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BCE v. 1976 DEBENTUREHOLDERS: AN UNEXAMINED QUESTION CONSIDERED

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A superior line of thought

DAVIES

BCE v. *1976 DEBENTUREHOLDERS*: AN UNEXAMINED QUESTION CONSIDERED

1. Introduction

BCE[1] was ostensibly a case concerning the obligations of a public corporation to its debentureholders in the context of a proposed change of control transaction. However, underlying this issue was the broader question of the duties of directors of a corporation that is put "in play", facing an inevitable change of control. Unfortunately, the Supreme Court's reasons did not focus on this broader question, instead focusing on the manner in which directors must reconcile competing interests of stakeholders under the oppression remedy and the plan of arrangement provisions of the Canada Business Corporations Act.[2]

The interests of shareholders were not thoroughly dealt with by the Court in its analysis in several respects. The Court focused in its discussion of the oppression remedy on the reasonable expectations of the debentureholders without reference to what the reasonable expectations of BCE shareholders were in the circumstances. Further, the Court did not address Canadian case law supporting the proposition that directors are required to take reasonable steps to maximize shareholder value when a corporation is "in play".

This comment considers the Court's missed opportunity to address these broader questions and considers whether the reasons in *BCE* displace prior case law that supports a duty to maximize shareholder value. I also consider distinctions between shareholder rights and remedies in Canada and Delaware that may justify or explain divergent judicial approaches to the application of the fiduciary duty in the change of control context.

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[1] *BCE Inc. v. 1976 Debentureholders*, 2008 SCC 69 ("*BCE*").
[2] R.S.C. 1985, c. C-44 ("CBCA"),

2. Directors' Duties in Change of Control Transactions: A Missed Opportunity

Immediately upon the Supreme Court's granting BCE's application for leave to appeal from the decision of the Quebec Court of Appeal, it was widely expected that the case would present an opportunity for Canada's highest court to clarify the duties of directors in the context of change of control transactions. The Quebec Court of Appeal's decision rejecting the transaction had turned on its application of the Supreme Court's 2004 decision in *Peoples Department Stores v. Wise*.[3] In particular, the Court of Appeal had focused on some of the more ambiguous passages in *Peoples* including that:

> "[i]n resolving these competing interests, it is incumbent upon the directors to act honestly and in good faith with a view to the best interests of the corporation. [*In using their skills for the benefit of the corporation when it is in troubled waters financially, the directors must be careful to attempt to act in its best interests by creating a "better" corporation,*] and not to favour the interests of any one group of stakeholders."[4]

Either the Quebec Court of Appeal had erred in its interpretation of *Peoples*, or the Supreme Court had in *Peoples* radically altered Canadian corporate law to a degree that had not been previously envisioned, with major impact on the freedom of directors to take steps that are designed to maximize shareholder value or otherwise advance the interests of shareholders. The Quebec Court of Appeal decision had elevated to a level of urgent national importance questions that had been raised following the Supreme Court decision in *Peoples* as to how a duty owed exclusively to the corporation and not any one group of stakeholders would be applied in the takeover context.[5] BCE's appeal, it was supposed, would both provide an opportunity for the Supreme Court to clarify its decision in *Peoples* and to demonstrate how the fiduciary duty set out in that case would be applied in the context of a change of

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[3] [2004] 3 S.C.R. 461 ("*Peoples*").
[4] *BCE Inc., Re* (2008), 43 B.L.R. (9TH) 157 at para. 66 (C.A.). Emphasized and bracketed text was omitted from the Quebec Court of Appeal's quotation.
[5] Wayne Gray, "A Solicitor's Perspective on *Peoples v. Wise*" (2005), 41 C.B.L.J. 184 at 189-190.

control transaction.[6] The case would be the first time that the Supreme Court considered the directors duties in such a context.

Defying these expectations, the Supreme Court addressed a narrower set of questions. Rather than provide a sweeping exposition of the duties of directors in the context of a change of control, the Court addressed the more discrete question of "what is required to establish oppression of debentureholders in a situation where a corporation is facing a change of control."[7] Notably, the Court did not address the question of whether the BCE board of directors was required to take the actions that it took in conducting an auction to maximize shareholder value.

