The Corporate Governance Expert’s Guide to the Care and Feeding of CLO’s/GC’s in Corporate Governance & Compliance

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Board Investigations of Corporate Conduct

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1. Introduction

When serious corporate wrongdoing is suspected, the corporation's board of directors often assumes responsibility for investigating the matter. The board will first seek to determine whether the allegations are true and then what, if any, action is necessary to remediate any damage that has been done to the corporation and to prevent any further harm. The board should, however, have a much broader focus. The board should be concerned with preventing or minimizing the erosion of confidence of the corporation’s investors and customers. It should also be mindful of regulatory action that could arise if the corporate wrongdoing rose to the level of being illegal. If the regulator has confidence in the board's process, it may be prepared to rely on the work of the board rather than conduct its own investigation. If it is satisfied that the board has remediated the problems and put the corporation on a path that promotes compliance, the regulator may even conclude that there is nothing to be gained from imposing sanctions on the corporation.

The way in which the board handles the investigation is critical. An investigative process that is poorly conceived and executed is not only unlikely to meet the objectives described above, it can itself do a great deal of damage to the corporation – and to the reputations of the directors involved in the investigation. This paper deals with the elements of an effective board-led investigation.

2. Recent Examples of Investigative Committees

In recent years, there have been a number of public examples of board investigations – both successful and unsuccessful. In this section, we describe several of these situations, in order to provide some context for the discussion of effective processes for investigative committees. We have also included a description of a recent investigation into wrongdoing at the RCMP, because of the important lessons we learned through our role in that investigation.

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2 The facts set out in this section were taken from the public record.

3 David Brown was the Independent Investigator for the Minister of Public Safety and the President of the Treasury Board with a mandate to examine certain questions and make certain recommendations relating to
(a) CP Ships

CP Ships’ problems began in 2004, when it failed to disclose that financial statements for the two previous years and for 2004 would have to be restated. The situation escalated when allegations were made that company insiders traded in shares of CP Ships while in possession of other non-disclosed information.4

A special committee of the Board (the "CP Ships Committee") chaired by Peter Dey was established in 2004. The CP Ships Committee was charged with responsibility for investigating the circumstances surrounding the restatement of the financial statements of the Corporation for the years 2002, 2003 and the first quarter of 2004 and stock trading activities by certain officers in May and June 2004. The committee was also charged with overseeing the defence against class action law suits filed following the restatement and with liaising with regulators. The CP Ships Committee and the process it followed is credited with saving the corporation from any regulatory sanction beyond a warning with respect to its disclosure.

(b) Hewlett Packard

In 2006, Hewlett Packard faced regulatory scrutiny and adverse publicity when an independent investigator was hired to look into information leaks at the board level. The scenario began in 2004 when the board began to discuss the future of then CEO Carly Fiori. Those discussions leaked from the boardroom in early 2005. In an effort to determine where the leaks originated from, board chair Patricia Dunn hired a private investigator. The results of the investigation were presented to the board in May 2005, identifying one of the members of the board as being the source of the leak.

The controversy surrounding this investigation related not to the leak, but to the methods used by the private investigator to identify the source of the leaks. The investigator used a technique referred to as "pre-texting" to obtain personal phone records of certain members of the board. Whether the practice of pre-texting was illegal at the time, a strong sense emerged that it was at least highly inappropriate. Hewlett Packard became mired in a number of civil and regulatory actions, including with the Attorney General of California, the Justice Department, the Securities and Exchange Commission and the Federal Communications Commission. Among other things, the resulting scandal led to the resignation of board chair Patricia Dunn.

(c) Nereus Financial Inc.

In Ellins v. Coventree Inc.5 it had come to the attention of the CEO of Nereus Financial Inc. that its controlling shareholder might be in breach of the shareholder agreement that precluded that shareholder from engaging beyond a certain level in the area of business identified as belonging to Nereus. Of the seven members of the board, two were nominees of the controlling shareholder, one was nominated by the minority shareholders, one was the CEO and three were

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4 The OSC estimated that those insiders avoided losses of nearly $1.5 million through their trades.

fully independent directors. Over the objections of the controlling shareholder and the CEO, the board resolved to establish an investigative committee (the "Nereus Committee") to review breaches of the Shareholder Agreement. The facts of the case made it inappropriate for the nominees of either shareholder group or the CEO to sit on the investigative committee. That committee was ultimately constituted with two of the three independent directors. The court accepted the recommendation of the Nereus Committee that the corporation proceed to litigation on the basis of failure of the controlling shareholder to comply with the shareholder agreement.

(d) Hollinger International

In 2003, one of Hollinger International's largest stockholders, Tweedy Brown Company, LLC, demanded that the board investigate over $70 million in non-competition payments to Conrad Black and other members of management in connection with the sale by Hollinger International of certain of its assets. Because the Tweedy Brown letter complained not only about the payments, but also about the role of the board in authorizing those payments, a new director, Gordon Paris, became a one-person committee formed to investigate Tweedy Brown's concerns. Raymond Seitz and Graham Savage were recruited to join the board a short time later and they were added to the committee.

The Hollinger Committee retained Richard Breeden as its counsel and ultimately made public a report that described management at Hollinger International as a "corporate kleptocracy". It concluded, among other things, that payments of over $30 million had been made by Hollinger International without appropriate approval. Following the release of its report, the Hollinger Committee negotiated with Lord Black both over how to deal with its findings and the conditions under which a strategic process would be undertaken by Hollinger International. The resulting "Restructuring Proposal" contemplated a number of actions to repay Hollinger International for the amounts that had been improperly paid out, to amend or terminate certain management arrangements between Hollinger International and entities controlled by Lord Black and to ensure board involvement in the strategic process.

The Restructuring Proposal began to unravel almost immediately – Lord Black reneged on his covenant to repay certain amounts he had received on account of non-competition payments. He also took a number of steps that undermined the restructuring process. These and other aspects of Lord Black's relationship with Hollinger International have resulted in a variety of civil, regulatory and criminal actions. At the time this paper was completed, Lord Black had been convicted by an Illinois court of various criminal counts relating to these matters and Hollinger International had filed for bankruptcy protection.

(e) Nortel

Nortel Networks Corp enjoyed tremendous product and capital markets success throughout the 1990s. As conditions in the technology sector began to weaken, problems with Nortel's accounting began to emerge. Despite optimistic forecasts by management throughout 2000 and 2001, Nortel was forced to implement a company-wide restructuring program that included firing two-thirds of its global work force. CEO John Roth stepped down in November 2001 and was succeeded in that position by the chief financial officer Frank Dunn. Mr. Dunn led a return-to-profitability bonus plan designed to encourage employees to meet established targets. This
plan, combined with market conditions that were continuing to deteriorate, led to more accounting problems.\(^6\)

In late July 2003, Nortel's auditor reported to the board that it had found problems with the use of accounting reserves. The board ordered an internal review, which ultimately led to a $948 million restatement later that year. In early 2004, the audit committee (the "Nortel Audit Committee") hired independent investigators to review Nortel's accounting. Mr. Dunn and a number of other finance executives were fired several months later.

The summary report of the Nortel Audit Committee's independent investigators was disclosed publicly. That report recommended a number of remedial measures, all of which were adopted by the Nortel Audit Committee. In May 2007, Nortel reached a settlement with the OSC. Under the terms of the settlement, Nortel agreed to pay $1 million in costs, but was not required to pay any penalty. The OSC said that a financial penalty would not act as a deterrent at this point in time and would penalize the company for the past conduct of former executives. The Settlement Agreement commented favourably on the work of the Nortel Audit Committee. On October 2007, Nortel reached a settlement with the SEC in which Nortel agreed, among other things, to pay $35 million civil penalty. In the settlement agreement, the SEC also commented favourably on Nortel's process in investigating the restatement issues and reporting to the regulators.

(f) Oracle

The facts in the Oracle decision\(^7\) arose from allegations that four officers and/or directors of Oracle had engaged in insider trading by selling some of their shares in Oracle prior to an unfavourable earnings announcement. The four individuals named were Michael J. Boskin (a director), Lawrence J. Ellison (Chairman and CEO), Jeffrey O. Henley (CFO and a director) and Donald L. Lucas (a director and Chairman of Oracle's Executive Committee).

Certain stockholders of Oracle initiated a derivative action.\(^8\) In order to satisfy the board's obligations with respect to the derivative action, two of the directors were asked to form a special

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\(^6\) In its settlement agreement with the OSC, Nortel agreed that at various times in 2000, 2002 and 2003, the emphasis by former members of Nortel's senior corporate finance management on meeting revenue and/or earnings targets led to a culture within the finance organization of Nortel that condoned certain inappropriate accounting practices which did not comply with applicable GAAP and were contrary to the public interest.

