

## securities bulletin

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### M&A Developments in Canada in 2008

The following is a brief review of M&A developments in Canada in 2008.

#### Introduction

M&A activity in Canada is regulated under:

- *Corporate Laws.* Canadian corporations may be incorporated under the federal *Canada Business Corporations Act* (CBCA) or one of the similar provincial or territorial business corporations acts. These statutes regulate a variety of ordinary and extraordinary (eg, statutory amalgamations and plans of arrangement) corporate transactions. Extraordinary corporate transactions must be approved by a special resolution of shareholders (typically two-thirds of the votes cast). Shareholders generally have the right to dissent from extraordinary corporate transactions and demand payment of the “fair value” of their shares (as determined by a court if necessary). Canadian courts have broad remedial powers to intervene in respect of transactions that are oppressive or unfairly prejudicial to, or that unfairly disregard the interests of, shareholders.
- *Securities Laws.* Securities regulation in Canada is the responsibility of the provinces and territories. Each province and territory has its own legislation and securities regulatory authority that regulate, among other things, take-over bids. The Provinces of Ontario and Quebec have additional rules (including approval by a majority of the minority shareholders and independent valuation of the subject matter of the transaction) designed to ensure fair treatment of minority shareholders in connection with certain types of transactions involving a corporation and its “related parties” (which include shareholders owning 10% or more of the voting securities of the corporation).

The provincial and territorial securities regulatory authorities coordinate their activities through the Canadian Securities Administrators (CSA), a forum for developing a harmonized approach to securities regulation across the country. The CSA has developed a system of mutual reliance pursuant to which one securities regulatory authority acts as the lead authority for reviewing regulatory filings of “reporting issuers”.

The Ontario Securities Commission (OSC) is generally regarded as the lead securities regulatory authority in Canada.

- *Stock Exchange Rules.* The two principal stock exchanges in Canada are the Toronto Stock Exchange (TSX) (senior market) and the TSX Venture Exchange (junior market). These exchanges regulate selected aspects of M&A activity.
- *Competition Law.* *The Canada Competition Act* confers upon the Commissioner of Competition and the Competition Tribunal the ability to review mergers to determine whether they will or are likely to prevent

or lessen competition substantially. Mandatory pre-merger notification of certain large mergers is also required.

- *Investment Canada Act and foreign ownership restrictions.* Transactions involving the acquisition by a non-Canadian of “control” of a Canadian business with assets that exceed prescribed monetary thresholds are reviewable under the *Investment Canada Act* and subject to approval by the federal Minister of Industry or, in the case of a cultural business, the federal Minister of Canadian Heritage. Other Canadian statutes limit foreign ownership in specified industries (eg, financial services, broadcasting and communications).

### **M&A Activity and Trends**

M&A activity remained strong in the first half of 2008 but cooled in the second half of 2008 as a result of credit concerns and economic uncertainty.

M&A trends in 2008 included: involvement by private equity funds, large cross-border transactions, increased willingness of acquirors to launch hostile and competing bids, increased institutional shareholder activism and growing recognition of national security interests.

Likely M&A trends for 2009 include: a buyer’s market, more mid-market and smaller size transactions, divestitures by foreign controlling shareholders to shore up capital base, infrastructure investments, increased distressed sales and increased foreign investment scrutiny.

### **M&A Developments**

Two significant decisions arose out of 2008 M&A transactions.

#### ***Directors Fiduciary Duties, Oppression Remedy, Plan of Arrangement Approval Process and Business Judgment Rule***

*BCE Inc. v. 1976 Debentureholders*  
(*BCE Decision*)

In the *BCE* decision, the Supreme Court of Canada (SCC) reversed a Quebec Court of Appeal decision, which overturned a Quebec Superior Court decision approving a plan of arrangement pursuant to which a consortium of purchasers proposed to acquire BCE Inc. (BCE) over the objections of a group of debentureholders of Bell Canada, a subsidiary of BCE.

In so doing, the SCC clarified its thinking with respect to the nature and scope of directors duties in the context of a change of control transaction where the interests of securityholders (in this case, shareholders and debentureholders) are affected differently.