Certainly, there was no need for the Court to evaluate whether the transaction was a good one from the perspective of shareholders. The answer to that question was utterly clear. The proposed leveraged buyout was exceedingly popular among shareholders who were to receive a substantial cash premium for their shares.[8] The plan of arrangement received a 97.93% approval from shareholders[9] and no shareholders of BCE opposed the plan of arrangement as being contrary to the interests of shareholders.

Instead of examining the obligations of BCE's directors with respect to the interests of shareholders, the Court accepted the course of action that the board had taken to create a competitive bidding process as permissible and reasonable in the circumstances, and then considered the reasonable

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[6] R. Rocha, "Lawyers eager for Supreme Court to hear BCE Case", *The Gazette*, May 23, 2008; "BCE v. Bondholders", *The Globe and Mail*, June 17, 2008 at B1; and A. Hudec, "BCE and the Lessons Learned", *The Globe and Mail*, December 2, 2008, online: *The Globe and Mail* <www.theglobeandmail.com>.
[7] *BCE*, *supra* at para 30.
[8] BCE, *supra* at para 20.
[9] *Ibid*, at para 19.

expectations of the bondholders and their claims of oppression in such circumstances.[10] Thus, it was unnecessary for purposes of disposing of the appeal for the Court to address whether the directors of BCE were duty bound to have pursued such a course.

Nevertheless, the Court's decision not to address, at least briefly, the unique interests of shareholders in a change of control transaction that drive the conduct of directors is disappointing. A consistent thrust of BCE's arguments at all levels of court had been that any evaluation of the reasonable expectations of the debentureholders grounding a claim of oppression must be determined in the context in which BCE found itself, having been put in play by its largest shareholder, and in light of the duties of the directors in that context.

The Court accepted BCE's submissions in some respects, acknowledging as factual matters that BCE was "facing certain takeover"[11] and that "BCE had been put in play, and the momentum of the market made a buyout inevitable."[12] However, the reaction of a board of directors to being put in play and the reaction of the market are functions, at least in part, of what the board and the market perceive to be the legal obligations of the board in that context. To conclude that a buyout was inevitable overlooks the question of whether the BCE board could legitimately have taken steps to frustrate any change of control transaction through defensive tactics.

Unfortunately, the Court did not even advert to the Canadian line of cases that recognized a duty on the part of the directors of a corporation that is in play to take reasonable steps to maximize shareholder value, consistent with the principles of the Delaware line of cases stemming from the

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[10] BCE, *supra* at para 106. The Court accepted as a uncontroversial proposition that the maximization of profit and share value are legitimate corporate objectives, subject to the restrictions that might be imposed by the oppression remedy. *BCE, supra* at para 64.
[11] *BCE, supra* at para 106.
[12] *BCE, supra* at para. 112.

seminal case of *Revlon Inc. v. MacAndrews & Forbes Holdings*.[13] Most of these cases[14] were decided before the *Peoples* decision. However, they also include the decision of the Ontario Court of Appeal in *Ventas Inc. v. Sunrise Senior Living Real Estate Investment Trust*[15] that was decided three years after *Peoples* and only weeks before BCE was put in play by Teachers'.[16] In *Ventas*, the Ontario Court of Appeal stated that there is "no doubt that the directors of a corporation that is the target of a take-over bid have a fiduciary obligation to take steps to maximize shareholder value in the process."

It is perhaps indicative of the lack of guidance provided by the Court's formulation of the fiduciary duty in *Peoples* that the Ontario Court of Appeal could state as a proposition without doubt that the fiduciary obligations of directors require them to take steps to maximize shareholder value in the context of a take-over bid. The indeterminacy of a duty that is exclusively "to the corporation" gives boards of directors and courts little guidance as to the appropriate yardstick against which to measure the discharge by the directors of their duties in any particular fact situation. Although the Ontario Court of Appeal did not address *Peoples*, the implicit conclusion in *Ventas* was that whatever a duty owed exclusivity to the corporation meant, it did not displace the fiduciary obligation of a board to maximize shareholder value when the corporation was being sold.

Thus, in light of the questions raised following the *Peoples* decision, and the confusion the decision created at the Quebec Court of Appeal in *BCE*, the question of how *Peoples* could be reconciled with the perceived duty to maximize shareholder value was ripe for examination. However,

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[13] 506 A.2d 173 (1986) ("*Revlon*").