\(^7\) In Re: Oracle Corp. Derivative Litigation 824 A.2d 917 (Del. Ch. 2003). The nature of the relief sought in this case is not relevant for the purposes of this paper. As described in the decision: "[t]he Oracle stockholders who file this action as derivative plaintiffs now seek to dismiss this action voluntarily, over the objections of Oracle's 'Special Litigation Committee', which has been empowered to investigate and decide whether to prosecute this action. By their dismissal motion, the moving derivative plaintiffs do not hope to terminate all litigation relating to the claims asserted in this action. Rather, the 'Delaware Derivative Plaintiffs' seek to dismiss only this case, leaving derivative actions involving the same subject matter pending in the state and federal courts of California."

\(^8\) When stockholders wish to commence a derivative action, they must first advise the board that they believe that an action should be commenced in the name of the corporation. The board then determines whether it believes that action is merited. If the board agrees with the plaintiff stockholders, the corporation launches the action. If the board does not agree, then the plaintiffs may pursue the matters in the name of the corporation themselves.
committee (the "Oracle Committee") to consider whether Oracle should take action against the named insiders. The Oracle Special Committee concluded that the insiders did not have material non-public information at the time of the sales and took steps to terminate the derivative action.

The two members of the Oracle Committee were both professors at Stanford University. Each of the three directors accused of trading with inside information also had ties to Stanford University. One was another Stanford professor who had taught one of the members of the Oracle Committee as a Ph.D. candidate and served with that member of the Oracle Committee on a committee at Stanford. Another was a major fundraising contributor to Stanford for whom a conference facility at that university had been named. The third was Oracle's CEO, who had made significant donations to Stanford (both personally and through Oracle) and who was contemplating further major donations at the time the two members of the Special Committee joined the board.

Vice Chancellor Leo Strine Jr. of Delaware's Court of Chancery denied the motion of the Oracle Committee to dismiss derivative claims brought by Oracle stockholders on the basis that the Special Committee had failed to establish its independence:

In the absence of a finding that the SLC was independent, its subjective good faith and the reasonableness of its conclusions would not be sufficient to justify termination. Without confidence that the SLC was impartial, its findings do not provide the assurance our law requires for the dismissal of a derivative suit without a merits inquiry.  

(g) YBM Magnex

YBM was a TSX listed company, with its head office in Newtown, Pennsylvania. In August 1996, YBM's board became aware of suspicions on the part of U.S. federal authorities that YBM was connected to an organized crime syndicate in Russia and that it had falsified its financial statements and customer lists to disguise the fact that it was not engaged in any legitimate business. YBM's board of directors struck a special committee to investigate these suspicions. By April 1997, the YBM Special Committee had concluded, among other things, that there was no evidence to tie senior management or any of YBM's original shareholders to any wrongdoing, although it recommended a number of changes to YBM's operations and controls. Later that year, YBM sold securities to the public without disclosing in the prospectus that YBM was under investigation or providing any information about the YBM Special Committee's mandate, the information it had received or its recommendations. Six months after YBM closed its public offering, U.S. authorities raided YBM's Newtown, Pennsylvania office and the Commission cease traded YBM's shares. In 1999, YBM pleaded guilty to conspiracy to commit fraud in the United States. In the context of the settlement of a civil action relating to these events, an Ontario court estimated that persons who acquired YBM shares in the 1997 offering lost more than $100 million and persons who had traded those shares in the secondary market lost more than $250 million.

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10 The facts of the YBM matter set out here are drawn from the OSC decision relating to YBM.
The OSC decision into this matter was critical of many aspects of the composition and process of the YBM Special Committee. Among other things, the chair of the YBM Special Committee was barred from being a director or officer of a public company for five years.

(h) RCMP Investigation

In 2003, allegations of mismanagement of the RCMP pension plan came to the attention of senior management of the RCMP. While then Commissioner Zaccardelli initially dealt with the allegations appropriately by ordering an internal audit, the process ultimately broke down when he failed to respond fully and in a timely manner to findings of that audit. Several of the individuals who had brought the matter to the attention of senior management and continued to push for more complete action were punished for their role, as was one member of the RCMP who was involved in the investigation of the matter.

The RCMP is an agency of the Federal Ministry of Public Safety and Emergency Preparedness. The federal government appointed David Brown as the Independent Investigator into matters relating to the RCMP pension and insurance plans. The report of the Independent Investigator found that the response of RCMP management to the issues in the pension and insurance plans had been neither complete nor timely. The report went further, however, concluding that events investigated had revealed a governance structure and culture that needed an overhaul.

Shortly after the report was released, the chief financial officer (who had ultimately been responsible for the controls that had proven to be inadequate) resigned. The five individuals who were instrumental in pursuing the issues were recognized for their contribution. The federal government accepted all of the recommendations of the Independent Investigator, including the appointment of a task force to deal with the governance and cultural issues identified as a result of the investigation.

3. Formation of an Investigation

(a) Factors Requiring Board Involvement in an Investigation

Most well-run corporations regularly test their compliance with legal obligations and corporate policies. Where breaches are identified, more detailed reviews may be conducted and remedial action taken. In many cases there is no special role for the directors in the conduct of their review (other than through the performance of their regular oversight function).

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11 (2003), 26 O.S.C.B. 5285 [YBM].
12 Allegations subsequently emerged about mismanagement in the RCMP insurance plan.
14 Guiliano Zaccardelli, the Commissioner of the RCMP during the relevant period, had resigned in December 2006 as a result of the testimony he had provided to a parliamentary committee in connection with the Arar affair.
15 David Brown was appointed to Chair the Task Force. The other members of the task force are Richard Drouin, Linda Black, Norman Inkster and Larry Murray. Carol Hansell is counsel to the task force.
Event driven investigations are also not unusual. Complaints of sexual harassment or other allegations of improper conduct raised through a corporation's whistle blowing process may prompt an internal investigation, for example. In many cases, these investigations are appropriately handled by management, with no need for outside, independent advice or any active involvement on the part of the board. For example, where neither the CEO nor the CEO's direct reports are implicated in the conduct being investigated, it is often appropriate for the investigation to be run by the corporation's general counsel (or another member of management in conjunction with the corporation's regular outside counsel).

There are, however, situations in which board involvement is desirable – even required. Where the situation is franchise threatening, the board must be closely involved (although it need not necessarily lead the investigation). Certainly where senior management is implicated, the investigation must be led by the board. Certainly, where regulators may be interested in the events at issue, it will be important that the investigation bear the imprimatur of the board.\(^\text{16}\)

When board investigation is called for, the nature of the independent directors' relationship to the corporation puts them in a position to both protect the interests of the corporation and to build trust with the corporation's investors, customers, regulators and other stakeholders. The fiduciary duty that underpins all aspects of directors' relationship with the corporation will drive them to look for ways to isolate and stop the offending conduct, deal with the wrongdoers and ensure that the corporation is moving forward. It will be in the corporation's interest to avoid regulatory and judicial sanctions and so the independent directors will seek to demonstrate to the authorities that the corporation has been reformed and that sanctions would at this point serve no purpose. The credibility that the independent directors bring to the investigative process comes in part through the skills, expertise and reputation that they each bring to the boardroom. Their credibility is enhanced by the fact that they are intimately familiar with the corporation and its management team, meaning that they are the most likely people to understand where the corporation's weaknesses are and, therefore, how the impugned conduct could have arisen. At the same time, however, they are sufficiently removed from the day-to-day operation of the corporation's business to be objective in their assessment of the findings of the investigation.

One should not be blind to the systemic conflicts inherent in board-led investigations, however. The board is an oversight body, but it is very much a part of the organization it serves. Even directors who have had no involvement in, or even knowledge of, the wrongdoing may be enough a part of the fabric of the organization that it is difficult for them to see clearly the cultural issues that allowed the conduct complained of to take place. Moreover, most directors will generally anticipate a long-term relationship with the corporation – and its management team. There may therefore be resistance to compromising those relationships. Finally, directors often have an instinct to avoid criticism (personally and for the corporation). Unless these systemic conflicts are properly managed, they can compromise the investigation and its results.

(b) Need for a Committee

When it has become clear that the board should take charge of an investigation, a committee of the board is typically struck to handle the investigation on behalf of the board. These

\(\text{16}\) This is discussed in greater detail in Section 5 of this paper.
committees are often called special committees or independent committees, largely to distinguish them from standing committees of the board, such as the audit committee or compensation committee. For the purposes of this paper, in order to differentiate committees struck to oversee an investigation from special or independent committees established for other purposes (such as related party transactions, change of control transactions or CEO searches), we refer to "Investigative Committees".17

There are a number of reasons for striking an Investigative Committee, rather than having the investigation handled by the full board. As discussed below, there will be independence issues that will preclude certain members of the board from participating in the process. However, even if all members of the board qualify as independent, the process becomes unwieldy if all directors participate in the process. Meetings will be held frequently and on short notice, often making it impossible to find a time when all members of the board can attend. It is much more practical to assign the responsibility for the investigation to a committee of directors who operate within the parameters of a mandate established by the board, reporting back to the full board at regular intervals and presenting the result of its work to the board with a recommendation on action that should be taken.

