ASSESSING FAIRNESS AND REASONABLENESS IN PLANS OF ARRANGEMENT: INSIGHTS FROM THE ALBERTA COURT OF KING'S BENCH

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On July 10, 2023, the Alberta Court of King's Bench (the "**Court**") issued a decision that provides helpful clarification concerning how courts in Alberta assess whether a proposed arrangement is fair and reasonable.

The decision involved an application by HEAL Global Holdings Corp. ("**HEAL**"), Pathway Health Corp. ("**Pathway**") and The Newly Institute Inc. ("**Newly**") for a final order approving a proposed plan of arrangement (the "**Arrangement**") under Section 193 of the *Business Corporations Act* (Alberta) ("**ABCA**"). An interim order setting the procedure for the proposed Arrangement was previously granted on April 25, 2023.

If the Arrangement was approved, Pathway would acquire all of the issued and outstanding shares of HEAL and Newly, with the exception of the Newly shares that were held by HEAL. Under the proposed Arrangement, Pathway would acquire such Newly shares on a basis of approximately 4.8 common shares of Pathway for each share of Newly, with the Pathway shares having a deemed value of $0.13 per share (though trading of Pathway shares on the TSX Venture Exchange prior to announcement of the transaction had been closer to $0.05). The application for final approval was opposed by six Newly shareholders, representing approximately 3% of Newly's issued and outstanding shares, primarily on the basis that the Arrangement was not fair and reasonable.

Applicable Test

The Court applied the test set out in *BCE Inc v 1976 Debentureholders* (the "**BCE Decision**") to determine if the proposed Arrangement should be approved. In the BCE Decision, the Supreme Court of Canada stated the purpose of a plan of arrangement was to, "permit major changes in corporate structure to be made, while ensuring that individuals and groups whose rights may be affected are treated fairly". In determining if a final application for a plan of arrangement should be granted, the test in the BCE Decision requires the court to consider (i) whether the statutory procedures have been met, (ii) whether the application has been put forward in good faith and (iii) whether the arrangement is fair and reasonable. In this case, the fairness and reasonableness of the Arrangement was the Court's central concern.

As outlined in the BCE Decision, the Court must ascertain whether a proposed arrangement is fair and reasonable by ensuring that there is a valid business purpose for the arrangement, and that the objections of those whose legal rights are being arranged are resolved in a fair and balanced manner. The BCE Decision sets out a non-exhaustive list of factors to guide courts in determining whether a plan of arrangement has reasonably addressed the objections and conflicts between the various parties. None of the factors are determinative of whether a plan of arrangement is fair and reasonable; instead, courts will take a holistic approach.

Analysis

The Court determined that the proposed Arrangement was not fair and reasonable based on several factors identified in the BCE Decision. The key factors are discussed below.

1. Did the Arrangement have a valid business purpose?

A plan of arrangement must provide positive value to the company in order to offset the fact that rights of certain shareholders are being altered. This analysis depends heavily on the circumstances of the case. Of note, representatives of Newly had indicated to the Court that Newly was suffering from declining financial health and, at the time of the application for the final order, was on the brink of insolvency. The Court noted that if a plan of arrangement is necessary for the company's survival, then a court must be more willing to approve the arrangement, despite prejudicial effects on certain shareholders.

The Court considered the declining financial health of Newly and determined that, as the Arrangement was necessary for the continued operations of Newly, it has a valid business purpose. However, while the Court acknowledged it must be more willing to approve the Arrangement in light of Newly's dire financial situation, the Court noted that the Arrangement must still be fair and reasonable and financial necessity is not a "rubber-stamp" that guarantees the proposed arrangement will be approved.

2. Did a majority of security holders vote to approve the arrangement?

54% of the Newly shares were represented at a special meeting of Newly shareholders to vote on the Arrangement, of which, 100% were voted in favor of the proposed Arrangement. However, nearly 41% of the Newly shares voted at the meeting were held by HEAL. The Court noted that as HEAL's shares of Newly were not subject to the Arrangement, it was not fair to allow them to have an equal say on the Arrangement. Additionally, the Court found that the information available to shareholders at the time of the special meeting was "prejudicially out-of-date". While the directors and officers of Newly (who voted nearly 20% of the shares at the meeting and who had agreed to vote their shares in favour of the Arrangement prior to the meeting) were aware of Newly's deteriorating financial condition, other shareholders were not.