[14] *CW Shareholdings Inc. v. WIC Western International Communications Ltd*. (1998), 39 O.R. (3d) 755 (Gen. Div.) ("*WIC*"); *Gazit (1997) Inc. v. Centrefund Realty Corp.* (2000), 8 B.L.R. (3d) 81 at para. 69 (Ont. S.C.J.); *Olympia & York v. Hiram Walker* (1986), 59 O.R. (2d) 254 at 272 (Div. Ct.); *Benson v. Third Canadian General Investment Trust Ltd.* (1993), 14 O.R. (3d) 493 at 500 (Gen. Div.); *Casurina Limited Partnership v. Rio Algom Ltd.* (2004), 40 B.L.R. (3d) 112 at para. 27 (Ont. C.A.); *347883 Alberta Ltd. v. Producers Pipelines Inc.* (1991), 80 D.L.R. (4th) 359 at 399-402 (Sask. C.A.); *Pacifica Papers Inc. (Re)* (2001), 15 B.L.R. (3d) 249 at para. 30 (B.C.S.C.), aff'd 19 B.L.R. (3d) 63 (B.C.C.A.).

[15] (2007) 222 O.A.C. 102, 29 B.L.R. (4TH) 312.

[16] See also *Re Sterling Centrecorp Inc*., [2007] O.J. No.3072 at para 42-45.

the Court's exploration of the topic was limited to a brief discussion of *Revlon* that did not fully engage the issue.[17]

3. *Revlon* meets *Peoples*

The trial judge in *BCE* was careful in his reasons not to set the *Revlon* duty against the *Peoples* concept of the fiduciary duty as a competing proposition. Without addressing whether a *Revlon*-like duty exists in Canadian law, the trial judge concluded that "the ruling in *Peoples* is not necessarily incompatible with *the application* of the *Revlon Duty* [by BCE]."[18] (emphasis added).

The Supreme Court's approach to *Revlon* was similar to the trial judge's. Rather than explore whether there are any special duties placed on directors in the context of a potential change of control, the Court, in a cursory fashion, considered the "*Revlon* line" from Delaware merely to address whether *Revlon* stands for the proposition that the interests of shareholders prevail over those creditors.[19] However, even on this narrow question the Court neither rejected nor endorsed Delaware law, but instead attempted to demonstrate that:

> "the *Revlon* line of cases does not displace the fundamental rule that the duty of the directors cannot be confined to particular priority rules, but rather is a function of business judgment of what is in the best interests of the corporation, in the particular situation it faces."[20]

The Court did not explore whether the corollary is true, to wit, that *Peoples* and the principle that the fiduciary duty is owed exclusively to the corporation does not displace an obligation of directors to

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[17] In addition to *Revlon*, the Court cited *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985) as part of the "Revlon line" of cases. The Court's reference to *Unocal* is confusing in two respects. First, *Unocal* is not usually viewed as part of the *Revlon* line as *Revlon* was decided after *Unocal*. Second, the quote attributed to *Unocal* in paragraph 86 of the Court's decision is in fact from *Revlon*.
[18] *BCE Inc., Re*, [2008] R.J.Q. 1029, 43 B.L.R. (4TH) 39 at para 203 (C.S. Que.) ("*BCE Trial Judgment*")
[19] This proposition addressed by the Court was not in fact a proposition put to the Court by BCE. BCE's submissions with respect to the *Revlon* line of cases, was that the duty to maximize shareholder value was a manifestation of the director's duty of loyalty where the corporation is facing a change of control.
[20] *BCE, supra* at para 87.

focus on shareholder value when the "particular situation" they face is a change of control. However, the Court leaves the implication that this coexistence of *Peoples* and *Revlon* is indeed possible, citing an article by former Delaware Supreme Court Chief Justice Veasey explaining that:

> "[It] is important to keep in mind the precise content of this "best interests" concept — that is, to whom this duty is owed and when. Naturally, one often thinks that directors owe this duty to both the corporation and the stockholders. That formulation is harmless in most instances because of the confluence of interests, in that what is good for the corporate entity is usually derivatively good for the stockholders. There are times, of course, when the focus is directly on the interests of the stockholders [i.e., as in *Revlon*]. But, in general, the directors owe fiduciary duties to the *corporation*, not to the stockholders. [Emphasis in original.]"[21]

The Supreme Court mysteriously ends its discussion of *Revlon* here. The Court does not answer the obvious question: whether in the context of a change of control the "focus" of directors in determining the best interests of the corporation is narrowed to the interests of shareholders, which seems to be the gist of the passage quoted above.