In some cases, it may be appropriate for an existing committee of the board to undertake an investigation. Typically, for example, the audit committee will be responsible for investigations into financial statement problems. This was the case, for example, when Nortel announced its first restatement (of approximately $900 million of liabilities carried on its June 30, 2003 balance sheet). Concurrent with this announcement, the Nortel Audit Committee initiated an independent review of the facts and circumstances that led to that restatement.

An argument can be made that the committee responsible for the area in which problems have been identified is itself in a conflict of interest in investigating the events at issue. For example, where a problem surfaces with respect to executive compensation matters, the compensation committee may be exposed to criticism for allowing the problem to develop. Where this is the case, other independent directors should be called upon to oversee the investigation. This will help to avoid the potential for the investigation to be tarnished by allegations of conflict. In some cases, there may be no clear conflict and no other independent directors with the necessary expertise to oversee an investigation effectively. Where this is the case, the committee and its advisors should be extremely sensitive to the potential for and perception of conflict that may compromise the confidence that important stakeholders have in the investigation.

When an existing committee of the board investigates past corporate conduct, it is important to revisit the composition of that committee to ensure that none of the members of that committee is conflicted. This occurred, for example, when Research in Motion started its internal investigation into possible backdating of options. It first announced that the investigation would be undertaken by its audit committee. Subsequently, it announced that two of the members of that committee were conflicted because of the possibility that they had received backdated options and would therefore not participate in the investigation.

17 We are also distinguishing Investigative Committees from what are often referred to as "Litigation Committees" – board committees struck to oversee the conduct of a particular law suit.
(c) Size of Committee and Selection of Committee Members

The number of directors who will sit on the Investigative Committee will vary. Like most committees, an Investigative Committee is typically comprised of at least three directors (although there is no requirement that requires three directors). One or two additional directors may be added, although the board should be mindful of constituting a committee that is so large that scheduling meetings becomes difficult.

How does a board determine which of its independent directors should sit on an Investigative Committee? A determination must be made about which of the independent directors has the time and aptitude for the assignment. Directors who are employed on a full-time basis may find it difficult to extricate themselves from their daily responsibilities to devote themselves to the work of the Investigative Committee. Directors who are retired may have other commitments that restrict their flexibility. Each director who agrees to serve on the Investigative Committee must understand the time demands involved in the assignment.

Finally, the characteristics that make an individual an attractive candidate for the board do not necessarily make that person suitable to serve on an Investigative Committee. Directors vary in terms of experience and quality of judgment. Directors who have had some experience with internal investigations can be very helpful.

(d) Independence of the Committee

The independence of the members of the committee from the matters that are under investigation is critical to the ability of an Investigative Committee to discharge its responsibilities and to the board to rely on the work of the Investigative Committee. It is important to note that the concept of "independence" for the purposes of the Investigative Committee may be different from the standards of independence used for the purposes of establishing independence of the board for regulatory purposes. Regulatory policies are based on independence from management – the purpose being to have boards established that are capable of establishing independent oversight over management.

Where a board-led investigation is required, it is quite likely that directors who are not considered independent of management will not be eligible to serve on the Investigative Committee. However, others may also be disqualified. The 2003 decision in Oracle discussed in Section 1 above is an important example. The OSC decision of the Ontario Securities Commission in YBM the same year provides another example. The YBM Special Committee was chaired by Owen Mitchell, who was a principal of the investment banking firm of First Marathon. First Marathon earned fees both on the transaction that gave rise to YBM's need for financing as well as on the public financing itself. The OSC concluded that the board could not rely on the work of the YBM Special Committee.

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18 Governance regulations in the United States and Canada require that audit committees have no fewer than three members. In Canada, National Policy 58-201 recommends (and in the United States, the New York Stock Exchange requires) that compensation committees and nominating committees also be comprised of no fewer than three directors.

The OSC found that Mr. Mitchell was in a position of conflict as a result of his dual role – Chair of the Special Committee and underwriter. The OSC stated several times that it took no issue with Mr. Mitchell's integrity. Although it did not view his conflict as a matter of intention or a lack of good faith, it did find that it compromised both his time and his judgment. The Commission also noted that Mr. Mitchell had a loyalty to his employer and the underwriting syndicate (in contrast to his loyalty to YBM). This made it difficult for Mr. Mitchell to establish that the disclosure recommended by the committee constituted full, true and plain disclosure. It found evidence indicating that Mr. Mitchell's conflict adversely affected his judgment (for example, he gave a copy of the forensic report to his employer, but not to the board or to the co-lead underwriter).

(e) Duties and Liabilities of Directors on the Committee

The duties of directors who sit on an Investigative Committee are no different from their duties in any other aspect of the responsibilities as directors. They must act in accordance with their fiduciary duty and duty of care.

The fiduciary duty requires each director to "act honestly and in good faith with a view to the best interests of the corporation". This can be quite a complex concept. Conflicts of interest present the greatest challenge to directors being able to discharge their fiduciary duty when they serve on an Investigative Committee. A director's fiduciary duty prohibits the director from preferring the interests of another person (including his or her own interests) to the interests of the corporation. It is therefore not open to the members of the Investigative Committee (or the board) to protect wrongdoers at the expense of the corporation. While it is not impossible for directors who have a conflicting interest to nevertheless act in the best interests of the corporation, the courts do not extend the benefit of the business judgment rule to decisions made by directors who have any interest in the decision. Thus the members of the committee must be free of any interest in the outcome of the investigation, other than the best interests of the corporation.

The duty of care requires each director to exercise the "care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances". This generally requires that directors obtain sufficient information and advice to be able to form a reasoned judgment and take the time to independently examine that information and advice thoroughly. Retaining appropriately qualified and independent counsel (who may in turn retain qualified forensic experts) is critical to discharging the duty of care. The members of the Special Committee must review the advice received critically and ask questions as necessary to satisfy themselves about the advice on which they are relying.

The courts in Canada will generally not substitute their own business judgment for that of the directors of a corporation if the directors acted in a manner consistent with their fiduciary duty and duty of care in reaching their decision. This "business judgment rule" shields the decisions of directors from judicial second-guessing if those business decisions were made honestly, prudently, in good faith and on reasonable grounds. As one court said, "... in such cases, the board's decisions will not be subject to microscopic examination and the court will be reluctant
to interfere and usurp the board of directors' function in managing the corporation". However, the business judgment rule does not inhibit regulators from taking issue with decisions made by a board. They will not defer to the work of the committee if they disagree with the judgments made.

Directors often wonder if their exposure to liability increases when they agree to sit on a committee. All directors are subject to the same duty of care. However, as discussed above, that duty takes into account the circumstances within which the director was operating. The circumstances in which members of the Investigative Committee operate are necessarily different from those of directors not on the Investigative Committee. For example, members of the Investigative Committee will have access to more information than will other directors, since only what the Investigative Committee considers material or relevant will be reported to the Board. Members of the Investigative Committee will also have closer contact with the advisors retained to advise the Investigative Committee and will have a different time frame within which to consider the information presented to them. Accordingly, although members of the Investigative Committee will be subject to the same duty of care as all other directors, they may attract more criticism, and even liability, because of their proximity to the issues under investigation.

In the YBM decision, the OSC held some, but not all, of the directors responsible for the deficiencies in the public disclosure. Not all directors stood in the same position. The OSC noted that more may be expected of persons with superior qualifications, such as experienced businesspersons. When dealing with legal matters, more may also be expected of a director who is a lawyer, because that person may be in a better position to assess the materiality of certain facts. Due to improved access to information, more may also be expected of directors serving on a special committee or on the audit committee. An outside director who takes on committee duties may be treated like an insider director with respect to matters that are covered by the committee's work. This is consistent with the OSC decision in Standard Trustco. Much of the OSC's discussion in that decision focused on the audit committee and the role it played in the events leading up to the release of inaccurate financial statements. The OSC had the following comments about the performance of the audit committee:


21 The YBM decision also noted that more may be expected of inside directors than outside directors. A CFO who is on the board may be held to a higher standard than one who is not, particularly if the CFO is involved in the matter at issue (in the YBM decision, the public offering).

22 Owen Mitchell, the chair of the Special Committee, first became involved with YBM two years before he joined the board. Through his employer, First Marathon, he had acted as agent when YBM raised funds through the sale of special warrants. The OSC found that he (along with YBM's outside counsel) possessed the greatest knowledge of the mandate, information obtained by and findings of the Special Committee. In addition, he was familiar with and experienced in the performance of his responsibilities regarding disclosure. As such, he was in a position similar to that of an inside director. The OSC issued an order prohibiting Mr. Mitchell from acting as a director of a reporting issuer for a period of five years and ordered him to pay costs of $250,000.

The members of the audit committees bore somewhat more responsibility than the other directors for what occurred at the July 24 directors’ meetings because they had a greater opportunity to obtain knowledge about and to examine the affairs of the companies than the non-members had and, consequently, more was expected of them in respect of overseeing the financial reporting process and warning other directors about problems.24

Directors may protect themselves from liability in three basic ways: appropriate diligence, indemnities and insurance. This paper outlines the steps that a board and Investigative Committee should take in order to be able to demonstrate appropriate diligence in connection with a board-led investigation. Appropriate diligence will also be important to regulators and the court of public opinion in relying on the work of the Investigative Committee.

