WHAT A DIFFERENCE A DEBT MAKES FOR BCE DEBENTUREHOLDERS

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In relatively unique and dramatic circumstances, the long-awaited decision of Silcoff J. of the Québec Superior Court was released at 7 p.m. (EST) on 7 March, 2008. Silcoff J.'s decision on the fate of the proposed take-over of BCE Inc. ("BCE") by way of a plan of arrangement (the "Plan of Arrangement") under section 192 of the *Canada Business Corporations Act R.S.C. 1985, c. C-44 (as amended)* (the "CBCA") was delivered in five separate judgments.

The five judgments dealt with (i) the approval of the Plan of Arrangement; (ii) a claim by CIBC Mellon Trust Company seeking relief with respect to the class of certain 1976 debentureholders; (iii) a claim by Computershare Trust Company of Canada seeking relief with respect to the class of certain 1996 debentureholders; (iv) a claim by certain individual members of the classes of 1976 debentureholders and 1996 debentureholders under the oppression remedy of the *CBCA*; and (v) a claim by certain individual 1997 debentureholders under the oppression remedy of the *CBCA*.[1]

The result of the five judgments is that the Plan of Arrangement was approved and the several claims of all of the classes of the Contesting Debentureholders were dismissed. As a result, the proposed sale of BCE to the consortium headed by the Ontario Teachers' Pension Plan Board ("Teachers") (through the nominal purchaser 6796508 Canada Inc. and referred to as the "Purchaser") can proceed.

The Contesting Debentureholders have appealed from the decision of Silcoff J. and it is impossible to be certain what the Québec Court of Appeal may decide, though the reasons given by Silcoff J. in each judgment do not seem to offer many obviously good grounds for a successful appeal.

Of the five judgments, the most important is the first, *i.e.*, the one giving approval to the Plan of Arrangement. So long as this decision stands, reversal by the Québec Court of Appeal of, for example, judgments (iv) and (v), *i.e.*, the claims under the oppression remedy, will not affect the completion of the transaction though, if the appeals are successful, they may require adjustments in the price that will actually be paid by the Purchaser.

The Background to the Transaction

In the last quarter of 2006, rumours circulated that Kohlberg Kravis Roberts & Co. ("KKR") was planning a take-over of BCE. Michael Sabia, the CEO of BCE, was instructed by the Board of Directors of BCE (the "Board") to tell KKR that BCE was not interested in pursuing such a transaction. Other rumours circulated early in 2007. On 9 April, 2007, Teachers, the largest single shareholder in BCE, filed a "Statement of Beneficial Ownership" under Schedule 13D with the United States Securities and Exchange Commission. The effect of that filing meant that BCE was officially "in play".

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[1] The order was opposed by the 1976, 1996 and 1997 debentureholders, sometimes called the Contesting Debentureholders.

The response of the Board was to accept that it was bound by the principles described by the Supreme Court of Delaware in *Revlon Inc. v. MacAndrew & Forbes Holdings, Inc*. (506 A. 2d 173, (Del. Sup. Ct., 1986)) and "had an overriding duty to maximize shareholder value and obtain the highest value for its shareholders while respecting the contractual obligations of the Corporation and its subsidiaries". On 14 April, 2007, the Board appointed a "Strategic Oversight Committee" (the "SOC"). The SOC sought advice from both prominent financial advisers and law firms. In the end, it was determined that an auction process would be appropriate.

As part of the auction process, one of BCE's financial advisors contacted all potential purchasers and provided each potential purchaser with the bidding rules, including a description of the criteria that would be used to evaluate each bid, and a form of proposed transaction agreement. Potential purchasers were advised that in evaluating any bid, BCE would consider the impact that any bidder's proposed debt and equity financing arrangements would have on, among others, BCE's debentureholders.

The auction process resulted in three offers being submitted, all of which were structured to add a substantial amount of new debt for which BCE would be liable and, the court noted, would result in a downgrade of BCE's debentures to below investment grade. All of the offers respected the debentures, except those debentures with near term maturities.