#### ***Background***

The *BCE* case involved a challenge by a group of Bell Canada debentureholders to the proposed acquisition of BCE by a consortium of purchasers pursuant to a plan of arrangement under the CBCA. Under the arrangement, which ultimately did not proceed for other reasons, BCE was to have assumed an additional C\$38.5 billion of debt, most of which was to have been guaranteed by Bell Canada.

As required under the CBCA, BCE convened a special meeting of its shareholders to approve the plan of arrangement. The plan of arrangement was approved by over 97% of the BCE shareholders.

No approval of the Bell Canada debentureholders was required, either under the CBCA or under the terms of the trust indenture pursuant to which the debentures were issued, because the legal rights of the debentureholders were not affected by the arrangement – the trust indenture did not contain change of control or credit rating covenants and permitted Bell Canada to incur or guarantee additional debt, subject to certain limitations which were not applicable in these circumstances. Up to the time of the plan of arrangement, the debentures had had an investment grade rating and Bell Canada had issued statements, including in the prospectuses pursuant to which the debentures were issued, to the effect

that it was committed to maintaining an investment grade rating for the debentures. These statements were, however, always accompanied by warnings that negated any expectation that this policy would be maintained indefinitely.

As required under the CBCA, BCE then applied to the Quebec Superior Court for approval of the plan of arrangement. At the approval hearing, the Bell Canada debentureholders objected to the arrangement and sought relief under the oppression remedy of the CBCA. They also alleged that the arrangement did not satisfy one of the tests required for court approval: namely, that the arrangement was “fair and reasonable” in relation to the debentureholders.

The basis of the debentureholders’ arguments was as follows:

- (a) *as it related to the oppression remedy* – even though the debentures did not contain covenants protecting the debentureholders from a ratings decline or a loss of investment grade status, based on Bell Canada’s previous conduct and public statements, they had a reasonable expectation that the BCE directors would protect their economic interests by putting forward a plan of arrangement that would maintain the investment grade status of their debentures; and
- (b) *as it related to the fair and reasonable test* - the arrangement did not address their rights in a fair and balanced way because, even though it did not affect their legal rights, the arrangement would reduce the trading value of their debentures and in some cases could reduce them to below investment grade rating.

**Decision**

In reaching its decision, the SCC first described directors’ fiduciary duties. It then considered whether the debentureholders were entitled to relief under either the oppression remedy or the “fair and reasonable” test, both of which, in the circumstances of the case, were checks on whether the directors had properly discharged their fiduciary duties.

**Directors’ Fiduciary Duties**

The SCC first reaffirmed its earlier decision in *Peoples Department Stores Inc.* that the fiduciary duty of the directors of a corporation is to the corporation, an entity separate from its stakeholders. The SCC noted, in particular, that “corporation” does not mean “shareholders”, thereby rejecting the argument in the *Revlon* line of cases in the United States that, in change of control situations, the directors have a duty to maximize shareholder value.

The SCC went on to say, however, that in considering what is in the best interests of the corporation, directors *may* look to the interests of, among others, shareholders, employees, creditors, consumers, governments and the environment to inform their decisions.

**Business Judgment Rule**

The SCC then reaffirmed that, in assessing directors’ decisions, courts should give appropriate deference to the business judgment of directors who take into account interests described above as long as those business decisions lie within the range of reasonable alternatives. In this context, the SCC recognized that, depending on the circumstances, when directors make decisions that are in the best interests of the corporation, some stakeholders may be “winners” and some stakeholders may be “losers”.

**Oppression Remedy**

The SCC stated that, in assessing a claim for oppression, a court must answer two questions:

- (a) *does the evidence support the reasonable expectation of the claimant?* – in this regard, the SCC stated that useful factors in determining whether a reasonable expectation exists include: general commercial practice, the nature of the corporation (ie, public or private, large or small, closely held or widely held), the relationship between the parties, past practice, steps the claimant could have taken to protect

itself, representations and agreements, and the fair resolution of conflicts between stakeholders; and

(b) *does the evidence establish that the reasonable expectation of the claimant was violated by conduct falling within the terms of the oppression remedy: namely, “oppression”, “unfair prejudice” or “unfair disregard” of a relevant interest?* – in this regard, the SCC stated that a claimant must show that the failure to meet the reasonable expectation involved unfair conduct and prejudicial consequences.

The SCC went on to say that conflicting interests among stakeholders must be resolved by the directors equitably and fairly in accordance with their fiduciary duty to act in the best interests of the corporation. In this regard, it added that there are no absolute rules and no principle that one set of interests should prevail over another.