It is always wise for directors to revisit their indemnities and insurance when an unusual event arises – particularly when they will play a leading role in dealing with the matter. It is beyond the scope of this paper to discuss the various issues relating to indemnities, except to note that directors should have contractual indemnities that provide, among other things, for real time payment of legal expenses as they arise. This will prevent the director from having to fund a defence with the promise of reimbursement by the corporation at some point in the future. Directors should also review their directors and officers insurance to confirm that there are no gaps that would prevent the insurance from responding if the directors are sued in connection with the investigation. For example, some policies may not cover law suits by shareholders. In many cases it will be possible for additional insurance to be put in place to cover exposure that may arise as a result of the investigation.

(f) Compensation

Members of the Investigative Committee typically receive additional compensation for their work on the committee. Compensation arrangements for a director’s work on the board and on its standing committees are typically intended to cover the regular business of the board. Retainers and per diems compensate directors for their time in preparing for and attending board meetings and for staying current with matters of concern to the corporation between board meetings. Equity-based compensation arrangements (such as deferred share units) are generally intended to align the interests of the directors with the interests of the shareholders.

The additional time and risk associated with joining an Investigative Committee should entitle directors on the committee to additional compensation. The time spent on the work on an Investigative Committee varies. The number, frequency and length of meetings depends on the scope and urgency of the mandate. It is important to take into account not just the time spent in meetings, but the time spent reading through what can be quite voluminous reports and analysis presented to the Investigative Committee by its advisors.

Although the time spent on the work of the committee can in some way be calculated, or at least estimated, the additional risk assumed by members of an Investigative Committee is not susceptible of quantification. That risk arises from the possibility that a stakeholder of a corporation, or an individual who is the subject of the investigation, takes exception with some

24  Ibid. at 245.
aspect of the investigation and sues the members of the Investigative Committee. As noted above, while the responsibility for oversight of the matter ultimately resides with the entire board, investors, regulators and other stakeholders will look first to those most involved with the investigation of the matter if they are unhappy with the result. Boards may therefore wish to consider this factor in determining the appropriate compensation for service on the Investigative Committee.

There is little guidance available on the form or quantum of the compensation that should be paid to members of an Investigative Committee (or any other special or independent committee). However, a review of a number of recent publicly disclosed compensation arrangements for special committees shows compensation arrangements either in the form of single lump sum payments or a combination of retainers, per diems and/or work fees. If the remuneration is based at least in part on per diems and/or work fees, then if the investigation lasts longer than anticipated, there will likely be no reason to revisit the remuneration. If, however, the payment takes the form of a lump sum, then it may be necessary for the board to consider additional payments if the Investigative Committee ultimately spends more time on the investigation than was originally anticipated.

The amounts paid will, of course, vary with the size of the corporation, the nature of the issue and the compensation arrangements otherwise in place for the board. Retainers and per diems are often aligned with those paid in respect of standing committees of the board. As is the case for standing committees, the chair of the Investigative Committee typically receives more compensation (often through the retainer) than other members of the committee. Work fees are also often reflective of the per diem paid in respect of board meetings. Boards may consider work fees appropriate if much of the work of the Investigative Committee is likely to be done outside of board meetings. To the extent that certain members of the committee (such as the Chair), devote more time to the investigation than others, it also provides a basis on which to align compensation with contribution.

(g) Mandate of the Investigative Committee

It will be important, both for the Investigative Committee and for the board, that the board approve a mandate for the Investigative Committee that sets out the scope of its authority and provides the Investigative Committee with the resources necessary for it to discharge its responsibilities. Where the investigation is overseen by a standing committee of the board, it may already have the authority to investigate the matters in question (as may be the case for the audit committee where an issue relating to the financial statements arises). However, where the matter is significant, the committee should nevertheless keep the board closely informed.

The mandate of the Investigative Committee should describe the issue that the Investigative Committee is being asked to consider. Without clear definition in its mandate, the Investigative Committee will find it difficult to determine when it has discharged its mandate. On the other hand, without knowing in advance what the investigation will reveal, a mandate that is too specific may have the effect of unnecessarily restricting the scope of the Investigative Committee's work.
The independent investigation into the Nortel financial statement issues was overseen by Nortel's audit committee. The summary of findings of the independent review described the objective of the audit committee in connection with this matter as follows:

The Audit Committee wanted to gain a full understanding of the events that caused significant excess liabilities to be maintained on the balance sheet that needed to be restated, and to recommend that the Board of Directors adopt, and direct management to implement, necessary remedial measures to address personnel, controls, compliance, and discipline.  

The committee must be unrestricted in its access to information and resources from within the organization. The committee must in turn ensure that its advisors have unrestricted access to those resources. This would typically come through a direction from the committee to senior management to provide documentation promptly to and cooperate fully with the investigators. The Nortel Report discloses the following process:

The Audit Committee expressly directed that requested documents be promptly provided and that employees cooperate with requests for interviews; the Audit Committee instructed senior management to implement these directions throughout the Company. Over the course of the inquiry, more than 50 current and former Nortel employees were interviewed, some more than once. While the independent inquiry did not examine the work of Nortel's external auditor, Deloitte & Touche LLP, several current and former engagement partners were interviewed. Hundreds of thousands of hard copy and electronic documents and emails were collected and reviewed from corporate headquarters in Brampton, from company servers, and from key employees in the business units and in the regions.

In YBM, the OSC was critical of the Special Committee for relying on management to provide Fairfax (its forensic investigators) with information about customers and end users. Management had restricted Fairfax to electronic searches and required the searches to be completed in ten days.

Fact finding will be an important part of the Investigative Committee's function. It will need to determine whether there has been any conduct that has led to an improper depletion of corporate assets (such as theft, fraud) or that violates social norms (such as harassment). If such conduct has occurred, it must determine who was responsible and whether it is still going on. From a process perspective, the mandate should set out how the committee will be run administratively. It may not be appropriate for the Investigative Committee to be subject to the same provisions as other committees of the board, for example, with respect to required notice periods.

It should be clear whether the Investigative Committee is required to make recommendations to the board of directors. While the board has the authority to delegate to the Investigative Committee the power to make decisions, that power is seldom delegated for two reasons. The members of the board who are not on the Investigative Committee are often not prepared to

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26  Ibid. at 2.
relinquish to the Investigative Committee unrestricted authority to make decision about how to deal with the findings of the investigation. At the same time, the members of the Investigative Committee are often not prepared to assume the responsibility for those decisions but prefer to offer recommendations to the board, with the final decisions being made by the full board.

(h) Disclosure of the Formation of the Committee

In many cases, public disclosure of the establishment of an Investigative Committee will be unavoidable. This is because the events or allegations that gave rise to formation of the committee are themselves disclosable or have otherwise become public. The formation of the committee then becomes an important part of the corporation's response to the event or allegation and so it will want to disclose the formation of the committee and its mandate in order to provide some comfort to the investing public that the corporation is taking the matter seriously.

However, there may be situations where disclosure about the Investigative Committee when it is formed is premature. Indeed, there are situations in which the existence of the committee need never be disclosed. For example, issues raised through the whistle blowing processes may, in some cases, call for the establishment of a board-led investigation (particularly where the conduct of the CEO is called into question). Disclosing the existence of the committee necessarily means disclosing the nature of the issue being investigated. Disclosure at an early stage can lend greater credibility to the allegations than they may subsequently be shown to deserve and destroy the reputations of those who stand accused (who may ultimately be shown to be blameless).

However, in still other cases, failure to disclose that a committee has been established can be a serious disclosure deficiency. In YBM, the OSC was very critical of the YBM board and management for failing to disclose the establishment of the YBM Committee and its mandate. The YBM Committee was advised by its external legal counsel to make such disclosure. The OSC noted that the Board knew that the purpose of the Special Committee was to independently investigate concerns arising out of the company's business specifically as a consequence of the investigation of YBM by the U.S. Attorney. Notwithstanding, the OSC found that the disclosure that ultimately appeared in the AIF (as set out below) was obscure.

