

A RAZOR'S EDGE: DIRECTORS' DUTIES IN A TIME OF ECONOMIC UNCERTAINTY

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In a recent case, *BCE Inc. v. 1976 Debenture Holders*, the Supreme Court of Canada has provided a useful summary of directors' duties during times of fundamental change within a corporation. This decision is of particular interest to directors and shareholders in public and privately held companies who are confronted with challenging strategic decisions in the current economic crisis. In the Summer and Winter 2007 issues of *Letter of the Law*, we discussed statutory remedies that offer shareholders the ability to protect their interests in a company. In British Columbia (and in most of the rest of Canada), this allows claims to be advanced against conduct within a company that is "oppressive" or "unfairly prejudicial" to shareholders. In the *BCE* case the Court clarified the law regarding the oppression remedy.

The case arose out of an offer to purchase all of the shares of BCE Inc. by a group headed by the Ontario Teachers Pension Plan Board. BCE is a large telecommunications company, which wholly owns Bell Canada. The buyout was opposed by debenture-holders of Bell Canada (mostly large financial institutions) on the grounds that the increased debt contemplated by the purchase agreement would reduce the value of their debenture bonds by an average of 20 per cent and they might be forced to sell their debentures at a loss.

In response, BCE created a bidding process, which required potential purchasers to conform to bidding rules and a form of purchase agreement. Bidders were also advised that BCE would consider the impact of bids on BCE and Bell Canada debenture holders as part of the evaluation process.

All bids that were received contemplated the addition of substantial debt for which Bell Canada would be liable. The debenture-holders opposed the arrangement that was ultimately entered into (a transaction worth approximately \$52 billion) on a number of grounds, including under the oppression remedy. Although the Supreme Court was concerned with a federally incorporated company, the Court's comments are equally applicable to companies incorporated provincially in British Columbia.

The Court first discussed the nature and scope of directors' fiduciary duties. Directors are responsible for the governance of the corporation and subject to two principal obligations: a

fiduciary duty to the corporation to act honestly and in good faith *and* a duty to exercise the care, diligence and skill of a reasonably prudent person in comparable circumstances. With respect to the fiduciary duty, the Supreme Court said that this requires directors to act in the best interests of the corporation. At minimum, this requires that the corporation meets its statutory obligations. In addition, the Court stated that directors *may* also consider the interests of shareholders, employees, creditors, consumers, governments and the environment in evaluating their decisions. Courts should give appropriate deference to the business judgment of directors who take these supplementary interests into account. The Supreme Court emphasized that the extent of the fiduciary duty will always depend upon the particular situation at hand.

The oppression provision in the British Columbia *Business Corporations Act* requires that the conduct being complained about amounts to “oppression” or “unfair prejudice” and the *Canada Business Corporations Act* also requires proof of “oppression” or “unfair prejudice” as well as “unfair disregard” of relevant interests.

In the *BCE* case, the Supreme Court emphasized that the oppression remedy seeks to ensure fairness—defined as what is “just and equitable”—but it also emphasized that oppression is fact-specific. Courts must consider business realities when faced with a claim of oppression. The remedy is therefore concerned with fair treatment and protecting the reasonable expectations of affected stakeholders—including shareholders—having regard to the specific circumstances.

Given these conditions, the Supreme Court held that there are two inquiries in a claim for oppression:

- Does the evidence support the reasonable expectations asserted by a claimant?
- Does the evidence establish that the reasonable expectation was violated by conduct falling within the terms “oppression” or “unfair prejudice”?

Accordingly, it is no longer sufficient to show that a shareholder’s expectations were not met—a failure to meet expectations must also involve an element of unfair conduct.

The Court listed a number of factors as considerations in determining whether a claimant held a reasonable expectation of being treated in a certain way:

- normal commercial business practices
- the size, nature and structure of the corporation
- personal relationships between the parties

- past practice, particularly among shareholders of a closely-held corporation
- steps the claimant could have taken to protect him or herself
- representations made to shareholders and the public
- the fair resolution of conflicting interests between those with a stake in the corporation.

The Supreme Court then found that the concepts of oppression, unfair prejudice and unfairly disregarding relevant interests are separate types of wrong or conduct that the oppression remedy seeks to address. “Oppression” is the most serious wrong and is generally associated with an abuse of power. “Unfair prejudice” and “unfair disregard of relevant interests” generally involve less offensive conduct. Examples of these latter types of unfair governance include: squeezing out a minority shareholder; failing to disclose related party transactions; changing a corporate structure to drastically alter debt ratios; paying dividends without a formal declaration; preferring some shareholders with management fees; paying directors’ fees higher than the industry norm; or improperly reducing a shareholder’s dividend.

In *BCE*, the Supreme Court considered that the debenture-holders held a reasonable expectation that BCE’s directors would consider their position in making decisions on the various share offers. Indeed, the evidence was that the directors did consider the interests of debenture-holders and made a decision in difficult circumstances, based on what they believed to be in the best interests of the corporation. In the circumstances, the Court found that this did not amount to conduct that was oppressive, unfairly prejudicial, or unfairly disregarded the debenture-holders’ interests. After the Court pronounced its judgment, the purchase agreement fell apart for other reasons so the debenture holders are effectively in the same position as they were before BCE decided to auction itself off.

The *BCE* case attests that, when a corporation is faced with difficult decisions, its directors’ obligations are first and foremost to act in the best interests of the corporation. However, they also need to appreciate that they should consider other factors, including the interests of shareholders, when determining the impact of corporate decisions. In turn, shareholders also need to appreciate that decisions made by directors will not be reviewed by the courts in a void. Judges will take into account business realities—including conflicting claims, expectations and prevailing market conditions—when deciding if directors have engaged in conduct that is oppressive or prejudicial to a claimant’s interests.