Marquee Energy Ltd.'s Successful Appeal: Shareholder Vote From Alberta Oilsands Inc. Not Required

November 28, 2016

We previously reported on the *Marquee Energy Ltd (Re)*, 2016 ABQB 563 [*Re Marquee*] judgement in our prior post, "Future Uncertainty in Plans of Arrangement" and noted that Marquee Energy Ltd. ("Marquee") intended to appeal the decision of the Alberta Court of Queen's Bench. On November 15, 2016, the Alberta Court of Appeal allowed Marquee's appeal and set aside the Court of Queen's Bench decision.

The Court of Queen's Bench decision required Alberta Oilsands Inc. ("AOS") to obtain shareholder approval of its proposed merger with Marquee, which was structured as a plan of arrangement under Section 193 of the Business Corporations Act (Alberta) ("*ABCA*"), before the court would grant a final order to approve the arrangement. In its written decision, the Court of Appeal set aside the Court of Queen's Bench decision and confirmed that, "*on balance, having regard to the deference owed to the directors, the need for certainty, and the absence of any statutory right to vote, a shareholders meeting of AOS should not be required.*" The decision has helped to restore certainty to this area of law, with the Court of Appeal finding that shareholder democracy does not "*undermine the legitimate powers of the directors of AOS to operate the corporation without having to check with the shareholders, except where specifically required to do so by statute*".

Background of the Action

The Court of Queen's Bench decision is summarized in our previous post, located here. AOS had a significant amount of cash from compensation received from the cancellation of oil sands leases and Marquee had oil and gas assets with significant development potential, but lacked development capital; accordingly, an AOS Marquee strategic merger made sense for both parties. After AOS received the cash compensation, Smoothwater Capital Corporation ("Smoothwater") an activist hedge fund, began acquiring shares of AOS, ultimately owning 15% of AOS' outstanding shares. Smoothwater opposed the merger with Marquee, and instead requested that AOS distribute its cash to its shareholders. Although the parties did contemplate carrying out the merger by way of an amalgamation under Section 183 of the ABCA which would have required a shareholder vote from each company, AOS and Marquee ultimately decided to proceed by way of a plan of arrangement under Section 193 of the ABCA

(the "Arrangement"). In accordance with the *ABCA*, the Arrangement did not require AOS shareholder approval, and also did not provide dissent rights to AOS shareholders who voted against the transaction. Among other reasons, the use of a plan of arrangement avoided the risk AOS' cash would be used to pay dissenting shareholders fair value for their shares – a right which dissenting shareholders would have been entitled to had an amalgamation been pursued.

The Arrangement contemplated that each Marquee share would be exchanged for 1.67 shares of AOS, resulting in Marquee becoming a wholly-owned subsidiary of AOS, and the former shareholders of Marquee becoming shareholders of AOS. Consistent with past industry practice, Marquee and AOS treated only the Marquee shares as being "arranged" and accordingly sought Marquee shareholders' approval, and not AOS shareholders' approval in respect of the Arrangement. The AOS shareholders securities were not being altered as a result of the Arrangement. Following completion of the Arrangement, it was proposed that AOS would then "vertically amalgamate" with Marquee, which also did not require AOS shareholder approval.

The Arrangement would result in AOS issuing approximately 206 million shares to the Marquee shareholders, resulting in dilution of the existing AOS shareholders of approximately 49%.

The Decision of the Court of Queen's Bench

MacLeod J. applied the test for approval of plans of arrangement set out by the Supreme Court of Canada in *BCE Inc. v 1976 Debentureholders*, 2008 SCC 69 ["*BCE*"]. BCE requires that the court must be satisfied that: (1) the statutory procedures have been met; (2) the application has been put forward in good faith; and (3) the arrangement is fair and reasonable. MacLeod J. found that the Arrangement was not put forward in good faith and would not be fair and reasonable unless the AOS shareholders were also permitted to vote on the Arrangement and were granted the right to dissent. In reaching this conclusion, the chambers judge found that the essence of the transaction between Marquee and AOS was a merger and that the primary reason for structuring the transaction as an arrangement as opposed to an ordinary amalgamation was to avoid having to obtain AOS shareholder approval. Further, the Court of Queen's Bench found that although the AOS shares were not being arranged, they were affected as a result of the dilution to their shareholding. Therefore, the Court of Queen's Bench found that while the combination of the two companies had a valid business purpose, as the business purpose could not be achieved until the vertical amalgamation of the companies, the method chosen by the parties was not in good faith as its primary purpose was to avoid the shareholder vote.