Over the last two years the Company became aware of concerns that had been expressed in the media and by government authorities generally concerning companies doing business in Eastern Europe and, particularly, in Russia. To this end, the Company has taken a number of steps to address these concerns, including:

2. the establishment of an independent committee of the Board of Directors who retained experts knowledgeable with political, social and economic issues in Eastern Europe to review the Company's operations to ensure that they are consistent with the standards applicable to Canadian public companies. Recommendations resulting from such review are being implemented by the
Company. The Board of Directors, through the Audit Committee, will monitor ongoing compliance by the Company with such recommendations. 27

(i) Participation of Those Not on the Committee

The formation of an Investigative Committee does not, of course, mean that other members of the board must be excluded from the process. In Nortel, independent and non-management members of the board attended meetings of the audit committee at which briefings were provided by counsel to the committee (accompanied by its accounting experts). In addition, the chairs of the audit committee and of the board were briefed between audit committee meetings so that they would be equipped with a "real time" understanding of the progress of the investigation. 28

(j) Participation of Management

The extent to which management is briefed on the work of the Investigative Committee depends, of course, on the role that management may have had in the matters that are the subject of investigation. For example, the Nortel Audit Committee was directing new corporate management to investigate issues identified by its independent counsel. Accordingly, counsel met regularly with management and the external auditors to provide facts developed in the course of its inquiry so that management would have the benefit of this information as it worked through Nortel's second restatement of its financial statements. 29

4. The Investigative Committee and Its Advisors

(a) Role of the Investigative Committee

Once an Investigative Committee is formed and its mandate determined, it is important for the members of the committee to understand their role in the investigation. It is not the role of the committee to conduct the investigation. Not only do the members of the committee not have the skills or time to conduct the investigation themselves, they must protect their ability to perform an effective oversight function. This requires them to maintain sufficient distance from the investigation to be critical about the reports they receive and to make the important judgments about the progress and results of the investigation. The appropriate role for an Investigative Committee is typically to put the investigation in motion, to have the results of the investigation reported to it and to then make decisions about the appropriate course of action based on those results.

In most cases, the first step for an Investigative Committee is to retain counsel. Typically counsel will then retain other experts (such as forensic investigators) necessary in order to advise the Investigative Committee. The Investigative Committee's relationship with counsel and with forensic investigators is discussed below.

28 Nortel Report, supra note 25 at 3.
29 Ibid.
(b) Selecting Counsel

An Investigative Committee will need expert legal advice because of the variety of legal issues that may arise in the course of an investigation. However, the most fundamental reason for the Investigative Committee to retain its own counsel is to advise the committee on the appropriate discharge of its responsibilities.

It is important to the process that counsel be independent with respect to the issues being investigated. Where senior management is the subject of the investigation, for example, it will seldom be appropriate for the board to rely on the corporation's regular outside counsel. Counsel's established relationship with management may make it defensive of management's conduct – it may even have provided advice with respect to that conduct. On the other hand, once counsel is engaged in the investigation, it may find that the dynamic with certain members of management becomes adversarial. It may be inevitable that this leads to a breakdown in the relationship between counsel and management. It may be difficult for counsel to be entirely objective when its own interests are at stake. The Investigative Committee can avoid these potential issues by retaining counsel with no previous material relationship with the corporation.

The YBM Committee relied on the advice of its regular outside counsel. The OSC was very critical of the YBM board for not retaining independent counsel for the Special Committee. One of the directors (who was also the chair of the outside counsel firm) argued that "lawyers were not going to solve this problem" and that what was needed was independent investigators to drill down and get the facts. Another director argued that retaining independent forensic experts was in some way the equivalent of retaining independent counsel. The Commission did not accept this rationale, noting, "[t]hat was clearly not its role or responsibility", 30 and found that the decision not to retain independent counsel was inconsistent with good process.

In order for an Investigative Committee to rely on legal advice as a part of its due diligence defence, that legal advice must be fully informed, ostensibly credible and within the lawyer's area of expertise. 31 Although the 1990 decision in Westfair 32 did not deal with an Investigative Committee, it does provide an example of a court not allowing a board to rely on legal advice as part of its due diligence advice. In that case, the board of directors had obtained legal advice from two major law firms in connection with its decision to pay a dividend of 100% of the previous year's retained earnings. Both firms provided opinions that the payment of dividends out of retained earnings would not be held to be oppressive, unfairly prejudicial to, or unfairly disregard the interests of the Class A shareholders. The Court found, however, that there were additional facts relevant to the impact of this dividend on the Class A shareholders (including that the company planned to borrow the amount of the dividend back from the common shareholders). Because the two law firms did not have the benefit of all of the facts, the Court held that the board could not rely on those opinions as part of its due diligence defence.

30 YBM, supra note 11 at para. 290.
Second, it must have been reasonable for the Investigative Committee to rely on counsel's advice. In *YBM*, the Chair of the Special Committee argued that he had relied on the advice of counsel in respect of YBM's obligation to disclose that the auditor would not be providing an audit opinion. The Commission found that disclosure in this instance could not be resolved by simply relying on legal advice. In view of the Chair's experience, he ought to have known at a certain point that YBM would not get its audit opinion and at the point he could not rely on legal advice as a due diligence defence.\textsuperscript{33}

(c) Forensic Support\textsuperscript{34}

The right forensic support can make all of the difference in getting at the facts in a timely way. In Canada, each of the big four accounting firms offers expert forensic expertise, as does Navigant Consulting and a number of other firms. As in all other things, every firm has particular experience and expertise that may make it most suitable for a particular assignment. Experience in a particular sector, for example, may be of great assistance in assembling and analyzing the facts. Board investigations of corporate conduct will typically require some type of investigative expertise, whether in the area of computer forensics, forensic accounting or interview skills. The sophistication of the systems and programs which the forensic investigators have available to them can also be crucial. We experienced that directly in the investigation of the RCMP pension plan matters.\textsuperscript{35} With only nine weeks from the date on which the federal government launched the investigation to the date on which the report was delivered, the ability of KPMG (which provided forensic support on that matter) to scan and analyze large volumes of email and identify for us the relevant events involving a large number of people over a four-year period was central to our ability to produce the report. In the short time available, KPMG collected significant amounts of data from RCMP servers (both from user files and emails), external media (such as CD-ROMS, DVDs and drives the RCMP had previously collected) and 15 personal computers used by individuals thought to potentially have information relevant to the mandate of the Independent Investigator. Relevant data was extracted from all sources and used to further the investigation.

Independence will be an issue in selecting forensic experts, just as it is in selecting counsel. The independence of a particular firm may be an issue if it has provided services (such as audit or tax work) to the organization in the past. Other relationships (such as familial relationships and past employment with the organization) may also compromise the independence of the forensic consultants in particular circumstances.

\textsuperscript{33} *YBM*, supra note 11 at paras. 545-546.

\textsuperscript{34} The authors acknowledge with thanks the insightful comments provided by Alan Stewart of Navigant Consulting on an earlier draft of this section and of Section 4(d).

\textsuperscript{35} *A Matter of Trust*, supra note 13.
(d) Privilege

An Investigative Committee will typically wish to restrict the ability of plaintiffs or law enforcement agencies to use the work product of its forensic investigators against the corporation in any legal proceeding. Where the work of the investigator is performed solely for the purpose of counsel providing legal advice, that may be achievable through the application of solicitor-client privilege.

The ability of a solicitor and client to communicate openly is fundamental to our legal system. Unless clients are able to communicate openly with their solicitors, they will be precluded from obtaining the advice necessary to protect their interests. Solicitor-client privilege exists to protect the direct communications (oral and documentary) prepared by the lawyer or client and flowing between them in connection with the provision of legal advice. The communication must be intended to be made in confidence, in the course of seeking or providing legal advice and must be advice based upon the professional's expertise in law.

When a forensic investigator provides information to the solicitor, whether solicitor-client privilege applies depends on the function that the investigator is performing. In the case of General Accident Assurance Co. v. Chrusz, Doherty J.A. (whose analysis of the principles underlying solicitor-client privilege was adopted by the majority of the Court) made clear that solicitor-client privilege extends to (i) communications by or to a third party who serves as a line of communication between the client and solicitor, and (ii) communications and circumstances where the third party employs an expertise in assembling information provided by the client and in explaining that information to the solicitor. He found that the applicability of solicitor-client privilege to third party communications in circumstances where the third party is not serving as a line of communication between the client and solicitor should "depend on the true nature of the function that the third party was retained to perform for the client". Further he found that a third party's function will not be essential to the maintenance and operation of the solicitor-client relationship where the third party's function is only to gather information from outside sources and pass that information on to the solicitor so that the solicitor might advise his client.

If the forensic investigator's function is to serve as a "translator", assembling the necessary information from the client and putting the client's affairs in terms that could be understood by the lawyer, then solicitor-client privilege is likely to apply.

The authors acknowledge with thanks the assistance of Jim Bunting of Davies Ward Phillips & Vineberg LLP in the analysis in this section on solicitor-client privilege.


As the court stated in Susan Hosiery v. Canada (Minister of National Revenue - M.N.R.) [1969], C.T.C. 533, 69 D.T.C. 5346, [1969] 2 Ex C.R. 408 (Ex. Ct.), the fact that an accountant was used by the client as a
Although the courts have extended privilege to the communications of third parties retained by the client to counsel (as discussed above), the safer practice is for the forensic experts to be retained by counsel to the Investigative Committee, rather than by the Investigative Committee itself. This is more likely to result in protection of solicitor-client privilege because, properly managed, it will be clearer that the sole purpose for the investigator's work is to provide information to counsel for the purpose of providing legal advice. In contrast, if the investigator is retained by the client, it could be argued by parties seeking to obtain the report that the investigator's work was not prepared solely for the purpose of legal advice and, therefore, that solicitor-client privilege does not attach.

