

LANDMARK CASE

BCE INC. v. 1976 DEBENTUREHOLDERS



CURRICULUM LINKS:

Canadian and International Law,
Grade 12, University Preparation
(CLN4U)

Understanding Canadian Law,
Grade 11, University/College
Preparation (CLU3M)

ESTIMATED TIME:

1 - 2 periods

IN THIS SECTION, YOU WILL FIND:

	PAGE
Case Summary	2 - 8
Student Resources:	
Classroom Discussion Questions	9
Activity 1	10 - 14
Activity 2	15
Teacher Resources:	
Activity 1: Answer Key	16

FIDUCIARY DUTY OF DIRECTORS AND OFFICERS IN A CORPORATE TAKEOVER: BCE INC. v. 1976 DEBENTUREHOLDERS

OJEN LANDMARK CASES

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- Student worksheets
- Cooperative learning activities
- Ideas for extension exercises

Landmark Cases are prepared by OJEN's justice and education sector volunteers, including law students, lawyers, judges and teachers. All OJEN resources are reviewed by both a lawyer and teacher and available at no cost in English and French. Grade 10 students review the materials and provide ideas and feedback on the readability of the resource.

OJEN aims to assist classroom teachers and enhance justice education opportunities for young people. If there is a case or topic that you would like to suggest as the next Landmark Case, please contact OJEN. We also welcome your feedback for improving and expanding our classroom resources. Examples of culminating activities, teaching strategies or modifications that are shared with OJEN may be added to the resource and distributed province-wide. Please forward comments, suggestions and ideas for new resources to info@ojen.ca.

BCE INC. v. 1976 DEBENTUREHOLDERS (2008)

BACKGROUND

Canadian corporations have a separate legal identity from that of their shareholders. This means that for the purposes of the law, a corporation is its own person with rights and duties similar to that of a natural person. For example, when a corporation is responsible for environmental damage, it is the corporation that is liable to pay damages, not the shareholders. Also, the shareholders do not have direct control of the corporation. Each share is a bundle of rights and liabilities which include a right to vote for a board of directors, often a right to dividends, and a right to a share of the corporation's assets upon winding up.

The directors are responsible for governing the corporation. They hire the officers responsible for the operations of the corporation and they make all the major decisions. In carrying out their responsibilities, the directors and officers have two main duties: the fiduciary duty and the duty of care. These duties are set out in s.122(1) of the *Canada Business Corporations Act (CBCA)*, the statute which sets out all the rules in relation to corporations.

Subsection 122(1)(a) of the *CBCA* outlines the fiduciary duty of directors and officers. This refers to the duty of the directors and officers to act in a manner that is honest and loyal to the corporation. Directors and officers should not make business decisions that would be harmful to the corporation or conduct fraud which would harm the corporation. As well, they must act honestly, not abuse their powers, nor only make a profit for themselves.

The directors and officers of a corporation also owe what is called in law a duty of care. This means that they must make informed decisions that are good for the company after having gathered all available information. For example, if the directors are planning to buy some equipment, they have to make sure that they have properly researched the suppliers, made sure that the equipment will improve the business and only buy it if there is enough money. The law requires this duty of directors and officers under ss. 122(1)(b).

CANADA BUSINESS CORPORATIONS ACT **DUTY OF CARE OF DIRECTORS AND OFFICERS**

122. (1) Every director and officer of a corporation in exercising their powers and discharging their duties shall

- (a) act honestly and in good faith with a view to the best interests of the corporation; and
- (b) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

It is fiduciary duty which is at issue in this case. The main issues surrounding this duty are: (1) what the word “corporation” means, and (2) whose best interests the directors and officers of a corporation should be acting on behalf of. There are two main schools of thought on this issue:

- **Shareholder Primacy:** This refers to the belief that directors only owe a duty to the shareholders of a corporation. This belief is premised on the notion that since shareholders are primarily concerned with profits, this should also be the main consideration of directors. As long as the corporation is acting legally, it is improper for the directors to consider anything that is not related to profits.
- **Stakeholder Primacy:** This refers to the belief that directors do not solely owe a duty to shareholders, but also towards other groups that are affected by the corporation, such as employees, creditors, and society at large. This belief holds that directors must balance the needs of all parties affected when making decisions.