The failure of the Court to distinguish Delaware law in this respect, suggests that the proposition in *Ventas* cited above has not been disturbed by the ruling in *BCE*. In effect, it appears that the Supreme Court is only making a formalistic point as opposed to a rule of substance: that although courts (such as in *Ventas*) may speak of a "duty" to maximize value for shareholders, the duty is to act in the best interests of the corporation, which in certain circumstances may require that directors "focus" on shareholder interests.

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[21] *Ibid*, citing E. Norman Veasey with Christine T. Di Guglielmo, "What Happened in Delaware Corporate Law and Governance from 1992-2004? A Retrospective on Some Key Developments" (2005), 153 U. Pa. L. Rev. 1399, at p. 1431.

4. Oppression versus Fiduciary Duty Claims

While it may not be clear whether a *Revlon*-like duty (or focus on shareholder interests) has survived the decision in *BCE* as a component of the fiduciary duty, shareholder interests in a change of control are certainly protected by the oppression remedy.

(a) The Reasonable Expectations of BCE Shareholders

Although the Court examined thoroughly the reasonable expectations of BCE debentureholders, despite submissions made on the subject by counsel for the intervening shareholder, the Court did not specifically assess the reasonable expectations of shareholders of BCE in the circumstances. This is in contrast to the reasons of the trial judge who considered the fairness of the result that the debentureholders were seeking from the perspective of shareholders, concluding that "it would have been unfair to the shareholders of BCE not to have maximized shareholder value" in order to reapportion the transaction consideration as requested by the debentureholders.[22] The trial judge explained:

> "In assessing the merits of the Oppression Remedies, the Court must consider not only the equities of granting the relief sough but, as well, the consequence to all the other stakeholder, including shareholders, in granting such relief."[23]

The Supreme Court did not similarly juxtapose the claimed expectations of the debentureholders with the reasonable expectations of shareholders. However, the Court's reasons do contain numerous indications that the reasonable expectations of shareholders included an expectation that the directors would have taken steps to maximize shareholder value in the circumstances. These indications include (i) the recognition by the Court that BCE faced an inevitable buyout; (ii) the factors for determining reasonable expectations enumerated by the Court such as general commercial practice which would

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[22] *BCE Trial Judgment*, *supra* at para. 208.
[23] *Ibid*, at para 211.

support a reasonable expectation that directors will maximize shareholder value in a change of control;[24] (iii) the Court's citation as an example of oppressive conduct the adoption of a poison pill to prevent a takeover bid;[25] (iv) the Court's acknowledgement that "[u]nder the business judgment rule , deference should be accorded to business decisions of directors taken in good faith *and in performance of the function they were elected to perform by the shareholders.*"[26]

(b) The Oppression Remedy in Lieu of Fiduciary Duty Claims

In *Peoples*, the Court reasoned that due to the availability of the oppression remedy to creditors, there was no need for the shifting of the fiduciary duty to creditors when a corporation is in the vicinity of insolvency.[27] Extending this reasoning to the situation of shareholders, a similar case could be made that the interests of shareholders of a corporation facing a change of control may be protected by the oppression remedy and not just the fiduciary duty.

Situating accountability to shareholders in change of control transactions within the oppression remedy has several advantages when compared to the fiduciary duty. As noted by the Court in *Peoples*, the oppression remedy provides a broad, comprehensive and open-ended shareholder remedy.[28] Procedurally, the oppression remedy is also less onerous than a derivative action which requires that the complainant obtain the leave of the court to bring suit.[29] In contrast, one consequence of the fiduciary duty being owed exclusively "to the corporation" is that complainants seeking to enforce the fiduciary

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[24] *BCE*, *supra* at para 73.
[25] *Ibid*, at para 93.
[26] *Ibid*, at para 99.
[27] *Peoples*, *supra* at para. 53.
[28] *Ibid*, at para 48.
[29] CBCA, s. 239.

duty must bring a derivative action in the name of the corporation rather than an action in their own name.[30]

Another advantage of the oppression remedy is that a finding of oppression is arguably less grave than a finding of breach of fiduciary duty. A claim of oppression may be made against the corporation itself, whereas a breach of fiduciary duty claim is, by definition, a claim that can only be made directly against the directors, and, if a breach is found, can result in personal liability of individual directors for which indemnification is not permitted under the CBCA.[31] Because oppression may or may not involve a breach by directors of their fiduciary or other duties to the corporation, the threshold for establishing a successful oppression claim is presumably lower, and a successful claim has different implications than a claim made against directors personally.