After considering all the facts, the SCC concluded that:

(a) the debentureholders did have a reasonable expectation that the BCE directors would take their position into account in deciding whether to proceed with the plan of arrangement, but the BCE directors had satisfied this expectation;

(b) the debentureholders did not have a reasonable expectation that the BCE directors would protect their economic interests by putting forth a plan of arrangement that would maintain the investment grade rating of their debentures, particularly since the debentureholders, who were sophisticated participants in the debt markets, could have protected themselves by bargaining for change of control or credit rating covenants in the trust deed governing the debentures; and

(c) faced with a duty to resolve the conflicting interests of stakeholders in a fair and equitable manner, the BCE directors had chosen to proceed with the plan of arrangement, which was arguably in the best interests of the corporation,

and that, as a result, the oppression remedy did not apply.

### **“Fair and Reasonable Test”**

The SCC stated that, in considering whether a plan of arrangement is “fair and reasonable”, a court must be satisfied that:

(a) the arrangement has a valid business purpose; and

(b) the objections of those whose legal rights (and in some exceptional circumstances which the SCC did not define, those whose economic or other rights) are being arranged are being resolved in a fair and balanced way.

After noting that:

(a) the legal rights of the debentureholders were not being arranged under the plan of arrangement;

(b) the present circumstances did not fall within the exceptional circumstances where non-legal rights, such as those advanced by the debentureholders, should be considered; and

(c) those whose legal rights were being arranged (ie, the BCE shareholders) had voted overwhelmingly in favour of the plan of arrangement,

the SCC concluded that the debentureholders should not be allowed to block the arrangement and that the plan of arrangement was “fair and reasonable”.

### **Comments on Decision**

Although directors of Canadian corporations are obligated to act in the best interests of the corporation, and not of any particular group of stakeholders, as a practical matter, in change of control circumstances, they will continue to make shareholders and shareholder value their primary focus since shareholder approval is critical to whether a change of control transaction will or will not proceed.

Canadian courts will be reluctant to overturn decisions made by directors in circumstances where the directors can demonstrate that they have followed a careful process that takes into account the interests of all stakeholders.

### **Shareholder Approval of Significant Share Issuances**

*In the Matter of HudBay Minerals Inc.*

*and*

*In the Matter of a Decision of the Toronto Stock Exchange*

*(HudBay Preliminary Decision)*

In the HudBay preliminary decision (a detailed HudBay decision will follow with expanded reasons), the OSC overturned a decision of the TSX approving the listing of the additional common shares to be issued by HudBay Minerals Inc. (HudBay) in connection with its proposed acquisition of all of the outstanding common shares of Lundin Mining Corporation (Lundin) pursuant to a plan of arrangement between HudBay and Lundin.

In doing so, the OSC clarified the circumstances in which it believes shareholder approval is required before a corporation may issue its shares to acquire another corporation.

### **Background**

Under the proposed arrangement, HudBay was required to issue additional common shares aggregating slightly over 100% of its outstanding common shares. Upon completion of the proposed arrangement, existing shareholders of HudBay and Lundin would each as a group own approximately 50% of the common shares of the combined corporation. In addition, five of the nine directors of the combined corporation would be Lundin directors.

Under the applicable corporate statutes, the plan of arrangement required the approval of the shareholders of Lundin but not the shareholders of HudBay.

Under the TSX listing rules, a corporation listed on the TSX is required to notify the TSX of any transaction involving the issuance of any of its securities, other than unlisted, non-voting and non-participating securities. The TSX has the discretion to accept or reject the notice and, if it accepts the notice, to impose restrictions on the transaction. In exercising its discretion, the TSX is required to consider the effect that the transaction may have on the quality of the marketplace based on a number of factors, including the size of the transaction relative to the liquidity of the corporation, any material effect on control of the corporation and the corporate governance and disclosure practices of the corporation.

As they relate to acquisition transactions, the TSX listing rules state that the TSX will require shareholder approval of a transaction if:

- (a) the number of securities to be issued by a listed corporation exceeds 25% of the outstanding securities of the corporation – this rule does not apply, however, where the corporation is acquiring another public company with more than 50 shareholders; or
- (b) in the opinion of the TSX, the transaction materially affects control of the corporation.