Traditionally, the common law precedent has been that directors only have a duty to shareholders in making decisions. However, recent cases granted directors more freedom in making their decisions. In *Peoples Department Stores Inc. (Trustee of) v. Wise*, [2004] (see OJEN’s Landmark Case on this decision), the Supreme Court of Canada (SCC) stated that the directors must act in the best interests of the corporation. In doing so, it may be appropriate, although not mandatory, to consider the impact of their decisions on shareholders or other groups with stakes in the corporation.

FACTS

Bell Canada Enterprises (BCE) is the company which owns Bell Canada. In 2006, it became apparent to BCE’s directors that the Ontario Teachers Pension Plan (Teachers) was in the process of trying to take over BCE. Teachers would do this by buying large numbers of BCE shares on the stock market. The BCE directors met and decided to intervene, believing it was not in the best interests of the shareholders to have a single party make a takeover bid rather than having multiple parties compete with one another. If multiple parties were involved, there would be a bidding war and the offer price for company shares would increase. Therefore, it was in the best interests of the shareholders to set up an auction process to purchase BCE shares.

Three different groups made offers for BCE. These offers were complex and all three involved Bell Canada taking on a substantial amount of new debt (i.e. \$30 billion). After reviewing the three offers, the BCE directors decided that the offer made by Teachers was in the best interests of BCE and BCE's shareholders.

CANADA BUSINESS CORPORATIONS ACT

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

- (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;

WHERE A CORPORATION IS INSOLVENT

(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
- (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.

APPLICATION TO A COURT FOR APPROVAL OF AN 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.

POWERS OF COURT

(4) 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 determining the notice to be given to any interested person or dispensing with notice to any person other than the Director;
- (b) an order appointing counsel, at the expense of the corporation, to represent the interests of the shareholders;
- (c) an order requiring a corporation to call, hold and conduct a meeting of holders of securities or options or rights to acquire securities in such manner as the court directs;
- (d) an order permitting a shareholder to dissent under section 190; and
- (e) an order approving an arrangement as proposed by the corporation or as amended in any manner the court may direct.

BCE and Teachers entered into an agreement, which 97.93% of the shareholders agreed to the terms of. Under the plan, the shareholders would receive 40% more for their shares than what they were worth on the stock market before the bidding began. This plan was subject to court approval under s.192 of the *CBCA*. As discussed below, the debentureholders opposed the offer made Teachers, which was accepted by BCE.

BEST INTERESTS OF DEBENTUREHOLDERS

A debenture is a loan given to a debtor. Debentures are eventually paid back to the debentureholder (i.e. creditor) with interest, thereby earning the debentureholder money on the original loan amount. The value of the debenture goes down if there is a chance that the loan may not be repaid. In addition, the chance of repayment is significantly reduced if the debtor takes on substantial amounts of new debt, as the more debt a company owes, the less likely they are to pay it all back.

In this case, the debentureholders were parties that had previously lent money to Bell Canada. They argued that, although the decisions of the BCE directors were in the best interests of the shareholders, they were not in the best interests of the Bell Canada debentureholders because the additional \$30 billion in debt taken on at the end of the auction process decreased the value of the Bell Canada debentures by approximately 20 percent.

The debentureholders opposed the takeover arrangement in court on two main grounds. (1) They sought relief under the oppression remedy under s. 241 of the *CBCA*. (2) They also alleged that the arrangement was not “fair and reasonable” and opposed court approval of the arrangement under s. 192 of the *CBCA*.

JUDICIAL HISTORY

The trial judge found that, although the takeover was not in the best interests of the debentureholders, that the directors had fulfilled their legal obligations as directors by acting in the best interests of the corporation. The trial court found in favour of BCE.