In order to maintain the integrity of the solicitor-client privilege, the retainer letter should be between the forensic expert and counsel. Communications should flow from the forensic expert to counsel and the advice to the Investigative Committee (which incorporates and relies on the work of the forensic consultant) should come from counsel. The report, any drafts and any working documents should be marked both "Privileged and Confidential" and "The report is prepared at the request of [name], [position], for the purpose of providing legal advice."

It is important to note that this approach has not been tested by the courts. However, because the principles underlying solicitor-client privilege have been applied consistently by the courts, aligning the relationship of the forensic investigators as clearly as possible with the provision of legal advice provides the greatest possible opportunity for protecting the work product of the forensic consultants.

(e) Who runs the investigation?

One of the major issues for an investigative committee is who will run the investigation. As discussed above, the board must preserve its ability to provide effective oversight of the investigative process and to consider the results of that process critically. For the most part, the day to day management of the investigation will fall to the Investigative Committee's counsel and the forensic consultants retained by counsel. The chair of the Investigative Committee should receive regular briefings from counsel, with the full committee being briefed as significant results emerge or as decisions must be made.

However, there can be issues with providing too much discretion to outside advisors. In an effort to be complete, advisors may tend to provide gold plated advice unless specifically instructed not to. Among other things, the Investigative Committee must be conscious of how to control the scope of its work. Many investigations turn up issues that are outside of the mandate. While an Investigative Committee should not ignore a smouldering problem just because it does not fall within its mandate, it should also not allow itself to be distracted by subsidiary issues. When the advisors uncover an issue unrelated to the Investigative Committee's mandate, the committee representative to put a fact situation before a lawyer did not make the communication any less a communication from the client to the lawyer. In contrast, in Prosperine (2004), 2004 CarswellOnt 434 (S.C.J.), aff'd 2004 CarswellOnt 5285 (C.A.) (WLeC), the town hired accountants to liaise with its legal department. The report included physical checks, interviews with police and insurance adjustors and taking of samples. The court concluded that the accountants did more than use its expertise to assemble information provided by Regional Municipality of Carleton staff and that its function was not integral to the solicitor-client relationship.
should consider whether the issue should be referred to management. If it is apparent that the matter must be investigated under the supervision of the board, the Investigative Committee should raise the issue with the full board. Unless the corporation would suffer some damage or loss from a delay in addressing the matter, the Investigative Committee should avoid expanding its own mandate without the authority of the board.

(f) Procedural Issues

Investigative Committees should concern themselves with the way in which those running the investigation are dealing with the individuals involved. It is important that the investigative process be carried out by knowledgeable professionals with appropriate expertise. The Investigative Committee should be clear with its advisors that only appropriate investigative techniques may be used. This will help the Investigative Committee to avoid the problems encountered by the Hewlett Packard board, described at the outset of this paper.

Although the investigation is intended to gather information to allow counsel to advise the Investigative Committee, the results of the investigation may be shared with other parties with other agendas and therefore the protocol under which the investigation conducted is very important. A standard introduction should be developed by the forensic investigators and counsel when interviewing employees. The introduction would include an explanation of the investigator's role, the fact that the investigator has been retained by counsel to the Investigative Committee, the interviewee's option to retain counsel and whether notes of the interview will be shared with regulators or other authorities.

The results of the investigation (and often the simple fact of the investigation being conducted) can be devastating to the individuals involved – whether or not they were guilty of misconduct. In order to protect the individuals, the investigation should be run as discretely as possible. Interviews should be held in a location where it is not obvious to others in the organization who is coming in and out of the interview room. Hard drives should be copied and documents collected at times and in a manner that attracts the least attention.

Some individuals will wish to consult with counsel. It is not appropriate for the corporation's in-house counsel to provide advice to individuals involved in the process and so, if they wish counsel, they will need to retain someone independent of the corporation. No negative inferences should be drawn from an individual's desire for counsel – it is important that those running the process respect the individual's right to legal advice. Most organizations have indemnities in place for their officers and directors. Absent extraordinary circumstances, those indemnities should be honoured throughout the course of the investigation – with provision for payments to be repaid, if the individual is ultimately found to have breached his or her fiduciary duty.

(g) When Is It enough?

One of the major issues facing the Investigative Committee is when enough work has been done that the investigation can be brought to a close and the Investigative Committee is in a position to make a recommendation to the board. The foremost consideration is, of course, whether the Investigative Committee believes that it has adequate information. Other considerations are cost and strain on the organization and on the individuals involved of prolonging the investigation.
Few boards will want to find themselves in the position of the YBM board. The deficiencies with the process arising from the composition of the committee are discussed elsewhere in this paper. The OSC decision discloses that the YBM Committee retained the Fairfax Group in November 1996 to determine the exact nature of YBM's difficulties with the State Department and/or the US Attorney's Office. Several weeks later, Fairfax advised the Chair of the YBM Committee that the State Department's investigations of YBM involved national security and organized crime issues. In February 1997, Fairfax again briefed the Chair of the YBM Committee, this time following its investigations of the records and operations of two YBM subsidiaries in Hungary. Fairfax's chief concern was the potential for money laundering in Hungarian operations. The Chair authorized Fairfax to conduct further background investigations into certain corporations and individuals.\(^{41}\) Several weeks later, Fairfax briefed the Chair of the YBM Committee and the full YBM Committee, YBM management and YBM's outside counsel. In the course of that briefing, Fairfax advised that a number of YBM's founding shareholders were linked to a Russian organized crime group, that some had links to, or were former members of the KGB and that these individuals retained significant ownership of YBM and exerted considerable influence over the company.\(^{42}\) Fairfax advised that, although there was no evidence of money laundering found, indicia of money laundering were present in Eastern European operations. Finally, Fairfax advised that there were difficulties in tracing YBM's significant customers and vendors. It recommended that further work be done including: the verification of customers, vendors, shipments, inventory and assets; interviews with the accountants and a review of their work papers and reports; further interviews with management of YBM and its subsidiaries; a review of cash management and banking arrangements; and an approach to the US Government, disclosing findings and offering cooperation.\(^{43}\)

Following this briefing, the Chair of the YBM Committee authorized Fairfax to verify YBM's customers and vendors. Management provided Fairfax with a 16-page list of US customers. This list was subsequently shown to be a complete fabrication. Fairfax's engagement came to an end in April 1997. It was not asked to perform the further work that it had recommended.

The OSC was critical of the YBM Committee for leaving the board with the impression that Fairfax was satisfied when, in fact, it continued to express concerns and recommend further work. The OSC stated that the entire board should have requested a meeting with Fairfax to discuss Fairfax's concerns regarding YBM's end users or money laundering and considering retaining Fairfax to do the additional work it had recommended.\(^ {44}\)

**(h) Action Arising from the Investigation**

At the conclusion of an investigative process, the Investigative Committee will make recommendations to the board of directors about action that should be taken. In Nortel, on recommendation of the Nortel Audit Committee, the board of directors terminated for cause the Chief Executive Officer, Chief Financial Officer and Controller as well as seven other senior

\(^{41}\) *YBM, supra note 11 at para. 54.*


\(^{43}\) *Ibid.* at para. 56.

\(^{44}\) *Ibid.* at para. 253
finance employees. "The Board of Directors determined that each of these individuals had significant responsibilities for Nortel's financial reporting as a whole, or for their respective business units and geographic regions and that each was aware, or ought to have been aware that Nortel's provisioning activity…did not comply with US GAAP."45 Also on the recommendation of the Nortel Audit Committee, the board of directors adopted the recommendations of its advisors which dealt generally with people, processes and technology. The Hollinger Committee recommended that action be taken against Lord Black and a number of other executives. Following its investigation, it also settled with Lord Black, restructuring arrangements that restricted his ability to continue to deal with the assets of Hollinger International as he had in the past.

5. When a Regulator Is Involved

(a) Avoiding a Regulatory Investigation if Possible

Where corporate conduct involves a breach of law – such as the corporation's public disclosure obligations under securities law – dealing with the regulator becomes an important focus for the Investigative Committee. The ideal result is for the regulator to be prepared to rely on the corporation's own internal investigation and to be satisfied that the remedial action taken by the board on the recommendation of the Investigation Committee obviates the need for any sanctions.

It is important for the Investigative Committee to have a thorough understanding of the facts surrounding the alleged wrongdoing before the regulator begins to form its view. This will assist the corporation in presenting complete facts to the regulator, which in turn will make the regulator's process in understanding the facts both more efficient and more accurate. Even if the regulator ultimately decides to conduct some level of investigation of its own, the corporation will be in a much better position to present the appropriate information to the regulator if its own investigation has been completed.