The SOC and the Board met frequently before the final decision was made to accept the Purchaser's offer. That offer was to buy the shares of BCE for $42.75, a 40% premium on the market price. In evaluating the fairness of the consideration to be paid to shareholders under the Plan of Arrangement, the Board and the SOC received a total of five opinions from their various financial advisors. The Board and the SOC did not receive a fairness opinion in respect of any debentureholders. The definitive agreement among the Purchaser and BCE was signed as of 29 June, 2007 (the "Definitive Agreement").

The Definitive Agreement

The method chosen to implement the Definitive Agreement was to use the machinery of section 192 of the *CBCA*. Under that section, an "arrangement", *i.e.*, a proposal for the re-organization of a corporation which requires court approval, can be used where, *inter alia*, there is an exchange of securities of a corporation for money. An arrangement can best be regarded as a court approved method for completing a complicated transaction. In the case of BCE, the court's approval of the Plan of Arrangement was sought (i) to transfer all the common and preferred shares of BCE to the Purchaser in exchange for the price offered by the Purchaser, (ii) the transfer of the shares from the Purchaser to a subsidiary ("Subco") in exchange for promissory notes and shares of Subco, and (iii) the amalgamation of Subco and BCE to form BCE Amalco. Each step had to be completed in order and none could be completed unless all the others were.

BCE brought a proceeding under section 192 of the CBCA for the approval of the Québec Superior Court for the Plan of Arrangement. The order was opposed by the Contesting Debentureholders. On 10 August, 2007, the court issued an interim order requiring BCE to hold a shareholders' meeting to obtain the views of the shareholders on the transaction. A meeting of the shareholders of BCE was held on 21 September, 2007 and a resolution approving the Plan of Arrangement was passed by 97.93% of the shareholders.

The Decision to Approve the Plan of Arrangement

On 10 October, 2007, BCE moved for final approval of the Plan of Arrangement. As has been mentioned, the Contesting Debentureholders were the only parties objecting to the Plan of Arrangement. In seeking the approval of the court for the Plan of Arrangement, BCE made three general arguments: it argued (i) that the Plan of Arrangement was fair and reasonable and that significant weight should be given to the overwhelming approval of the Plan of Arrangement by BCE's shareholders; (ii) that the Contesting Debentureholders had no standing to oppose the approval of the Plan of Arrangement as they are creditors of Bell Canada, not BCE, and the implementation of the Plan of Arrangement does not affect Bell Canada, only BCE; and (iii) that the Contesting Debentureholders are in a position that is no different from any other creditor, or, indeed, the employees, suppliers and unsecured creditors of Bell Canada, none of which are given standing to vote on the Plan of Arrangement.

Silcoff J. dealt with the argument that the Contesting Debentureholders had no standing under section 192 of the CBCA by observing that a guarantee had been given by BCE and that with the increased debt which BCE would assume it would be prudent to assume that they had standing and deal with their objections rather than deny them the opportunity to make their case.

The crucial question faced by Silcoff J. under section 192 of the CBCA was whether the Plan of Arrangement was "fair and reasonable". (page 26) This requirement is not expressly stated in the *CBCA* but is an important consideration in the Policy Statement (Policy Statement 15.1) issued by the Director (a civil servant appointed by the Minister of Industry) to perform various administrative functions under the CBCA. Silcoff J. accepted the statement of the Director in section 4.01 of the Policy Statement:

> **4.01** The Director believes that in addition to demonstrating compliance with the judicial requirements [of the Act] … and statutory and court-ordered procedural requirements (including those designed to ensure procedural fairness), *there rests with the applicant proposing an arrangement an onus to demonstrate that the proposed arrangement is fair from the perspective of the security holder constituencies whose rights are affected by the arrangement*.
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> (Emphasis added by Silcoff J.)

Silcoff J. held that, from the perspective of the shareholders, the Plan of Arrangement was fair and reasonable. Among the factors justifying this conclusion were the premium paid to the shareholders, their overwhelming approval of it, the actions of both the Board and the SOC and the fairness opinions obtained by the Board. Specifically, Silcoff J. commented that:

> [146] The Court is particularly impressed by the fact that the shareholders approved the Plan of Arrangement by a majority of some 97.93%. Although, in and of itself, these results do not bind the Court, they are, at the very least, indicative of the acceptance by the shareholders of the wisdom, sincerity and good faith of the SOC and the Board in recommending the approval of the Plan of Arrangement.