HudBay notified the TSX of the arrangement. The TSX accepted the notice and approved (subject to completion of the arrangement) the listing of the additional common shares to be issued by HudBay pursuant to the arrangement. In its decision, the TSX concluded, without reasons, that “in this circumstance the rules would not require the transaction to be approved by HudBay shareholders”.

In November 2008, HudBay and Lundin issued a joint press release announcing the arrangement. In the press release, HudBay and Lundin indicated that the Lundin shareholder meeting to approve the plan of arrangement would likely take place in the second quarter of 2009 and that the arrangement would likely close before the end of May 2009. After the press release was issued, the market price of the HudBay

common shares dropped by approximately 40% and several disgruntled HudBay shareholders objected to the arrangement and requisitioned a shareholder meeting for the purpose of replacing the HudBay board of directors. Eventually, the Lundin shareholder meeting to consider the plan of arrangement was scheduled for January 26, 2009 and the requisitioned HudBay shareholder meeting was scheduled for March 31, 2009 (ie, too late to have any effect on whether the arrangement would proceed or not).

In response to the scheduled timing of the two meetings, a HudBay shareholder applied to the OSC for an order setting aside the TSX decision, requiring HudBay to call and hold a shareholder meeting to approve the issuance of the HudBay common shares pursuant to the arrangement and prohibiting HudBay from closing the arrangement without HudBay shareholder approval. In its application for the order, the HudBay shareholder argued that the TSX decision should be set aside because the public interest and, in particular, protection of the quality and integrity of the marketplace and investor confidence required a vote.

### **Decision**

The OSC first considered whether it should defer to the decision of the TSX. Generally, the OSC defers to the judgment of the TSX in decisions relating to the TSX listing rules. However, after reviewing the facts, and in particular the fact that the TSX had provided no explanation with respect to why it reached the decision it did, the OSC concluded that it should review the TSX's decision.

The OSC concluded that the principal considerations that should be taken into account in determining whether to accept a notice with respect to the issuance of securities and to impose restrictions on the transaction were the following:

(a) *the impact of the transaction on the shareholders of the listed corporation* – the OSC concluded that, as evidenced by the significant

decline in the market price of the HudBay shares, the proposed transaction would have an enormous impact on the rights and economic interests of the HudBay shareholders;

(b) *the level of dilution on the shareholders of the listed corporation* – the OSC concluded that the level of dilution (ie, over 100%) was “extreme” and at the outer edge of the range of dilution in similar transactions previously approved by the TSX;

(c) *composition of the board of the combined corporation* – the OSC noted that the board of directors of the combined corporation would be five Lundin and four HudBay directors and concluded that such a fundamental change required shareholder approval; and

(d) *governance practices and fair treatment of shareholders of the listed corporation* – the OSC concluded that the action of HudBay in scheduling its requisitioned shareholder meeting after the Lundin shareholder meeting was an attempt to frustrate the legitimate exercise by the HudBay shareholders of their right to require a shareholder meeting to consider the replacement of the HudBay board of directors before the arrangement could proceed (or in other words, unfair to the HudBay shareholders).

Based on the foregoing, the OSC concluded that the quality and integrity of the marketplace would be significantly undermined by permitting the arrangement to proceed without the approval of the HudBay shareholders. It also concluded that allowing the transaction to proceed without the approval of the HudBay shareholders would be contrary to the public interest. It therefore issued the order requested.

### **Comments on Preliminary Decision**

In the past, many Canadian market participants have expressed the view that a TSX listed corporation should not be exempted from the requirement to obtain shareholder approval for the issuance of securities where the corporation is acquiring another public company

and the number of securities to be issued is more than 25% of the outstanding securities of the corporation. Among other things, they point to the listing rules of other major exchanges (eg, AMEX, LSE, NASDAQ and NYSE) which require shareholder approval of share issuances exceeding specified thresholds.

In October 2007, the TSX initiated a review of its securityholder approval requirements for acquisitions and requested comments from market participants. The TSX's review remains outstanding. The HudBay preliminary decision should provide an impetus and a framework for the TSX to complete its review and make a decision.

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### **A Cautionary Note**

The foregoing provides only an overview. Readers are cautioned against making any decisions based on this material alone. Rather, a qualified lawyer should be consulted.

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