CANADA BUSINESS CORPORATIONS ACT

APPLICATION TO COURT RE OPPRESSION REMEDY

241. (2) If...the court is satisfied that...

(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.

The Court of Appeal overruled the trial judge's decision and found that the takeover deal was invalid because it was not fair and reasonable to the debentureholders. The court found that the directors had to ensure that a takeover bid did not negatively affect the debentureholders. The case was appealed to the SCC.

SUPREME COURT OF CANADA

The SCC ruled in favour of BCE and the takeover arrangement was allowed to proceed. The SCC assessed whether the oppression remedy should apply, and also whether the takeover arrangement was "fair and reasonable".

1. Oppression Remedy under s. 241 of the *CBCA*

Under the oppression remedy, the courts can order directors of corporations to take certain actions if the directors have been found to be acting in a way that is unfair to any security holder, director or officer of the corporation. Security holders include shareholders and debentureholders. The oppression remedy was enacted to ensure that the rights of minority shareholders in corporations were not violated by the majority. For example, a violation could arise if two majority shareholders each holding 40% of the shares decided to use their 80% control to reduce the profits for the remaining 20% shareholders. In this situation, the shareholders holding 20% of the shares could seek an oppression remedy through the courts.

The SCC found it was not reasonable for the debentureholders to expect the directors to act in a way to maintain their economic interests. First, they looked at normal commercial practice. This type of takeover, where a company takes on more debt, is not unusual or unforeseeable to debentureholders. At the time they made their loans, the debentureholders to BCE should have known that a takeover was possible. They could have negotiated to protect themselves in such situations, but chose not to. Second, Bell Canada had previously been taken over by BCE. Therefore, the debentureholders knew that such a takeover had previously happened, thus should have expected that it may happen again. Third, no representations or promises had been made to the debentureholders that this type of takeover would not occur.

Finally, the SCC held that directors have a duty of care to the corporation, and any conflicts between other parties (e.g. shareholders, creditors, etc.) must be resolved with this in mind. The SCC found that everything the directors did was in the best interests of the corporation. Bell Canada needed to make significant

internal changes to be successful in the future, and the company would be more flexible if one party took over the whole company rather than it be fractured by various parties having some element of control. If Teachers took over, BCE would become more flexible, making it easier for the company to make all of the changes required.

As such, the SCC found that there was no reasonable expectation that the debentureholders' economic interests would be protected. The court held that the only reasonable expectation was that the directors merely consider the economic interests of the debentureholders, which the evidence showed they did.

2. Court Approval Process under s. 192 of the CBCA

Section 192 of the *CBCA* sets out a court approval process for complex corporate arrangements such as the BCE/Teachers plan. The purpose of this section is to allow major changes in a corporation's structure, while ensuring that security holders whose rights may be affected are treated fairly. BCE asked the court to approve the takeover plan and the debentureholders contested this request.

To be approved, a company making an application (in this case, BCE) must prove the following three requirements:

1. That statutory procedures have been met.
2. That the application has been put forward in good faith.
3. That the arrangement is fair and reasonable.

The third requirement was the focus of most of the debate in court on the application. For an arrangement to be fair and reasonable, the court must engage in two inquiries.

First, the arrangement must have a valid business purpose. In other words, there has to be a positive value to the corporation to justify the burden or disadvantage the arrangement places on various security holders. An important factor in determining if there is a valid business purpose is whether the new arrangement is necessary for the corporation to continue operating. If the arrangement is necessary for continued operation, the court will likely find any arrangement fair. However, if the arrangement is unnecessary or if there are better alternative arrangements, the court will likely find it unfair.

Second, the arrangement must balance the rights of parties affected in a fair manner. One important factor to look at is whether the majority of security holders have voted to approve the arrangement. Also, the court will ask itself whether a security holder who is an intelligent and honest business person would approve the plan. In doing so, the court assesses if a reasonable person would make a similar decision under the same circumstances.

Applying the above tests to the BCE takeover, the court approved the takeover under s. 192 and found that all three requirements were met.