> [147] Moreover, there is no evidence whatsoever susceptible of creating any reasonable doubt in the minds of an informed investor in that regard. The 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.

In dealing with the specific question whether the Plan of Arrangement was fair and reasonable with respect to the Contesting Debentureholders, Silcoff J. relied on his reasons for judgment in dismissing the two applications brought by the Contesting Debentureholders under the oppression remedy. The broad test (sub-section 241(2) of the *CBCA*) of the actions of a corporation, its board or a majority shareholder that is applied to determine if they are oppressive of a shareholder or creditor is whether the acts are "oppressive or unfairly prejudicial to or that unfairly [disregard] the interests of any security holder".

In applying this test to the claims of the Contesting Debentureholders, he said: (para. 162)

> [199] There is no serious evidence that the rights of the Contesting Debentureholders were disregarded by the BCE Board, let alone unfairly disregarded. On the contrary, the evidence discloses that their rights were in fact considered and evaluated. … accordingly, the Contesting Debentureholders could not reasonably expect BCE to reject a transaction that maximized shareholder value, on the basis of any negative impact [on] them.

The Contesting Debentureholders argued that the decision of the Supreme Court of Canada in *Peoples Department Stores Inc. (Trustee of) v. Wise*, [2004] 3 S.C.R. 461, 244 D.L.R. (4th) 564 ("Peoples"), has made the *Revlon* test inapplicable in Canada. While the Supreme Court in Peoples rejected the argument that the "best interests of the corporation" meant only the best interests of the shareholders, it held that the phrase required consideration of the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment.

Silcoff J. said, quoting his own reasons for judgment:

> [203] Contrary to the views expressed by the Contesting Debentureholders, the Court finds that the ruling in *Peoples* is not necessarily incompatible with the application of the *Revlon Duty* by the BCE Board in accepting Purchaser's offer. Given all the circumstances, the Court is satisfied 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. The sole fact that the shareholders stand to benefit from the transaction while the debentureholders are prejudiced, in and of itself, does not give rise to a conclusion that the directors have not performed their fiduciary duties to the corporation in an appropriate manner.

Silcoff J. concluded that it was in the best interests of BCE that the Plan of Arrangement be approved.

Conclusion

The Contesting Debentureholders faced several hurdles in making their case that the Plan of Arrangement unfairly disregarded their interests. First, while BCE had guaranteed the obligations of Bell Canada to them, they were not creditors of BCE but of Bell Canada and the Plan of Arrangement had no formal effect on Bell Canada. Second, the wording of the trust indentures did not deal with a "change of control" so that the Contesting Debentureholders had no claim for breach of the terms of the trust indentures. Third, in its essence, the claim of the Contesting Debentureholders was little more than a complaint that, since the shareholders were doing so very well under the Plan of Arrangement, it was only fair that they too should share in the bounty.

It was not hard for the court to reject the last argument. The most important aspects of the several judgments are the following:

- the Board behaved in an exemplary fashion. It was not only a largely independent board but it appointed a very capable SOC;
- that the SOC and the Board obtained fairness opinions with respect to the offer made to the shareholders. (The fact that no such opinion was sought with respect to the Contesting Debentureholders was a reflection of the fact that, as Silcoff J. held, they had no real basis for a claim that they had been treated badly);
- the Board and the SOC successfully obtained competing bids for BCE and, consistent with their obligations, chose the one that maximized shareholder value;
- Silcoff J. accepted that the *Revlon* test, as perhaps qualified by the decision of the Supreme Court in *Peoples*, applied and that the principal duty of the Board was to seek to maximize shareholder value, though not at the unfair or unreasonable expense of the other stakeholders identified by the Supreme Court; and
- finally, in balancing the claims of BCE to have the Plan of Arrangement approved and the Contesting Debentureholders to oppose it, Silcoff J. made it clear that the Board would not have been doing what it should if it had allowed the claims of the Contesting Debentureholders to trump an arrangement so obviously beneficial to the shareholders. That judgment was also reflected in his approval of the Plan of Arrangement.