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# Corporate Governance and Protection of Creditors: The Supreme Court of Canada Decision in the *BCE* Case and its Implications on the Current Debate

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Milan Sýkora

## Abstract

Traditionally, it was mainly contract and insolvency law what protected creditors of corporation against maladministration of their advanced money by the corporation. However, this protection did not always succeeded and creditors were often being left with only little bit more than nothing when their debtor was dissolved. Many corporate governance scholars tried to react on this by imposing fiduciary duties towards corporation's creditors. I will analyze both scholarship and current state of law and I will try to find boundaries of creditors' rights in modern corporate law. This essay will firstly explore academic discussion between scholars promoting flat contract protection of creditors, on the one hand, and other scholars allocating further rights to corporation creditors. As we will see, their point of view may vary depending on the financial situation of the corporation. Secondly, I will review a recent decision of the Supreme Court of Canada in a take-over case that pushes this discussion further as it deals with pure economic rights of creditors in situations where these are not yet residual owners of the corporation. Thirdly, I will analytically try to find the right place for the decision in the aforementioned debate and conclude this essay.



## Anotace

Tradičně to je především smluvní a insolvenční právo, co zajišťuje ochranu věřitelům obchodních společností proti tomu, aby tyto zneužily jimi poskytnutý úvěr. Nicméně v mnoha případech zůstávají pohledávky věřitelů z velké části neuspokojeny, pokud je prohlášen konkurz na majetek společnosti. Mnoho teoretiků corporate governance se pokusilo reagovat na tento neblahý stav pomocí teorie fiduciárních povinností společnosti a jejích manažerů vůči věřitelům. Hranice mezi těmito povinnostmi a tradiční ochranou se pokusím nalézt pomocí analýzy teoretických prací a stavu současného právního řádu v komparativní rovině. Nejdříve podrobně prozkoumám akademickou debatu mezi zastánci ochrany v kontraktuální ochrany jako jediné možné a žádoucí, na jedné straně, a akademiky, kteří usilují o rozšíření těchto práv, na straně druhé. Jak uvidíme, rovnováha v této debatě se posunuje dle finančního stavu společnosti. Za druhé, podrobně rozeberu nedávné rozhodnutí Kanadského nejvyššího soudu ve věci nepřátelského převzetí, které pojednává o ekonomických právech věřitelů obchodních společností, ve vhrli, kdy tyto společnosti jsou v obstojné finanční kondici. Za třetí potom toto rozhodnutí umístím do kontextu současné debaty a uzavřu tuto práci.

# 1. Introduction

As any other branch of law, corporate law is, at the end of the day, about maximizing social welfare[1] by protecting and balancing interest of involved parties. Nevertheless, the balance in corporate law encompasses a large number of parties with conflicting interests. Moreover, these parties are interacting with each other in something as intangible as a corporation (despite the corporation's very tangible factories, gas plumbs and other assets). Out of these interest groups, the corporation's creditors comprise one of the most important constituencies and this essay focuses on their protection.

Traditionally, protection of creditors was assured through insolvency law and contract law.[2] However, this protection can result in inefficiencies as especially unsecured creditors are often left with nothing after the corporation is dissolved in liquidation insolvency proceedings.[3] This provoked a broad scholarship that extended the creditors' rights beyond the boundaries of this traditional view. By analyzing scholarship, current state of law and a recent court decision of the Supreme Court Canada, I will try to find boundaries of these rights in modern corporate law.

This essay will firstly explore academic discussion between scholars promoting flat contract protection of creditors, on the one hand, and other scholars allocating further rights to corporation creditors. As we will see, their point of view may vary depending on the financial situation of the corporation. Secondly, I will review a recent decision of the Supreme Court of Canada in a take-over case that pushes this discussion further as it deals with pure economic rights of creditors in situations where these are not yet residual owners of the corporation. Thirdly, I will analytically try to find the right place for the decision in the aforementioned debate and conclude this essay.

# 2. Debate between *Contractarians* and *Fiduciarians*

In the debate if and how should the corporate law take into account interests of corporate creditors, we may identify two main groups of scholars – the *contractarians* and the *fiduciarians*. The first group, already established in literature, [4] believes that the market and contract mechanisms are

[1] Ranier Kraakman et al., *The Anatomy of Corporate Law: A comparative and Functional Approach* (2nd edition, Oxford University Press 2009) 28

[2] ibid 115; Andrew Keay, 'Directors' Duties to Creditors: Contractarian Concerns Relating to Efficiency and Over-Protection of Creditors' (2003) 66 Modern Law Review 665, 665

[3] Philip Wood, *Law and Practice of International Finance* (Sweel & Maxwell 2008) at 5.17

[4] See for example Keay (n 2) 666.

sufficient to efficiently protect creditors. The latter group of scholars, whose common denomination was invented by the author, believes in much wider protection, concretely in imposition of fiduciary duties to directors to take into account interests of creditors. This Part will deal with these two approaches and in the last sub-part tries to find common ground of both groups.