In certain respects, the oppression remedy may in fact be better suited for grounding shareholder complaints relating to the sale process than the fiduciary duty. Even Delaware jurists, including former Chancellor William Allen, have characterized the legal development by Delaware Courts of the fiduciary duty to police the conduct of directors in corporate takeovers as an exercise in judicial innovation by courts equipped only with "the bluntest of tools" in the fiduciary duty.[32] This innovative use of the fiduciary duty was necessary in order for the Delaware courts have a means to respond to the

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[30] This conclusion is inescapable based on the Court's survey of remedies under the CBCA. See *BCE, supra* at paras. 34-46.

[31] CBCA, *supra*, s. 124. The corporation may not indemnify an individual director or officer unless the individual "acted honestly and in good faith with a view to the best interests of the corporation".

[32] W.T. Allen, J. B. Jacobs and L.E. Stine, Jr. "Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law" (2001), 26 Del. J. Corp. Law 860 at p. 866.

> "Required to develop a body of rules to impose legal order upon a phenomenon (a dynamic revolution in corporate merger activity)… and equipped with but the bluntest of tools, the Delaware courts employed the fiduciary duty doctrine to evaluate the decisions of corporate directors in a multitude of circumstances. Fulfilling that role inspired the courts to innovate…"

The authors suggest a number of "mid-course corrections" to "preserve the benefits of those innovations and eliminate their dysfunctions." *Ibid* at p. 867.

phenomenon of board entrenchment in the context of the unprecedented, high-octane market for corporate control that emerged in the 1980s.

In Canada, there has been a relative paucity of legal challenges to directors' conduct during takeovers and, consequently, Canadian courts have had markedly fewer opportunities to consider the duties of directors in such circumstances with the result that Canadian law in the area has been less developed than in Delaware. Moreover, the law in Canada on the subject of the duties of directors during a takeover has evolved primarily as a result of challenges brought not by shareholders but by "bitter bidders" complaining that the board of the target in accepting a competing bid has not maximized value.[33]

The prominence of "bitter bidders" as opposed to shareholders in driving the development of the Canadian law of corporate takeovers could be attributable to factors which make shareholder complaints more difficult to bring in Canada, such as differences between the availability of class proceedings in Canada compared to the United States, the potential for costs awards against unsuccessful plaintiffs or the lack of economies of scale due to the relatively small size of average Canadian companies. However, another factor could be that differences in shareholders' rights under Canadian corporate law compared to Delaware law give shareholders alternative and effective means to ensure that corporate directors advance the interests of shareholders.

The board of directors of a widely held Canadian public company has little ability to resist a change of control transaction that is favoured by its shareholders. This, is in comparison to the arsenal

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[33] For example see *Ventas*, *CW Shareholdings* and *Pente Investment Management Ltd. v. Schneider Corp* (1998), 113 O.A.C. 253. Schneider also involved a complaint by a shareholder of Schneider that supported the objections of Maple Leaf Foods to Schneider's entering into an agreement that precluded Schneider from accepting a higher offer from Maple Leaf. Delaware has its share of "bitter bidder" cases, including *Revlon*. However, *Revlon* duties have been further developed in cases that are true shareholder complaints. See e.g. *In re Netsmart Technologies, Inc. Shareholder Litigation*, 924 A.2d 171 (Del. Ch. 2007); and *Lyondell Chemical Company v. Ryan*, Del. Supr. No. 401, 2008.

of defensive measures available to the boards of American public companies. In Canada, most corporate statutes allow shareholders to requisition shareholder meetings at which the entire board of directors may be removed and replaced with new individuals more attuned to the interests of shareholders.[34] In contrast, shareholders of a Delaware corporation seeking to obtain the control of the corporation from the incumbent board typically must wage successful proxy battles at two successive annual general meetings in order to take control of two-thirds of the board of directors. Further, Canadian shareholder rights plans (also known as "poison pills") are only watered-down versions of their American counterparts, as a result of the practice of Canadian securities commissions to essentially limit the use of poison pills to a time-buying tool to attract alternative options for shareholders rather than to ward off hostile acquisitions altogether.[35] Securities regulators in the United States, in contrast, do not police the use of poison pills with the result that poison pills may be used as effective obstacles to a prevent a company from being put into play.

