



CORPORATE LAW:

The BCE Case: Consequences on the Duties of Boards of Directors

Bell Canada Entreprises (« BCE »), Canada's telecommunications giant, was recently at the center of the most important corporate law dispute in Canadian judicial history. Indeed, a group of BCE's bondholders vigorously contested the plan for the acquisition of BCE implemented by the Ontario Teachers Pension Plan ("Teachers", one of Canada's major institutional investors). The structure of this acquisition plan, a leveraged buyout, necessitated massive loans against BCE's assets.

This increase of BCE's indebtedness reduced the resale value, on the securities markets, of the bonds issued by BCE. Hence, BCE's bondholders argued that by omitting to consider their interests, as stakeholders of the corporation, BCE's board of directors had failed in its duties by approving *Teachers* plan.

Yet, it was classically understood that a board of directors possessed full managerial powers, with the mandate of acting according to the interests of the shareholders. The definition of the board of directors' mandate has undergone a constant evolution. Rather than solely the interests of the shareholders, it is the interests of the corporation itself that the directors must now take into account.

In 2008, it is this question of the directors' mandate that was brought before the courts, being at the heart of the BCE case. Firstly, the Québec Court of Appeal decided in favour of the bondholders, assessing that BCE's board of directors had failed to consider their interests as stakeholders. This decision was finally overturned by the Supreme Court of Canada. While the reasons of this last decision have not yet been published, the BCE case, as the latest jurisprudence of major import on the question, nevertheless offers a unique opportunity to learn more on the extent of the board of directors' duties.

Duty of the Directors

When taking a decision, the board of directors must act in accordance with the interests of the corporation. The question has always been what, exactly, constitutes this "interest of the corporation". The answer has greatly evolved.

In the beginnings of corporate law, it was thought that a board of directors should act according to the interests of the shareholders. The only duty of the directors was thus to maximize the value of shares. After a while, the courts brought forward a specification: the directors had to take into account the interests of *all* shareholders and thus, avoid harming the interests of minority shareholders in favour of the others'.

However, the courts have gradually broadened this restrictive interpretation of the directors' mandate. Indeed, it was realized that the interest of the corporation was larger than simply the maximization of the shareholders' profit. It was the welfare of the corporation itself, the maximization of *its* value, that had to be taken into account.

From there, it was only a short step to consider not only the interest of the corporation as a legal entity, but also the interests of all stakeholders implicated in its existence: the shareholders themselves, but also creditors (bondholders, as a case in point), employees, clients, suppliers, and even the State and the environment.

In Canada, it is the ruling of the Supreme Court of Canada, in *Peoples' Department Stores Inc. vs Wise* (2004), that set the precedent and definitively set aside the rule of the shareholders' interest. In this decision, the Supreme Court also stated that:

“In determining whether they are acting with a view to the best interests of the corporation **it may be legitimate**, given all the circumstances of a given case, for the board of directors to consider, *inter alia*, the interests of [the stakeholders].”

However, the Supreme Courts' *Peoples* ruling does not impose a *firm obligation* to take into account the interests of stakeholders. It does not, either, offer guidelines for the directors so that they may navigate between these diverse, often contrary, interests. Such are the interests that were opposed in the BCE case.

The Bondholders against BCE

At the beginning of the year 2008, the Québec Court of Appeal issued its decision in the BCE case. *Teachers* wished to acquire a majority participation in BCE's stock, for the total sum of 51.7 billion dollars. This acquisition was to take the form of a leveraged buyout, through loans guaranteed by BCE's assets, with the consequence of increasing the corporation's indebtedness.

This contemplated leveraged buyout was very unwelcome by the bondholders. Indeed, an increase in indebtedness would lead to a reduction of BCE's credit rating and, consequently, to a very noticeable devaluation of the bonds issued by BCE. Thus, the BCE bondholders, as stakeholders in the corporation, attempted to block this transaction. Their arguments invoked the obligation, for BCE's board of directors, to take into account their interests.

The Québec Court of Appeal decided: the transaction would not go forward due to the directors' failure to consider the interests of the bondholders. In this fashion, the Court of Appeal now imposed upon directors, beyond the faculty identified by the Supreme Court in *Peoples*, a duty to take into account the interests of a stakeholder.

This decision was reversed by the Supreme Court of Canada, which has positive impact on a practical level. Were it not for the appeal to the country's highest Court, the Court of Appeal's ruling would have had weighty consequences on the financial markets—the precedent created by the Court of Appeal challenged the concept itself of leveraged buyouts.

Indeed, any transaction by leveraged buyout would have been susceptible to be blocked as soon as it would have been detrimental to a stakeholder. From allowing bondholders to oppose a transaction on the basis of its effect upon the corporation's credit rating (and incidentally upon the bonds' resale value), there is but one step to allowing, as an example, suppliers, clients, or labour unions to oppose a transaction involving the transfer of a corporation's activities, as that transfer would lead to loss of employment for labourers and loss of contracts for local suppliers.

At the time of this newsletter's writing, the grounds for the Supreme Court's ruling have not yet been made public; it will be interesting to read the legal reasoning behind this decision.

Indeed, the prejudice alleged by the bondholders was relatively indirect and was mainly a consequence of the sophistication of today's financial markets. Also, one must not forget that the relationship between BCE and its bondholders was contractual in nature: the subscription of bonds had been duly negotiated by the bondholders, which in their majority were institutional investors more than experienced in this type of investment. Under its legal and contractual obligations toward the bondholders, BCE was well within its rights to undergo a leveraged buyout. It will then be interesting to see the Supreme Court's position in the face of such an extension of the board of directors' duties.

Also, it remains to be seen whether the Supreme Court will maintain the jurisprudence it set out in its *Peoples* ruling relatively to the interests of stakeholders. Indeed, we will see whether the Supreme Court will reaffirm the precedence of the obligation to maximize the corporation's value, while specifying that the interests of the stakeholders are only elements that may, rather than must, be taken into account.

On the opposite, it is also possible that, while it reversed the Court of Appeal's ruling in this specific instance, the Supreme Court will seek to advance Canadian corporate law by identifying an obligation to consider the interests of stakeholders. In this case, it would be interesting for the Supreme Court to provide guidelines for the appreciation of such interests: must they be considered individually as well as collectively, so that the harm caused to a single stakeholder may block the contemplated transaction? Rather, must the interests of all stakeholders be considered

globally, in order that a decision of the board of directors be deemed legitimate as long as it serves the common good even if certain stakeholders suffer as a result?

In any event, one can hope that the Supreme Court, through its reasons to be published, will resolve these issues, in what promises to be one of the keystone decisions of Canadian corporate law.

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