NO CHANGES TO ARRANGEMENTS: ALBERTA COURT OF APPEAL UPHOLDS DIRECTORS' CHOICE OF TRANSACTION STRUCTURE IN MERGER OF MARQUEE ENERGY LTD. AND ALBERTA OILSANDS INC.

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On November 15, 2016, the Alberta Court of Appeal overturned[1] a lower court decision that would have required Alberta Oilsands Inc. ("**AOS**") to obtain approval of its shareholders to the acquisition of Marquee Energy Ltd. ("**Marquee**") by means of a plan of arrangement of Marquee, even though approval of the AOS shareholders was not a statutory requirement under the transaction structure chosen by the parties.

Key Facts and Judicial History

The case involves a merger between two companies incorporated under the *Alberta Business Corporations Act* ("***ABCA***")[2] operating in the oil industry: AOS and Marquee. The business plan underlying this transaction was to combine the companies and use AOS's cash—$35 million received from the Alberta government as compensation for cancelled oil sands leases—to develop the oil and gas assets owned by Marquee. An amalgamation of the two companies would require a vote by shareholders of both companies and give rise to statutory rights of dissent and appraisal under the *ABCA*. Smoothwater Capital ("**Smoothwater**"), a 15% shareholder of AOS, opposed this business plan and had indicated that it would vote against the transaction and likely exercise its dissent rights and demand to be paid by AOS the fair value of its shares. In order to avoid such situation, Marquee and AOS structured the transaction as an arrangement of Marquee under section 193 of the *ABCA*, whereby each share of Marquee would be exchanged for 1.67 AOS shares, with the result being that Marquee would become a wholly owned subsidiary of AOS. The arrangement would be subject to the approval of 2/3 of the votes cast by Marquee shareholders and the approval of the court. Following completion of the arrangement, AOS and Marquee would complete a vertical amalgamation under s. 184 of the *ABCA*, which would not require shareholder approval and which would not give rise to rights of dissent and appraisal.

As is required under the *ABCA*, as well as under a number of Canadian corporate statutes, including the *Canada Business Corporations Act* and the *Ontario Business Corporations Act,* Marquee applied for and obtained from the Alberta Court of Queen's Bench, a preliminary order, which among other things confirmed the requirement for approval of the arrangement by Marquee's shareholders. Smoothwater then applied for and obtained an amendment of the preliminary order to require that the transaction also be approved by the AOS shareholders and to grant dissent rights, on the same basis as the Marquee shareholders. Marquee appealed.

Key Findings

In overturning the chambers judge's decision, the Court of Appeal applied the three-part test for approval of a plan of arrangement as set out in *BCE Inc. v. 1976 Debentureholders*[3]: an application for a plan of arrangement must: (i) comply with all statutory and court-mandated requirements; (ii) be brought in good faith; and (iii) be fair and reasonable. In determining whether an arrangement is fair and reasonable, the Court must consider whether the arrangement has a valid business purpose and whether the objections of those whose legal rights are being affected are being resolved in a fair and balanced way. The Court of Appeal held that all three requirements were satisfied on the facts. In so holding, the Court of Appeal made the following key findings:

- **AOS was not the corporation being arranged, and was therefore not subject to the statutory requirement for a shareholder vote on the proposed arrangement**. Under the *ABCA*, the court must order a meeting of the shareholders of the corporation being arranged ("**arranging corporation**") to vote on the proposed arrangement in accordance with specified thresholds.[4] The Court of Appeal found that Marquee was the arranging corporation, but AOS was not. It reached this conclusion by applying the reasoning of the 2006 Ontario court decision in *McEwen v Goldcorp Inc*.[5] The Goldcorp case arose out of a very similar arrangement transaction, whereby each share of Glamis Gold Ltd. was exchanged for 1.67 treasury shares of Goldcorp Inc. plus a nominal cash payment. Goldcorp held that the arranging corporation was Glamis but not Goldcorp on account of the following factors: the transaction would result in Glamis shareholders holding Goldcorp shares, whereas Goldcorp. shareholders would continue to hold Goldcorp shares; the transaction would not affect the rights and privileges attached to Goldcorp shares; there was no change of control of Goldcorp; and the nature of Goldcorp's business was not materially changed. Applying the reasoning of Goldcorp, the Court of Appeal held that Marquee (like Glamis) was the arranging corporation and AOS (like Goldcorp) was a non-arranging corporation.
- **The "fairness and reasonableness" of the arrangement is to be measured only from the perspective of the stakeholders of Marquee, the arranging corporation**. Though an AOS shareholder, Smoothwater was not a stakeholder of Marquee. The *ABCA* does not contain any provision that would require shareholders of two corporations entering into a transaction to be treated equally. Therefore, the fairness and reasonableness of the Marquee arrangement did not depend on equal treatment as between the

shareholders of Marquee and AOS.

- **It was not bad faith for the directors of AOS and Marquee to structure the transaction in a way that avoided triggering a shareholder vote of AOS with accompanying dissent and appraisal rights.** The *ABCA* contemplates multiple methods of effecting a business combination of two corporations, including by amalgamation or arrangement, and the choice of transaction structure among these methods is left to the directors of the participating corporations. The Court of Appeal rejected Smoothwater's argument that the principles of "shareholder democracy" meant shareholders should have a say in fundamental changes being proposed to a corporation. Rather, except where required by statute, the directors are placed in control of the corporation and can execute many transactions without submitting them to shareholder approval. As the chosen transaction structure did not require a vote of the AOS shareholders or that the AOS shareholders be granted dissent or appraisal rights, the AOS shareholders were not being deprived of any pre-existing right. The Court of Appeal held that it was not open to the chambers judge to re-characterize an arrangement as in substance an amalgamation, and then use such re-characterization to vary the transaction structure chosen by the directors.

Conclusion

The Court of Appeal ultimately confirmed that, absent a statutory requirement or stock exchange rule, a shareholder vote of the acquiring company is not required to complete the acquisition of the shares of a target by plan of arrangement. This is so even where the primary reason for using the plan of arrangement appears to have been to avoid potential dissent that would have made it impracticable to effect the transaction under the more straightforward corporate procedure of amalgamation. This decision of the Court of Appeal accords with prevailing public M&A practice in Canada and shuts a potential floodgate, which would have remained open if the lower court's decision had stood, of more dissident shareholders challenging arrangement transactions.

However, there is a postscript to this decision that highlights the practical perils of "structuring around" a dissident shareholder. Although the Court of Appeal ultimately rejected Smoothwater's claim, the decision did not hand AOS and Marquee an unequivocal victory: after the Court of Appeal rendered its decision, Smoothwater and the arranged corporation (the "**New Marquee**") entered into a settlement agreement pursuant to which Smoothwater would obtain a seat on the board of New Marquee, have New Marquee reimburse it for expenses incurred in the course of the dispute, and receive additional shares in New Marquee. In other words, though the proponents of the arrangement took on a dissident shareholder and won at court, they still had to offer that shareholder significant compensation. This outcome may serve as a cautionary tale about the perils of structuring transactions around a large and vocal shareholder.

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[1] *Smoothwater Capital Corp. v Marquee Energy Ltd*., 2016 *ABCA* 360 [Marquee].[ps2id id='1' target=''/]
[2] RSA 2000, c B-9.[ps2id id='2' target=''/]
[3] 2008 SCC 69 *[BCE]*.[ps2id id='3' target=''/]
[4] *ABCA*, s. 193(4).[ps2id id='4' target=''/]
[5] (2006), 21 BLR (4th) 262 (Ont SCJ) affm'd (2006), 21 BLR (4th) 306 (Ont Div Ct) [*Goldcorp*].[ps2id id='5' target=''/]

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.