In particular, in assessing whether the arrangement or plan was fair and reasonable, the court focussed on the protection of legal interests (under s. 192) rather than economic interests. Section 192 protects legal interests, not economic ones. The value of the debentureholders' investments were affected, however their legal rights were not altered. The debentureholders could have negotiated protections against takeovers in their initial loan agreements, and since they did not, this arrangement did not violate any of their contractual or legal rights. Therefore, the SCC found it was fair and reasonable for the purposes of section 192.

CONCLUSION

By ruling in favour of BCE, the SCC upheld the precedent established in *Peoples*. The court affirmed that directors must act in the best interests of the corporation, and in doing so, may consider the interests of various affected groups, including shareholders and debentureholders, but are not required to do so. Ultimately, the directors must act in the best interests of the corporation and its operations. The role of the court is not to second guess the business decisions of the directors, who are expert business persons, but rather to ensure that a legally sound decision making process was followed.

The BCE takeover subsequently failed due to accounting issues, and Teachers sold off most of their shares in BCE.

CLASSROOM DISCUSSION QUESTIONS

1. Explain the relationship between the corporation and its shareholders. If a corporation is found liable for environmental damage, are the shareholders responsible to pay for the damages as owners of the company? Why or why not?
2. What duties are the directors of a corporation responsible for in the operation of a corporation? What two main duties does the *CBCA* say that directors have in carrying out their responsibilities?
3. Do you agree that directors should only have a responsibility to the shareholders? Should directors also have a duty toward other groups that are affected by the corporation? Why or why not?
4. What is a debentureholder? Why did the debentureholders disapprove of the BCE takeover? What remedies did they seek?
5. The SCC found that the economic interests of the debentureholders were affected, however their legal rights were not. Explain what is meant by this.
6. Would this case have been decided differently if the debentureholders' legal rights had been violated?
7. Do you think directors of corporations should have to equally balance the interests of the corporation, the shareholders and the creditors when facing financial difficulty?
8. Why do you think that the court would be reluctant to second guess business decisions?
9. What impact does this SCC decision have, if any, on the actions of directors? On shareholders and debentureholders? On other groups affected by the corporation? Explain.

BCE INC. v. 1976 DEBENTUREHOLDERS: ACTIVITY 1

There is an ongoing debate about whose interest the directors must consider when acting on behalf of the corporation. The law currently allows directors to consider the interests of any affected party as long as the directors are ultimately working in the best interests of the corporation. When considering the best interests of the corporation, directors can take into account the interests of the shareholders, employees, creditors, and the community at large. Directors no longer need to act solely in the best interests of the shareholders.

This decision falls somewhere in between the two schools of thought mentioned below, shareholder primacy and stakeholder primacy.

Shareholder primacy holds that the directors should only be concerned with profits, as they are agents of the shareholders. Shareholders are the owners of the corporation and therefore only their interests are relevant.

Stakeholder primacy holds that all stakeholders, including shareholders, creditors, employees, the community and the environment, must be considered when making business decisions. The corporation is viewed as a social entity and not simply a business belonging to the shareholders. Therefore, the directors should be concerned with the interests of all of society, not just the shareholders.

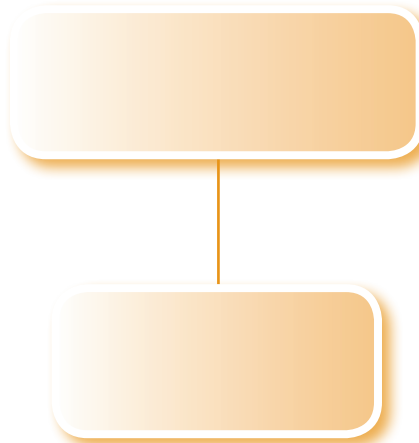
PART A: MIND MAPPING

The following diagram depicts the two schools of thought, stakeholder primacy and shareholder primacy, in a picture format. Label the following:

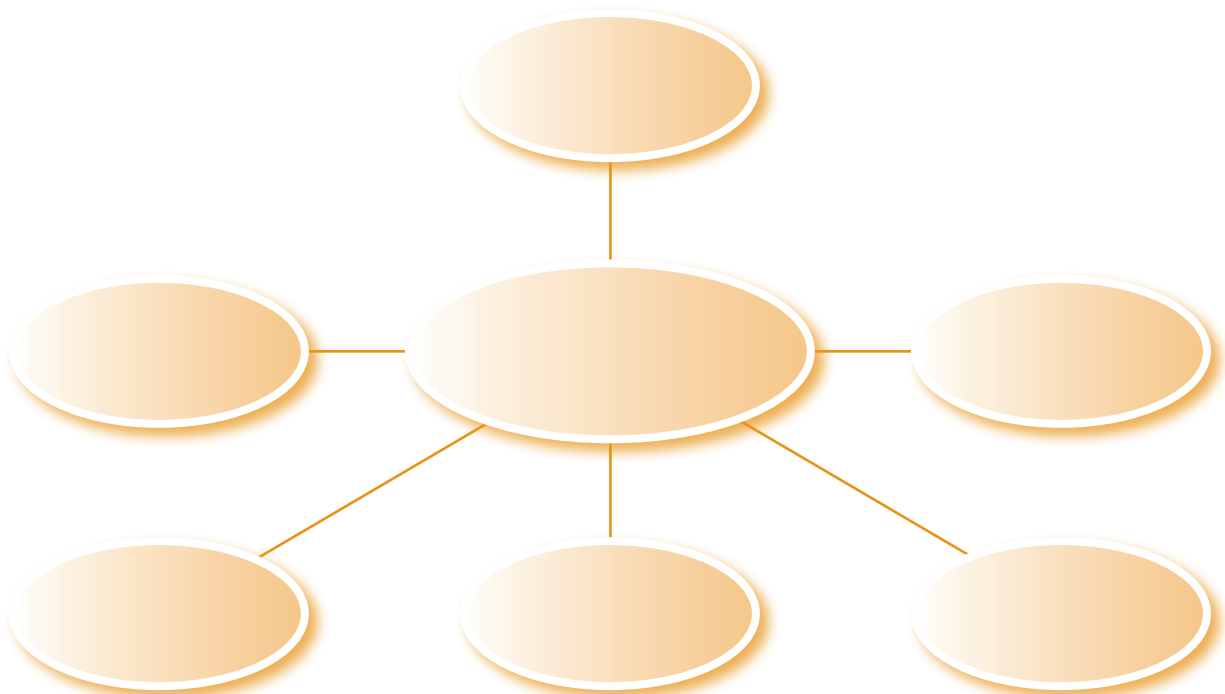
- Each diagram heading, identifying which picture represents stakeholder primacy and which picture represents shareholder primacy.
- Each shape in the diagram, identifying who or what belongs in each shape.

BCE INC. v. 1976 DEBENTUREHOLDERS: ACTIVITY 1

PRIMACY



PRIMACY



STUDENT RESOURCES



BCE INC. v. 1976 DEBENTUREHOLDERS: ACTIVITY 1

PART B: LOOKING AT BOTH SIDES OF THE ISSUE

- In groups, write a letter to the Board of Directors of BCE in which you state your case for either shareholder primacy or stakeholder primacy. Your letter should include arguments that support your claims. Use the chart below to organize your thoughts.
- The following day, exchange letters with someone from the opposing side and respond to the letter using legal arguments presented in this case. Use the chart below to organize your thoughts.

ARGUMENTS FOR SHAREHOLDER PRIMACY	ARGUMENTS AGAINST SHAREHOLDER PRIMACY
ARGUMENTS FOR STAKEHOLDER PRIMACY	ARGUMENTS AGAINST STAKEHOLDER PRIMACY

STUDENT RESOURCES

BCE INC. v. 1976 DEBENTUREHOLDERS: ACTIVITY 1

PART C: DEBATING THE ISSUE

Hold a class debate on the issue of whose best interests directors should be acting on behalf of, (i.e. stakeholder primacy or shareholder primacy). This can be done in small groups or by dividing the entire class in half. Refer to the exercises you completed for Part A and Part B to help you prepare your arguments and anticipate those of the opposing side. Prepare questions and rebuttals accordingly.