## A. Contractarians

Arguably the most influential academic movement in corporate law, the *law and economics* movement,[5] left also its footprints in the debate of corporate creditors' protection. The opinion presented by these scholars at both sides of the Atlantic is probably best described as *contractarian* approach. Their focus lies in the contractual nature of the relation between different stakeholders of the corporation. The main devices of creditor protection are *ex ante* protection mechanisms of contract law.

The core of the *contractarian* scholarship is the theory of the firm as the way of looking at corporations. The premise is based on an influential theory of Coase that was presented in his seminal work *The Nature of the Firm*.[6] Its basic focus is the corporation as a complex net of market based relations.[7] Because of its focus on the relations behind the corporation as opposed to theories focusing on the corporate body itself it is usually referred to as '*the nexus of contracts theory*'.[8]

The explanation of existence of corporations, according to *the nexus of contract theory*, minimization of transaction costs. Because contracting is more favourable when made through a viable corporate device, corporations were born.[9] Public concerns viewing corporation as a social institution are usually put aside.

Furthermore, corporate law literature of *law and economics* movement usually considers directors of corporation as agents of shareholders. It provides various explications, but the most common is based on minimization of agency costs as shareholders are usually best motivated to monitor the management.[10] As consequence, the corporation itself in economic theory "disappears" and is reduced

[5] Keay (n 2) 674
[6] Ronald H. Coase, 'The Nature of the Firm' (1937) 16 Economica 386
[7] Frank H. Easterbrook and Daniel R. Fischel, 'The Corporate Contract' (1989) 89 Columbia Law Review 1416, 1422
[8] Michael C. Jensen and William H. Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure' (1976) 4 Journal of Financial Economics 305, 311; Easterbrook and Fischel (n 7) 1425
[9] Jensen and Meckling (n 8) 7; Frank H. Easterbrook and Daniel R. Fischel, *The Economic Structure of Corporate Law* (Harvard University Press 1991) 67
[10] Jensen and Meckling (n 8) 16

to a convenient legal fiction.[11] The minimization of agency costs is fostered as shareholders tend to be residual claimants of the corporation's assets.[12] In sum, shareholders are for various reasons beneficiaries of the directors' fiduciary duties.

The *contractarian* approach to corporate creditors fosters the contractual nature of their relations with the corporation. Under usual circumstances, it does not consider them as significant risk bearers as these are residual claimants – corporation's shareholders.[13] Now I will analyze the presumption of contractual protection of creditors.

Firstly, the *contractarians* assume that creditors of corporations protect themselves against the corporation's insolvency by discounting their advanced credit.[14] If the borrowing corporation wants to minimise this discount and obtain cheaper credit, it has to negotiate security on the raised debt[15] or include bonding and monitoring covenants into the credit contracts.[16] These are mechanisms not available to the shareholders. Markets and negotiation are therefore the main mechanisms of creditor protection.

Secondly, the creditors are protected by monitoring that is conducted by the shareholders. The shareholders being the residual claimants are to be paid upon insolvency as the last and therefore have incentives to monitor efficiently the management to take the right amount of risk.[17]

Thirdly, the creditors should not benefit from fiduciary duties of the directors as those are owed to other actors.[18] Simultaneously, there are two other problems with imposition of fiduciary duties: (i) they have operating costs,[19] and (ii) they tend to be diluted if owed to several diverse actors with conflicting interests.[20] The dilution would probably consist mainly in shifted perception of risk in investment project that would ultimately lead to underinvestment to preserve the risk-free position of creditors.[21] A final technical argument added by Fischel is that fiduciary duties are natural to relations

[11] ibid 12
[12] Easterbrook and Fischel (n 9) 67
[13] Even though, they become residual owners upon insolvency of the corporation. Paul Davies, 'Director's Creditor-Regarding Duties in Respect of Treding Decisions Taken in the Vicinity of Insolvency' (2006) European Business Organization Law Review 302, 306
[14] Daniel R. Fischel, 'The Economics of Lender Liability' (1989) 99 Yale Law Journal 133, 125
[15] And hereby gain super priority upon insolvency. Philip Wood (n 3) at 5-06
[16] Fischel (n 14) 136
[17] Davies (n 13) 305, Keay (n 2) 668
[18] It remains insignificant, at this precise point, whether these are shareholders or the corporation itself.
[19] Henry N. Butler and Larry E. Ribstein, 'Opting Out of Fiduciary Duties: A Response to the Anti-Contractarians' (1990) 65 Washington Law Review 1, 54
[20] Let's see the example of Dutch experiment of employee trusteeship. Boards of large Dutch corporations were charged with fiduciary duty to both shareholders and employees. Costs were so high that this law was soon abolished. Kraakman et al. (n 1) 102
[21] Len Sealy and Sarah Worthington, *Sealy's Cases and Materials in Company Law* (9th edition, Oxford University Press 2010) 307

where one party delegates power to another.[22] No such delegation, but a clear bargain is usually made between the corporation and its creditors.

