Words of caution for executing mergers

December 20, 2023

A plan of arrangement (referred to in this article as an Arrangement) is a procedure by which a corporation is restructured or merged with another entity to effect certain fundamental changes to the corporation. The process involves court oversight to ensure fairness to all stakeholders involved in the Arrangement, and the Court must ultimately approve the proposed Arrangement. Section 192 of the *Canada Business Corporations Act* and the equivalent provincial legislation (including section 193 of the Alberta *Business Corporations Act*) govern Arrangements.

To determine whether a final order for an Arrangement should be granted, the Court must be satisfied that (a) statutory procedures have been met, (b) the Arrangement is put forward in good faith, and (c) the Arrangement is fair and reasonable. Determining whether an Arrangement is fair and reasonable involves consideration of the purpose and necessity of the Arrangement and any objections raised in relation to the Arrangement by relevant stakeholders.

In *HEAL Global Holdings Corp (Re)*, 2023 ABKB 451 (*HEAL Global Holdings*), the Alberta Court of King's Bench confirmed that while financial necessity is an important consideration in determining whether an Arrangement is fair and reasonable, it is not determinative. Instead, the Court will undertake a holistic evaluation of several factors, which may outweigh the impending insolvency of a party to the Arrangement.

Background

HEAL Global Holdings Corp (HEAL), Pathway Health Corp (Pathway) and The Newly Institute Inc (Newly) brought an application for a final order approving a proposed Arrangement. Under the Arrangement, Pathway would acquire all common shares of HEAL and all common shares of Newly, excluding common shares of Newly that were already held by HEAL.

On April 25, 2023, an Interim Order was granted and set the procedure for the proposed Arrangement. On May 30, 2023, Newly held a special meeting with its shareholders to vote on the Arrangement. Only 54.5 per cent of Newly shareholders were represented at the special meeting, but 100 per cent of the votes cast were in favour of the Arrangement. Importantly, the Court noted that:

- Of the total number of Newly shares, 10.5 per cent exercised dissent rights and had no right to vote on the Arrangement, and another 3 per cent cast no vote and advised Newly they opposed the Arrangement.
- Of the 54.5 per cent of Newly shares that voted in favour of the plan, HEAL held 40.7 per cent and the directors/officers of Newly held 19.7 per cent

While Newly was solvent at the time of the April Interim Order, its financial position had quickly deteriorated such that it was nearly insolvent as of May 31, one day after the Arrangement was passed in the special meeting. Newly's shareholders were not aware of these concerning financial developments before voting at the special meeting.

The applicable test

In considering whether to grant a final order approving the Arrangement, Justice Sidnell applied the test from the Supreme Court decision in *BCE Inc v 1976 Debentureholders*, 2008 SCC 69 (*BCE*). Under the *BCE* test, the Court must be satisfied that:

a. the statutory procedures have been met;
b. the application has been put forward in good faith; and
c. the Arrangement is fair and reasonable.

To determine whether a proposed Arrangement is fair and reasonable, the Court must be satisfied that (i) the Arrangement has a valid business purpose, and (ii) the objections of those whose legal rights are being arranged are being resolved in a fair and balanced way. This analysis is applied from the perspective of the corporation being arranged, not from the perspective of any other party to the Arrangement.

Decision

At the outset, Justice Sidnell found the Arrangement was necessary to Newly's continued operations because it was "on the brink of insolvency," and therefore the Arrangement had a valid business purpose. However, after reviewing the non-exhaustive list of factors from *BCE* for whether an Arrangement has reasonably addressed the objections and conflicts between the different parties,[1] Justice Sidnell concluded that the Arrangement was not fair and reasonable because:

- many of the shares voting in favour of the Arrangement were held by HEAL, despite the fact that HEAL's shares in Newly were not subject to the Arrangement;
- the information available to Newly's shareholders regarding Newly's financial position was prejudicially out of date, especially considering Newly's directors and officers may have known of Newly's deteriorating financial position at the time of the vote;
- the Arrangement would split the Newly shareholders into two groups with different rights, privileges, restrictions, and conditions. In particular, HEAL was not obligated to surrender its Newly shares or become a shareholder of Pathway, while remaining Newly shareholders would receive Pathway shares in exchange for Newly shares;

- Newly shareholders essentially lost all their dissent rights, as dissenting shareholders would have their shares automatically converted to shares in Pathway under the Arrangement;
- although not strictly necessary under the *Business Corporations Act*, Newly failed to appoint a special committee of independent directors to review the Arrangement, despite one of its directors having a material conflict of interest in the Arrangement; and
- although not strictly necessary under the *Business Corporations Act*, Newly failed to obtain an independent fairness opinion which would have assisted its shareholders, independent directors, and the Court in determining whether the Arrangement was fair and reasonable.

Ultimately, Justice Sidnell concluded that while the Arrangement would provide for Newly's continued existence and save the corporation from insolvency, the adverse effect on the rights of opposing and dissenting shareholders was too substantial to approve the Arrangement.

Takeaways

HEAL Global Holdings demonstrates that even where an Arrangement may remedy a corporation's pending insolvency or be motivated by some kind of financial necessity, it does not guarantee that the Arrangement will be approved by the Court. The determinative question remains whether the Arrangement is fair and reasonable, and the Court may consider factors such as:

- whether the Arrangement is voted on by shareholders who are not actually subject to the Arrangement;
- whether the Arrangement treats shareholders in the same class differently;
- whether the Arrangement removes or neutralizes shareholder dissent rights;
- whether the shareholders have accurate and up to date financial information when voting on a proposed Arrangement;
- whether the corporation has appointed a special committee to consider the Arrangement; and
- whether the corporation supports the Arrangement with a fairness opinion.

HEAL Global Holdings has yet to be considered by higher courts, but corporations considering effecting a merger by way of an Arrangement under the Alberta *Business Corporations Act* or *Canada Business Corporations Act* will want to take note of Justice Sidnell's analysis regarding the fair and reasonable test.

For more information on *HEAL Global Holdings* or considerations in effecting an Arrangement, please reach out to one of the key contacts below.

[1] See paragraph 43 of *HEAL Global Holdings* for the list of factors.

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