3. What is the proportionality of the compromise between various security holders?

The Court noted that the proposed Arrangement would split the Newly shareholders into two groups with different rights, privileges and restrictions, contrary to Section 26 of the ABCA.

While HEAL would not be required to surrender its shares of Newly for shares of Pathway under the Arrangement, the rest of the shareholders of Newly would be. The Court found that this different treatment of shareholders of the same class was an indicator that the proposed Arrangement was neither fair nor reasonable.

4. Can the shareholders access dissent and appraisal remedies?

The interim order granted by the Court provided shareholders with the right to dissent with respect to the Arrangement, and shareholders holding 10.5% of the Newly shares had exercised such right prior to the special meeting. Because of Newly's impending insolvency, Newly had indicated in its information circular sent to shareholders that it may be unable to pay dissenting shareholders fair market value for their Newly shares, and, if Newly notified dissenting shareholders of its inability to pay and such shareholders did not withdraw their written objection to the Arrangement, they would be deemed to have agreed to the exchange of their Newly shares for Pathway shares. The Court found that this deeming language runs contrary to the ABCA, which indicates that, upon such notice being provided, a dissenting shareholders may either elect to withdraw its objection (in which case, its full rights as a shareholder are reinstated) or retain its status as a claimant against the corporation. As a result, the Court found that the terms of the Arrangement in combination with Newly's poor financial situation effectively removed the right of dissent to the Arrangement. While not conclusive on its own, this was another factor used to determine that the Arrangement was not fair and reasonable.

5. What are security holders' positions before and after the Arrangement?

The Court focused on the effect the proposed Arrangement would have on the economic interest of current shareholders of Newly. Newly had suggested that the proposed Arrangement provided good value to Newly shareholders (considering that Newly shareholders would receive value of approximately $0.22 to $0.24 per share, based on the recent trading value of Pathway shares). However, the Court determined that, without a fairness opinion, there was no basis in which it could consider the outcome of the Arrangement to be good value for Newly shareholders, particularly in light of the recent transactions in which shares of Newly were valued between $0.50 and $1.00.

6. Has the Arrangement been approved by a special committee of independent directors?

A special committee of independent directors of Newly was not formed to review the proposed Arrangement. Instead, the Arrangement was approved by two independent directors who had relatively little experience with

Newly and who were appointed after negotiations with Pathway had already begun. Although there is no requirement for an arranged company to create a special committee of independent directors, particularly for small start-up companies like Newly, it was part of the Court's holistic consideration in determining whether the Arrangement was fair and reasonable.

7. Is there a fairness opinion from a reputable expert?

Newly did not receive a fairness opinion with respect to the proposed Arrangement, citing financial difficulties. While not required, the Court noted that an independent fairness opinion would have been beneficial in this situation given the wide variation in Newly's share valuation prior to announcing the transaction (which ranged from $0.12 to $1.00 per share).

8. What is the impact on various security holders' rights?

The Court noted that there is no requirement for a company to be solvent under the ABCA in order to effect an arrangement, in contrast to the *Canada Business Corporations Act* (CBCA), which requires that a company be "not insolvent". However, the Court found that solvency can still be considered in light of the fair and reasonable test. Newly indicated that it was solvent when the interim order was granted; however, by May 31, 2023, Newly was unable to pay the dissenting shareholders or satisfy its other debt obligations. This change in the financial circumstances adversely impacted the rights of various shareholders by:

- causing the financial information at the special meeting to be outdated;
- rendering Newly unable to pay the dissenting Newly shareholders the fair value of their shares, effectively excoriating their dissent rights; and
- transforming the arrangement of a solvent company to an insolvent company.

Key Considerations

The Court's decision in this case highlights some important considerations for companies when considering a plan of arrangement:

- Although a court must be more willing to approve a plan of arrangement in situations where it is financially necessary for the company, this is not a guarantee that the arrangement will be approved regardless of the negative impacts on shareholders. The arrangement must still be fair and reasonable.
- While not required for a court to approve a plan of arrangement, companies should consider obtaining independent fairness opinions, as they may be valuable to both the court and to shareholders in considering whether a plan of arrangement is fair and reasonable.
- Companies must ensure that shareholders are provided with accurate and up-to-date information that allows them to make informed decisions regarding a plan of arrangement.

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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.