Marquee appealed the decision, arguing that it was not open for the chambers judge to apply the *BCE* test, and in the alternative, that he erred in not following BCE and the Ontario case of McEwen v. Goldcorp Inc. (2006), 21 BLR (4th) 306 (Ont. S.C.J. (Div. Ct.)); aff'd (2006) 21 B.L.R. (4th) 306 (Ont. Div. Ct.)) ["*Goldcorp*"], where a similar transaction was approved without requiring a shareholder vote from the non-arranging company.

The Court of Appeal Decision

The Court of Appeal held that Smoothwater, which was not a shareholder of Marquee, had limited standing to challenge the fairness of the Arrangement, relying on the Goldcorp decision and confirming that the fairness and reasonableness of an arrangement must be considered from the perspective of the corporation being arranged, which in this case, is Marquee and not the corporation which is issuing shares, in this case, AOS.

The Court of Appeal found that the Court of Queen's Bench had erred in principle because: (1) the decision was based on the assumption that "*Marquee and AOS should be treated equally, something not found in statute;*" (2) it "*examined fairness from the perspective of AOS, not Marquee*"; and (3) it "*assumed that it was bad faith for the directors to structure a transaction in a way that will not require a shareholder vote, where there are other structures that would require such a vote*." The Court of Appeal noted that there was a legitimate business reason for structuring the merger as an arrangement quite apart from solely avoiding an AOS shareholder vote: had there been a vote and a large number of shareholders had dissented, there would be less cash available to implement the business plan to develop Marquee's assets. It also acknowledged that there was "circularity" in the bad faith argument relied on by the Court of Queen's Bench in its decision, as it "*assumes that the shareholders had a right to vote, that right was taken away from them, and therefore they should be given back that right to vote*". Under the ABCA, shareholders of AOS are not provided with the right to vote on an arrangement.

The Court of Appeal's findings were underpinned by certain Canadian corporate law principles which were decisive in the Court of Appeal's conclusions:

- Looking to the specific words of the statute: the Court of Queen's Bench decision was heavily influenced by principles of "*corporate democracy*" or a "*balance of shareholder choice and the board's ability to manage the corporation*". The Court of Appeal acknowledged that "*intuitively, it seems that shareholders should have a say in fundamental changes, and the ABCA does give them such rights in specific situations.*" However, it pointed out that "*an arrangement by another corporation that will affect Alberta Oilsands is not one of them*". It also noted that when shareholders elect directors, they know the directors can enter into transactions, including fundamental ones, without being required to consult the shareholders and that shareholders "*do not have a right or veto over those transactions, and they cannot come to court to ask the Court to review or veto* transactions on their behalf ". The Court of Appeal also considered the fact that dissent rights are specifically excluded from the arrangement provisions in the ABCA. It follows that the "*intuitive attractiveness of equality of treatment between the shareholders of Marquee and AOS finds no support in the statute*". Shareholder democracy does not "*undermine the legitimate powers of the directors of AOS to operate the corporation without having to check with the shareholders, except where specifically required to do so by statute*". The Court of Appeal was not prepared to read in additional shareholder rights into the ABCA to address any perceived unfairness; instead it held to the divisions or rights and responsibilities set out therein.
- Certainty in law: Directors of public companies need certainty and predictability in the law. Under both BCE and *Goldcorp*, similar transactions were allowed to proceed without requiring a shareholder vote from the company not being arranged. The Court of Appeal noted that "*there is merit to the position that the*

choice of the structure should not be taken from directors without an express statutory provision to that effect".

For additional analysis on the decision, please see Borden Ladner Gervais LLP's post entitled "Alberta Court of Appeal Clarifies Fair and Reasonable Test on Plans of Arrangement".

Updates and Next Steps

On November 14, 2016, the Arrangement was approved by Marquee shareholders at a special meeting. In its press release dated November 14, 2016, Marquee confirmed that it intends to seek a final order from the court approving the Arrangement as soon as possible, subject to receipt of approval from the TSX Venture Exchange. The Court of Appeal decision specifically set aside MacLeod J.'s order that the final order be heard in front of him.

This successful appeal was a welcome decision, as it confirms the validity of the use of, and process involved in, plans of arrangement widely used in corporate restructurings. It remains to be seen whether or not Smoothwater will appeal the decision to the Supreme Court of Canada, and if so, if the Supreme Court of Canada would hear such appeal. Smoothwater has publicly indicated that it intends to appear at the hearing for the final order and to object to the implementation of the plan.

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