The reliance that the regulator will be prepared to place on the internal investigation will depend very much on how the investigation is handled. We have touched on the key elements of an effective internal investigation in this paper. The features of the internal investigation which will promote confidence of the regulators include the following:

- the investigation is directed and conducted independent of possible wrongdoers and those who may have acquiesced in wrongful conduct
- the scope of the investigation is not inappropriately restricted
- competent people with adequate resources conduct the investigation
- regulators have unrestricted access to the investigators throughout the course of the investigation and the reports of the investigators (means waiving privilege)
- the corporation deals swiftly and effectively with the wrongdoers, remediates wrongful conduct and compensates those who suffered losses

45 Nortel Report, supra note 25 at 7.
(b) Credit for Cooperation with the OSC

In 2002, the OSC announced Credit Cooperation Guidelines (the "OSC Guidelines"). These guidelines set out the factors that the OSC will consider in determining whether the way in which the corporation has handled a breach of securities laws justifies something less than a full regulatory response to that breach. The rewards for cooperation described in the OSC Guidelines are intended to encourage issuers to self-police their compliance with securities laws, to self-report breaches that come to light and to self-correct the behaviours that led to the failure to comply.

The Guidelines are based on market participants reporting to the appropriate authorities serious problems in respect of their systems of internal control, the reporting of financial results, misleading disclosure, illegal trading or any other inappropriate activity that has impacted investors or cast doubt on the integrity of Ontario's capital markets. In addition to cooperating with the regulators, the Guidelines contemplate the market participant taking corrective action, dealing with employees, officers and directors who have acted in a manner contrary to Ontario securities laws and providing full restitution to any investors who may have been harmed.

The Guidelines provide that no credit for cooperation will be given where, in the course of the investigation, the market participant puts the interest of the firm, or its officers, directors or employees ahead of its obligations to clients, shareholders, or the integrity of Ontario's capital markets.

The benefits of cooperating with the OSC are compelling. If "potential respondents" act in a responsible manner during the course of an investigation and have self-policed, self-reported and self-corrected the matters under investigation, staff may recommend that the matter not be prosecuted or that no action at all needs to be taken. It may recommend sanctions such as a settlement, undertakings or a warning letter. Where staff proceeds to prosecute notwithstanding cooperation in accordance with the Guidelines, staff may narrow the scope of the allegations and recommend reduced sanctions.

However, the Guidelines can create a dilemma for an Investigative Committee. Once securities regulators are advised of certain matters, there is the potential for the board to lose control of the agenda. For this reason, boards and Investigative Committees may prefer to wait to advise regulators until they are certain that it is necessary.

(c) Examples of Credit for Cooperation

The OSC has praised CP Ships for its handling of the disclosure and trading issues it faced in 2002 and 2003. Michael Watson, Director of the OSC's Enforcement Branch, said: "They did everything right in accordance with Credit for Cooperation." The OSC has specifically cited the following eight steps taken by CP Ships as demonstrating the cooperation expected by the OSC:

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46 These guidelines are set out in OSC Staff Notice 15-702 – Credit for Cooperation.
47 Ontario Securities Commission, Perspectives (Fall 2005) at 4.
• the establishment of a Special Committee to investigate the issues
• an initial meeting with staff to discuss concerns of the Special Committee about trading by insiders
• public disclosure of the existence of the investigation being conducted by staff
• public disclosure of the fact that trading by insiders should not have taken place
• the provision of all relevant documents
• unlimited access to and cooperating of the Special Committee's advisors
• restitution to CP Ships by the four insiders for the loss avoided on their trades
• the review and revision of CP Ships' insider trading and corporate disclosure policies done at the company's initiative

The high level of cooperation by CP Ships contributed to the determination by the OSC that it was possible to adequately protect the public interest by issuing a caution rather than commencing formal proceedings.

More recently, in the Nortel settlement, OSC noted that Nortel had acted in accordance with OSC Staff Notice 15-702. The settlement agreement lists a number of mitigating facts. The Settlement Agreement noted that when it was first apprised of the need for the first restatement, the Audit Committee initiated the independent review of its own accord and in circumstances where it had no belief that misconduct was involved. It also noted that the Audit Committee (consisting solely of outside directors) supervised and directed the independent review and retained experienced counsel with no prior relationship with Nortel to assist it. The Nortel Settlement Agreement also refers to the information provided to OSC staff. Among other things, Nortel promptly reported to OSC staff the need for each of the restatements, the independent review and the review of revenue recognition errors. In addition, Nortel assisted staff in its investigation by volunteering documents and making present and former officers and directors available to staff to be interviewed on request. Through its independent counsel, the Audit Committee provided reports to staff on the progress of each review. The findings of the independent review and the revenue independent review were publicly disclosed.48

6. Conclusion

Issues requiring a board-led investigation usually arise without warning and the severity of the issues often are not immediately apparent. However, matters can escalate with alarming speed, and if not quickly addressed by appropriate action, can become franchise-threatening. The decisions that will have the biggest impact on the success of the board investigation will be made in the early days of the crisis. Unless the proper process is established from the outset, the investigation may be fatally flawed (as was the case in Oracle and YBM as a result of lack of independence of the special committee).

Without knowing what crisis might befall the corporation, a board of directors needs to be prepared to respond to a crisis when it occurs. The following considerations will have an impact on the ability of a board to respond effectively:

- The board needs to be constituted with enough directors who are independent of management and of any obvious influential stakeholders (such as a controlling shareholding), that a special committee can be constituted. This was an important factor in the recent case involving Nereus discussed at the outset of this paper. The directors who qualify as independent must have sufficient availability that they would be able to spend significant time on an issue if called upon to do so.

- The board should be conversant with the steps that would need to be taken if a board-led investigation were necessary – but should not be overly anxious to use its new "tool kit". A board-led investigation attracts a great deal of attention, is time-consuming for the board and can be expensive. Careful consideration should be given to the range of options available in dealing with the crisis (including, for example, a management-led investigation). Where the board involvement is called for, though, the board should act decisively in forming an Investigative Committee and charging that committee with the appropriate authority.

- The board needs to know to whom they will reach out for advice. Since the corporation's regular outside counsel will likely not be independent for the purposes of the investigation, the board will need to identify other counsel to provide it with advice. That counsel should be experienced in board investigations and be capable of winning the confidence of the Investigative Committee and of the regulators.

As the forgoing analysis illustrates, an Investigative Committee of the board, properly constituted, mandated and resourced, can successfully uncover and rectify alleged wrongdoing while, at the same time, minimizing the erosion of confidence by the corporation's investors and customers and keeping the regulators on the sidelines. We hope that the guidance provided in this paper will help any board faced with these challenges to achieve equally positive results.
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The BCE Litigation: Principles of Corporate Law Reaffirmed
THE BCE LITIGATION:
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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.

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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" 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.


\(^5\) 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. 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.

but such prejudice will not normally be unfair.\(^7\) The Ontario Court of Appeal recognized in the seminal case of \textit{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 \textit{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"."\(^10\)

\textbf{(ii) Bad Faith}

Although bad faith is not a necessary element of an oppression action, the Ontario Court of Appeal in \textit{Brant} in considering the comparable provision of the \textit{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".\(^11\)

\textbf{(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

\begin{itemize}
  \item[8] \textit{Brant, supra} at 301.
  \item[10] \textit{Brant, supra} at 306.
\end{itemize}
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.\(^\text{14}\) (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 fire\(^1\) 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.**\(^\text{15}\) (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.\(^\text{16}\)


\(^{16}\) *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.*, 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.

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. 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."

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

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


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.\textsuperscript{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 \textit{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, \textit{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 \textit{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. \textbf{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.}\textsuperscript{22} (emphasis added, footnotes excluded)

\textsuperscript{21} \textit{RJR Nabisco, supra} at 1519.

\textsuperscript{22} \textit{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.
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 \textit{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.\(^{28}\)

\[(v) \quad \text{Corporations Are Permitted to Change Publicly Pronounced Financial Policies}\]

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 \textit{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:

\begin{itemize}
  \item \textbf{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}\n\end{itemize}

\begin{footnotes}
\item \(^{27}\) Revlon, supra at 146-147.
\item \(^{28}\) First Edmonton Place Ltd. v. 315888 Alberta Ltd., (1988), 40 B.L.R. 28 (Alta. Q.B.) at 57; Koehnen, supra at 78.
\end{footnotes}
in good faith with a view to the best interests of the corporation and exercise care, diligence and skill.\textsuperscript{29} (emphasis added)

Similarly, in \textit{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.\textsuperscript{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.\textsuperscript{31}

\textbf{(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 \textit{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 \textit{CBCA}. In making an order approving a plan of arrangement under section 192 of the \textit{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 \textit{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 \textit{CBCA};

2) the Arrangement is put forward in good faith; and


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

\textsuperscript{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, \textbf{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.\textsuperscript{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, \textit{prima facie} fair and reasonable. Once those elements are established, the burden then shifts to those opposing the plan of arrangement.\textsuperscript{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:

\begin{itemize}
\item [192.] (1) In this section, "arrangement" includes
\begin{itemize}
\item [(a)] an amendment to the articles of a corporation;
\item [(b)] an amalgamation of two or more corporations;
\item [(c)] an amalgamation of a body corporate with a corporation that results in an amalgamated corporation subject to this Act;
\item [(d)] a division of the business carried on by a corporation;
\item [(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;
\item [(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;
\item [(f.1)] a going-private transaction or a squeeze-out transaction in relation to a corporation;
\item [(g)] a liquidation and dissolution of a corporation; and
\item [(h)] any combination of the foregoing.
\end{itemize}
\end{itemize}

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:

\begin{itemize}
\item [(2)] For the purposes of this section, a corporation is insolvent
\begin{itemize}
\item [(a)] where it is unable to pay its liabilities as they become due; or
\end{itemize}
\end{itemize}


\textsuperscript{33} \textit{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. 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."  