Another important difference between Canadian and Delaware corporate law is that Delaware law does not have any equivalent to the flexible oppression remedy. Given the acknowledgement of Delaware jurists that the Revlon duty grew out of judicial innovation due to a lack of alternative tools, query whether the Delaware courts confronted in 1985 would have found it necessary to innovate with the fiduciary duty had shareholders of Delaware corporations enjoyed recourse to the oppression remedy and been equipped with other shareholder-friendly rights that shareholders of Canadian companies enjoy. Despite similarities between corporate structures in Delaware and Canada, differences in the rights of shareholders to protect their own interests, including through the oppression remedy, has

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[34] CBCA, *supra*, s.143. In addition, shareholders of Canadian corporations have much greater access to the management proxy circular and may very inexpensively propose their own nominees to be included on the ballot at annual meetings.

[35] Canadian securities regulators exercise this power pursuant to National Policy 62-202 – *Take-Over Bids- Defensive Tactics*, 20 OSCB 3525.

arguably relieved the Canadian fiduciary duty from filling the more expansive role that it has taken on in Delaware.

Nevertheless, even though the oppression remedy may be a more suitable avenue for shareholders to protect their interests in a change of control context, *Revlon*-like duties do have a logical home within the fiduciary duty. The fiduciary duty is "better described as the duty of loyalty."[36] As explained by the Court in *Peoples*, this duty of loyalty requires that directors avoid conflicts of interest with the corporation and avoid abusing their position to gain personal benefit.[37] *Revlon* duties are not duties distinct from or an exception to the duty of loyalty owed to the corporation but rather a manifestation of the duty of loyalty in the context of an inevitable change of control. The mischief that the *Revlon* line is designed to prevent is the misuse by directors of their control over the corporation to protect their own interests when they face serious conflicts of interest that are innate in the takeover context.[38]

It would have been welcome for the Supreme Court to have considered the *Revlon* line of cases, including the Canadian cases that have been consistent with *Revlon* such as *WIC* and *Ventas*, from this perspective. Although no assertion was ever raised that BCE's directors had failed to properly protect against the influence of conflicts of interest, an analysis would have been helpful to avoid confusion in future cases where the directors have not properly insulated themselves from conflicts. Future cases are bound to arise where directors fail to take steps to maximize shareholder value in change of control in situations where they are motivated by entrenchment or other self-interest. Certainly the oppression

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[36] *Peoples*, *supra* at para. 32.
[37] *Ibid* at para. 35.
[38] Stephen H. Halperin and Robert A. Vaux, "The Role of the Target's Directors in Unsolicited Control Transactions", *Critical Issues in Mergers and Acquisitions – Domestic and International Views, Papers Presented at the 6th Queen's Annual Business Law Symposium* (Kingston: Queen's University, 2000) at 109-14. See also *WIC*, at p. 768-769. In *Revlon*, the directors were faulted for acting to protect their own self-interest by preparing an offer that protected against a perceived but unsubstantiated threat of personal liability. *Revlon*, *supra*.

remedy would be available to shareholders in those circumstances. However, the availability of the oppression remedy should not preclude the logical application of the fiduciary duty in such circumstances.

5. Conclusion

The *BCE* decision has clearly confirmed that the directors of a corporation *may* seek to maximize value for shareholders in the context of a change of control. However, the decision failed to tackle head on whether the fiduciary duty *requires* that directors focus on shareholder interests when a change of control is inevitable. This lacuna may well prove difficult for boards of directors in the future. By not addressing the numerous Canadian cases finding a duty to maximize shareholder value when a corporation is in play, the Court has left a degree of uncertainty over the extent to which these cases are inconsistent with *Peoples* and *BCE*.