Debate Proposition: Corporate directors should be acting on behalf of all stakeholders in society, including shareholders, employees, creditors and society at large.

Debate Structure: One team argues in support of the proposition and one team against it.

1. The supporting position presents their arguments (5-7 minutes)
 - Give a good introduction that gets the opposing team's interest and attention
 - State your main points, giving evidence and reasoning for your arguments
 - Give a strong conclusion
2. The opposing position questions the supporting position (3-5 minutes)
 - Ask questions about the supporting team's position
 - Prepare questions to challenge them in advance
3. The opposing position presents their arguments (5-7 minutes)
 - Give a good introduction that gets the supporting team's interest and attention
 - State your main points, giving evidence and reasoning for your arguments
 - Question the supporting position
 - Give a strong conclusion
4. The supporting position questions the opposing position (3-5 minutes)
 - Ask questions about the opposing team's position
 - Prepare questions to challenge them in advance

5. The supporting position presents their rebuttal (5 minutes)

- Restate and strengthen your position
- Identify how your argument is stronger than the opposing position
- Summarize your case and give a strong conclusion

6. The opposing position presents their rebuttal (5 minutes)

- Restate and strengthen your position
- Identify how your argument is stronger than the supporting position
- Summarize your case and give a strong conclusion

BCE INC. v. 1976 DEBENTUREHOLDERS: ACTIVITY 2

THE COURT APPROVAL PROCESS

In deciding this case, the SCC assessed if the oppression remedy under s. 241 of the *CBCA* should apply, and also whether the takeover arrangement was “fair and reasonable” under s. 192 of the *CBCA*.

In assessing whether the takeover arrangement was “fair and reasonable,” the court reviewed section s. 192 of the *CBCA*, which sets out a court approval process for complex corporate arrangements. The purpose of this section is to permit major changes in a corporation’s structure, while ensuring that security holders whose rights may be affected are treated fairly.

To be approved, a company making an application (in this case, BCE) must prove the following three requirements:

1. That statutory procedures have been met.
2. That the application has been put forward in good faith.
3. That the arrangement is fair and reasonable:
 - The arrangement must have a valid business purpose
 - The arrangement must balance the rights of parties affected in a fair manner.

ROLE PLAY

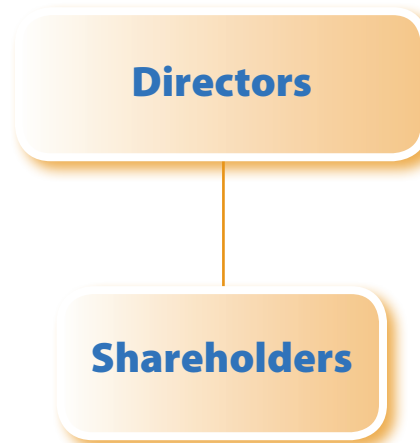
The *BCE Inc. v. 1976 Debentureholders* decision has just been released, and you are the CEO of Bradshaw Corp., a company considering a merger very similar to the one BCE was considering. You have read the decision but do not fully understand the court approval process under s. 192 of the *CBCA*. You have decided to have a meeting with your lawyer, who is very familiar with this case, and have asked him/her to explain what is included in s. 192 of the *CBCA*, the SCC’s decision and what it may mean for Bradshaw Corp.

With a partner, write a dialogue between the CEO of Bradshaw Corp. and the lawyer, which highlights your understanding of s. 192 of the *CBCA*, the SCC’s decision on the court approval process and how it applies to Bradshaw Corp.

Once you have written your script, role play the meeting between the CEO of Bradshaw Corp. and the lawyer, for your peers.

BCE INC. v. 1976 DEBENTUREHOLDERS: ACTIVITY 1 - ANSWER KEY

SHAREHOLDER PRIMACY



STAKEHOLDER PRIMACY