(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". In applying this test the Court does not consider third parties whose rights

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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. 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". 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"?

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").

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

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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. 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.

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., and Re Alabama, New Orleans, Texas & Pacific Junction Railway Co. 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., for instance, the court overruled a complaint by the company's joint venture partner (Lukoil) that the arrangement, if

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41 Arrangement Judgment, supra at para. 166.
42 Policy Statement, s. 3.10.
44 [1891] 1 Ch. 213 (C.A.) [Alabama Railway].
approved, would result in a breach of the parties' joint venture agreement. Lukoil's objections were judged irrelevant.\textsuperscript{46}

In \textit{Re Telewest Communications plc (No. 2)},\textsuperscript{47} an insolvent company sought approval of an arrangement under the English \textit{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 [\textit{i.e.}, shareholders]."\textsuperscript{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 \textit{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.\textsuperscript{49} The reasoning in this case has been adopted in Canada,\textsuperscript{50} and is consistent with cases such as \textit{PetroKazakhstan}.

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

The judge in \textit{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".\textsuperscript{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.\textsuperscript{53}


\textsuperscript{47} [2005] 1 B.C.L.C. 772 (Ch. D.) [\textit{Telewest}].

\textsuperscript{48} \textit{Telewest}, supra at p. 782.

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

\textsuperscript{50} \textit{Re Trend Management Ltd.} (1977), 3 B.C.L.R. 186 at 192 (S.C.).

\textsuperscript{51} [unreported], September 3, 1998 (Ch. Div) [\textit{BAT Industries}].

\textsuperscript{52} \textit{BAT Industries}, supra at p. 6.

\textsuperscript{53} \textit{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.

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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.*, 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".

In *Ventas Inc. v. Sunrise Senior Living Real Estate Investment Trust*, 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". 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.*, 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". 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

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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.
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.\textsuperscript{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.\textsuperscript{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


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". 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, 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".

However, the SCC noted in *Peoples* that Canadian courts have long recognized the discretion enjoyed by directors in soundly managing the corporation. 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.*:

> "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

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66 *CW Shareholdings*, supra at 768-769

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


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

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 Desalliers 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

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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.
Kent Thomson

Fellow, American College of Trial Lawyers and Head, firm’s litigation department in Toronto, with extensive experience in complex and "high stakes" litigation. Has acted as counsel in a number of the leading cases in Canada in a wide range of areas, including commercial disputes, securities cases, environmental matters, competition law, constitutional challenges and class actions. Recently acted as counsel for BCE Inc. in trial and appellate proceedings in Quebec Superior Court, Quebec Court of Appeal and Supreme Court of Canada arising from the $52 billion takeover of BCE by the Teachers Consortium. This is widely considered to be one of the most important commercial cases ever decided in Canada. Has appeared at all levels of court throughout Canada including in the Supreme Court of Canada, as well as in complex domestic and international arbitrations in Canada, the US, Europe and Africa. Has been recognized repeatedly as one of Canada’s leading litigation counsel by, among others, Chambers Global: The World’s Leading Lawyers, The Best Lawyers in Canada and International Who’s Who of Commercial Litigators. Called to Ontario Bar (1984).

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Supplementary Information
Carol Hansell

Carol Hansell is a senior partner practising corporate and securities law. She has acted for both private and public corporations and for governments on a variety of matters, including acquisitions, financings and reorganizations. She is recognized as a leading practitioner by Law Business Research's International Who's Who of Corporate Governance Lawyers, by the Canadian Legal LEXPERT Directory in the areas of mergers and acquisitions, and corporate and commercial law and by Best Lawyers in the areas of corporate governance and corporate law.

Carol is an internationally recognized expert in corporate governance. The International Who's Who of Corporate Governance Lawyers refers to her as "The top lawyer in Canada for this work". She regularly advises boards and their committees in the context of transactions, board investigations and special committee work and on their governance practices generally. She acts as an advisor to several board Chairs. She also participates regularly in board meetings of several significant organizations to provide them with immediate advice with respect to both their process and the substantive issues before the board. She works with investors in structuring their investments and with management teams in all aspects of governance. Her clients have included the Bank of Montreal, Biovail, Canada Post, Celestica, Minacs, Tarion and Toronto Port Authority. She has also worked closely with two large private, family-owned multinational companies to develop ownership and governance strategies as part of their family succession planning. Carol also has extensive experience with investigative work, both for special committees of private sector boards and for government. In 2007, in her capacity as counsel for the Independant Investigator into matters related to the RCMP pension and insurance fund, she worked closely with a large forensics team to produce the final report. She also acted as counsel to the Task Force on Governance and Cultural change in the RCMP.

Carol serves on the board of directors of the Bank of Canada (Canada’s central bank) and on the board of directors of Toronto East General Hospital. She is a member of the Advisory Board of the Literary Review, the Governance Leadership Council of the Ontario Hospital
Association and the Canada-Russia Corporate Governance Advisory Council established by the Schulich School of Business.

Carol is a past director of Royal Group Technologies Limited (a Canadian manufacturer, with shares listed on the NYSE and the TSX). She joined Royal Group as one of five new directors recruited to help the company recover from various legal and regulatory challenges. With a new management team in place, the Royal Group board oversaw the development of a new strategic direction and the ultimate sale of the company. Carol is also a past member of the board of the Public Sector Pension Investment Board (a Crown corporation that invests cash flows from the pension plans of the federal public service, Canadian Forces and R.C.M.P.) and of the Centre for Ethics and Corporate Policy in Canada. She served as a director and Vice Chair of the Institute of Corporate Directors and is a member of the faculty of the National Association of Corporate Directors, a Washington-based organization focusing on board leadership issues.

Carol is active with the American Bar Association. She is the incoming Chair of the Corporate Governance Committee and Co-Chair of the Sub-Committee on International Developments. She also serves as Special Canadian Advisor to the Committee on Corporate Laws. Carol has had extensive involvement in the development of public policy in Canada. She served as the Special Advisor to the Task Force on the Independence of the Bar established by the Law Society of Upper Canada, and as a member of staff for The Toronto Stock Exchange's Committee on Corporate Governance in Canada (which produced the Dey Report) and provided advice to the Joint Committee on Corporate Governance (which produced the Saucier Report). She has led three public policy forums to elicit the views of senior members of the business community on the development of governance regulations in Canada. She is a member of the Securities Advisory Committee ("SAC"), which provides advice and assistance to the Ontario Securities Commission. She was a member of the Five Year Review Committee, the Advisory Committee established by the Minister of Finance to review securities laws in Ontario (which produced the Crawford Report). She has also served as a Commissioner on the Blue Ribbon Commission on the role of the board of directors in corporate strategy established by the National Association of Corporate Directors in Washington, D.C. In 2005, Carol received an Outstanding Public Contribution Recognition Award from the Schulich School of Business.

Carol has written and published a number of papers, articles and commentaries on this topic and has also spoken widely in the area. Carol is the author of What Directors Need to Know: Corporate Governance, a resource for corporate directors, and Directors and Officers in Canada: Law and Practice, a loose-leaf service, and is a contributing editor to Corporate Governance, a quarterly journal published by Federated Press. She teaches in the Directors Education Program jointly offered by the Institute of Corporate Directors and the Rotman School of Management. She has been a course director and member of faculty for the National Securities Law LL.M. Program at Osgoode Hall Law School. In 2002, Carol was appointed as an Adjunct Professor of Osgoode Hall Law School. Carol has taught courses
on corporate and securities law, financial statements, transactions and negotiation skills and has chaired and spoken at conferences on a variety of corporate and securities law topics for a number of law schools, business schools and conference organizations. In 2004, she Co-Chaired the Law Society’s Special Lectures: Corporate & Commercial Law.

Carol received a B.A. in History from the University of Western Ontario in 1981, an M.A. in International Relations from the University of Toronto in 1982 as well as an LL.B. from Osgoode Hall Law School and an M.B.A. from the Schulich School of Business at York University in 1986. Carol is a member of the Toronto Club.
About the Firm

Davies Ward Phillips & Vineberg LLP is an integrated firm of more than 250 lawyers with offices in Toronto, Montréal, New York and an affiliate in Paris. The firm is focused on business law and is consistently at the heart of the largest and most complex commercial and financial matters on behalf of its clients, regardless of borders.

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We act for a wide range of leading industrial and commercial companies and financial institutions, both public and private, in Canada, the United States and abroad. As well, our clients include governments, regulatory bodies, charitable organizations, international agencies, educational institutions, individuals and trusts and estates. Many clients are directed to us for special-purpose engagements by other North American and international law firms.

All law firms are not created equal. The difference at Davies Ward Phillips & Vineberg is we consistently produce superior results for our clients.

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