Future Uncertainty In Plans Of Arrangement

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In *Marquee Energy Ltd (Re),* 2016 ABQB 563, a case concerning the structure of the proposed merger between Alberta Oilsands Inc. ("AOS") and Marquee Energy Ltd. ("Marquee"), the Alberta Court of Queen's Bench cast a degree of uncertainty in what has historically been a predictable and widely used arrangement process under the *Business Corporations Act* (Alberta) ("ABCA"). In his decision Justice A.D. Macleod challenged the fairness of AOS' decision to structure the merger by way of a court-supervised plan of arrangement pursuant to Section 193 of the ABCA and to not provide the AOS shareholders with a right to vote on the proposed arrangement. In what many in the industry consider a surprising ruling in favour of AOS's significant shareholder, Smoothwater Capital Corporation ("Smoothwater"), Justice A.D. Macleod ruled that the court would not grant a final order to approve the arrangement unless the shareholders of AOS had voted to approve the arrangement. As a result, there is now a question as to whether acquiring companies may have to provide their shareholders with a right to vote on a proposed arrangement under Section 193 of the ABCA, notwithstanding that neither the legislation nor the policies of the TSX Venture Exchange contain a requirement for a shareholder vote of an acquiring company when the shares of the acquiring company are not being arranged. The appeal of the decision is scheduled to be heard on November 9, 2016.

Legislation

There are different ways to merge or amalgamate companies under the ABCA. Section 183 of the ABCA provides for the amalgamation of two or more arm's length corporations and requires that the shareholders of each of the amalgamating companies approve the proposed amalgamation by not less than two-thirds approval. Where the corporations are not at arm's length, Section 184 of the ABCA may be used which provides for short-form amalgamations (e.g. where a company wishes to amalgamate with its wholly owned subsidiary), in which case shareholder approval of the amalgamation is not required.

Alternatively, Section 193 of the ABCA governs court-supervised arrangements. Section 193(3) specifically states that a court-supervised arrangement may only be used in the event that it is "impracticable" to effect the arrangement under any other applicable provision of the ABCA. Historically, the courts have typically not required the shareholders of the acquirer company to approve the proposed arrangement because their shares aren't being arranged; the only shareholders permitted to vote upon the

arrangement would usually be the shareholders of the company being acquired, whose securities are being “arranged” under the arrangement.

Background

AOS received roughly $35 million in 2015 from the Government of Alberta for the cancellation of certain oil sands licenses in an urban development region of Fort McMurray. AOS and Marquee, who had conventional oil and gas assets but needed better capitalization, entered into discussions in relation to a merger. Smoothwater, a holder of approximately 14% of the shares of AOS, objected to this merger as it wanted AOS to distribute its cash out to its shareholders instead. The decision notes that AOS initially advised the CEO of Smoothwater that AOS shareholders would be given a vote on the merger (though the decision did not contain a description on how the CEO of Smoothwater had been so advised). However, AOS and Marquee subsequently announced that the merger would take effect by way of a court-supervised plan of arrangement under Section 193 of the ABCA (the “Arrangement”), which meant that the AOS shareholders would not be entitled to vote on the Arrangement.

Pursuant to the Arrangement, the intention was that each Marquee share would be exchanged for 1.67 shares of AOS, and that following the purchase of the shares and the conclusion of the Arrangement, Marquee and AOS would vertically amalgamate under s. 184 of the ABCA to continue under the name “Marquee Energy Ltd.” The Arrangement was drafted in such a way as to not include the amalgamation. This meant that once the Arrangement was completed, a vertical amalgamation between what would then be a parent and its wholly-owned subsidiary could proceed without a shareholder vote, pursuant to Section 184 of the ABCA.

Smoothwater, in opposition of the merger, brought an application seeking the right to vote on the Arrangement. Marquee and AOS opposed the application, arguing that the securities of AOS were not being arranged and that the legal rights of the AOS shareholders were not affected by the Arrangement.

Decision

Even though this was in relation to an amendment of an interim order, and not the final order approving the Arrangement, the court applied the test set out by the Supreme Court of Canada in *BCE Inc. v 1976 Debentureholders,* 2008 SCC 69 [*BCE*] to determine whether or not the Arrangement should be approved. The court in *BCE* confirmed that prior to approving a plan of arrangement, 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. To be fair and reasonable, the Court determined that the arrangement must have a valid business purpose and the objections of those whose legal rights are being arranged are being resolved in a fair and balanced way. MacLeod J. found that the tests in this case could not be met.

