement is fair and reasonable is primarily concerned with affected parties whose legal rights are being arranged. The SCC has affirmed that non-legal interests should only be considered in exceptional circumstances.

In its decision, the SCC concluded that the proposed arrangement affected only the debentureholders' economic interests (i.e., the preservation of the trading value and investment-grade status of their debentures) and not their legal rights (i.e., the investment and return they contracted for); therefore, the debentureholders did not constitute an affected class under section 192 of the CBCA. In this case, the impairment of the debentureholders' economic interests did not constitute an exceptional circumstance where non-legal interests should be considered.

Implications of the SCC's Reasoning

The SCC's reasons provide welcome clarification on the fiduciary duties of directors. The description of directors' fiduciary duties cannot and should not be reduced to a simple test or a definitive set of priorities to be used to balance competing stakeholder interests. However, the SCC has gone some way to describe directors' duties, in that directors must treat stakeholders equitably and fairly, with regard to all the circumstances, and the reasonable expectations of stakeholders.

On the other hand, the latitude granted to directors under the business judgment rule may make it more difficult for plaintiffs to establish a claim of oppression, as they will have to prove that their expectation was objectively reasonable and that breaches of this expectation were oppressive, unfairly prejudicial, or unfairly disregarded their interests.

It may be unclear in other contexts how competing stakeholder interests should be balanced. Clearly, in transactions that involve a change of control, shareholder value will continue to be an important consideration for directors. That said, the BCE decision leaves directors with little guidance in the context of other transactions, for example a transaction that does not maximize shareholder value. The broad and general nature of the principles set out in this case will probably not yield predictable results, with the result that directors' duties in specific factual contexts will have to be fleshed out through further litigation.

Even when it comes to the general principles, the BCE decision has left some major questions unanswered, and has perhaps opened the door to new and intriguing legal questions.

For example, the SCC mentioned in passing that, given the differences between an action for oppression and an objection to an arrangement under section 192 of the CBCA, it is possible that a court could find an action to be fair and reasonable but also oppressive. This is a result of the fact that section 192 is concerned with legal rights, whereas the oppression remedy is concerned with the stakeholder's "reasonable expectations", an analysis that plays no role in an arrangement evaluation. The SCC tentatively agreed with the QCA that "a finding of oppression sits ill with the conclusion that the arrangement involved is fair and reasonable."

Also, in its description of the positive duties of directors in Canada, the SCC suggested in its oppression analysis that the corporation itself has "duties as a responsible corporate citizen." This may be merely a shorthand method of referring to statutory responsibilities in relation to the environment or corporate employees. Yet the seemingly open-ended nature of those duties leaves the door open for more expansive challenges based upon a corporation's relationship to the broader community.

The BCE decision is by no means revolutionary. Rather, it represents an incremental, but important, step in the evolution of a uniquely Canadian corporate jurisprudence.