Application and Analysis of the Test

Were the statutory procedures met?

Further to the provisions in the ABCA, an application under s. 193(3) cannot be brought unless it is impracticable to effect the arrangement under any other provision of the ABCA. Here, MacLeod J. noted that before the court "rubber-stamps" an arrangement, the court ought to look at the proposed arrangement very carefully and should balance the alleged impracticability of using those other provisions against the value of the rights that would be sacrificed if one uses the arrangement process rather than the provisions which provide for the approval of the shareholder of both amalgamating companies. Smoothwater vigorously argued that this "impracticability" requirement could not be met. Although the court held that there may be some impracticability in effecting the arrangement under a different provision of the ABCA, it declined to make a ruling on whether or not s.193 (3) could be satisfied.

Analysis: MacLeod J. noted that the United States Securities Act of 1933 might cause an issue of impracticability, but did not delve any further into the analysis on this point. Historically, companies and lawyers in the industry have maintained, and courts have accepted, that having to comply with United States securities rules was likely enough to satisfy this threshold of "impracticability", which Macleod J. himself noted in his decision, was a low threshold. As MacLeod J. refrained from making a ruling on impracticability, this decision introduces an element of uncertainty for companies as no direction was given on the considerations that should factor into balancing impracticality with the other rights potentially sacrificed in an arrangement process.

Was the application in good faith?

MacLeod J. held that the overall proposal by AOS and Marquee to merge the two businesses was put forward in good faith. However, the court went on to find that the Arrangement, which did not include the subsequent vertical amalgamation, did not actually achieve the result of combining the businesses, but instead simply resulted in the restructuring of AOS and Marquee, so that the companies could later be amalgamated without AOS shareholder approval under Section 184 of the ABCA. In addition, the court noted that Smoothwater had made numerous other allegations in respect of unfair dealings between the parties. Based on this, the court held that the Arrangement was not put forward in good faith as it had been done primarily to avoid a vote of AOS shareholders.

Analysis: Justice A.D. Macleod appears to have analyzed the proposed AOS and Marquee transaction as a whole, and it is possible that the fact that AOS had previously told Smoothwater that AOS shareholders would be entitled to vote on the merger, as well as certain other previous dealings referenced in the decision, factored significantly into his ultimate decision.

Was the Plan of Arrangement fair and reasonable?

When determining whether the arrangement was fair and reasonable, the court factored in whether there was a valid business purpose and how the conflicts between Smoothwater and the other interests were being resolved. The business purpose of merging AOS and Marquee was found to be valid, however the legal structure labelled as a plan of arrangement was found not to have accomplished the intended purpose of combining the two entities, which the court noted would not occur until after the vertical amalgamation was effected. The court found that the sole purpose of the Arrangement was to allow the subsequent vertical amalgamation to be done without an AOS

shareholder vote under Section 184 of the ABCA. It held that in the spirit of the legislation, the test in *BCE* and in view of the transaction as a whole, fairness and reasonableness demanded that AOS shareholders should have a right to vote, similar to the right they would have been given had the merger proceed by way of amalgamation under s. 183 of the ABCA.

Analysis: Arguably, a company and its wholly owned subsidiary can combine their businesses without having to operate as one legal entity. Whether or not this is argued as an error in law remains to be seen in the appeal which is scheduled to be heard on November 9, 2016.

Implications

The Court of Queen's Bench ruling represents a significant departure from established law surrounding plans of arrangement in Alberta and may have significant implications for how arrangements are structured going forward. The decision indicates that when considering a proposed arrangement, the impracticability of using other provisions under the ABCA must be balanced against the loss of safeguards that would be sacrificed if one uses the arrangement process, though no direction was given by the court on the considerations that should factor into this balancing act. The uncertainties created will undoubtedly introduce extra time and cost consequences for companies wishing to complete a plan of arrangement in Alberta. However, the decision by Justice A.D. Macleod references a number of factual events between the parties which may have added to the perception of bad faith leading to the decision to require an AOS shareholder vote and are unique to the relationship between AOS, Marquee and Smoothwater. As such, the decision may have been driven by very specific facts. As the decision is being appealed, it is not clear at this time what effect this decision will have in structuring plans of arrangements under Section 193 of ABCA. We will continue to monitor the appeal, and its impacts, going forward.

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