The *contractarians* tend to restrict creditors as beneficiaries of fiduciary duties on the presumption that creditors are well protected by other means. They have monitoring and bonding covenants they bargained for, they have priority in insolvency and imposition of fiduciary duties towards them would dilute the effect of these duties as they are already owed to other constituencies.

## B. Fiduciarians

On the contrast, the *fiduciarians* tend to promote imposition of fiduciary duties of directors towards the corporate creditors. There are various reasons why they argue so. In this sub-part, I will review arguments of various academic movements why such fiduciary duties should be imposed and enforced to the benefit of the corporate creditors.

Emergence of *law and economics* movement brought a new wave of academics reacting to the efficiency based theories. Scholars of this veawe were usually opposing outcomes of the *law and economics* literature as exaggerated and unfair.[23] They often looked at corporations from wider perspective as on social institutions with wider a community meaning.[24] From this point of view, a limited protection of creditors seemed to be unfair and socially imbalanced.[25]

These academics therefore sought after further possibilities of creditor protection. Some of them promoted employee participation in boardrooms[26] while the others suggested changes in classic patterns of fiduciary duties of directors.[27] Their main argument was the unlikely vulnerability of diversified shareholders *vis-a-vis* corporate failures and, at the same time, other stakeholders being much more dependent on survival of the corporation.[28]

Unlike the *law and economic* scholars, the *fiduciarians* highlight the variety of creditors. Keay assumes that not all creditors are capable of assessing the credit risk of their counterparties and that

[22] Fischel (n 14) 147

[23] See for example analysis in Keay (n 2) 677.

[24] For further analysis see John E. Parkinson, *Corproate Power and Responsibility: Issues in the Theory of Company Law* (Clarendon Press 1993) 260 or Irene L. Fannon, *Working within Two Kinds of Capitalism: Corproate Governance and Employee Stakeholding: US and EC Perspectives* (Hart Publishing 2003) 89.

[25] Gavin Kelly and John Parkinson, 'The Conceptual Foundations of the Company' in Andrew Gamble et al. (eds.), *The Political Economy of the Company* (Hart Publishing 2000) 117

[26] Parkinson (n 24) 397

[27] Edwin M. Dodd, 'For Whom are Corproate Managers Trustees?' (1932) 45 Harvard law Review 1145, 1154. For discussion and further analysis see Fannon (n 24) 100

[28] As for example employees develop firm specific risks Kelly and Parkinson (n 25) 124. Or trade creditors that may face cross defaults once their main business partner defaults Wood (n 3) at 4-16

their bargaining power is not big enough to negotiate appropriate bonding and monitoring mechanisms in their contracts.[29]

Furthermore, their contracts are, as in the case of shareholders, negotiated *ex ante*. In the real world, no contract is complete and no party can protect themselves by anticipating any future event in the contract.[30] Therefore, protection by means of fiduciary duties of directors towards creditors may bring more (i) efficiency[31] and (ii) fairness to corporate law.[32]

The more conservative group of *fiduciarian* scholars promotes imposition of fiduciary duties in favour of creditors in case of vicinity of insolvency. It has two basic explanations.

Firstly, once the equity has been dissipated, the shareholders do not bear the risk of turndown of the corporation while they participate at its commercial success. There are, therefore, incentives for the corporation maximizing shareholders' value by engaging in extremely risky operations.[33]

Secondly, in vicinity of insolvency, as the equity balance sheet cushion is dissipated, the stakeholders are being turned into factual residual claimants as there is no equity left to be distributed among shareholders upon winding up.[34]

More progressive *fiduciarians* tend to take into account interests of broad classes of stakeholders at all times, e.g. not only in vicinity of insolvency.[35] They claim that by being passive and diversified, the shareholders lost their privileges and their interests in the corporation should not be raised above interests of other stakeholders.[36] In effect, fiduciary duties are owed to all stakeholders at the same time and a balance has to be found when their interests are conflicting.[37]

*Fiduciarians* believe that it is not possible to justly protect interests of creditors without imposing further fiduciary duties on directors and these duties being in favour of creditors. They are very heterogeneous group, though artificially established for the purpose of this essay. Their opinions, therefore, vary on the extent of these fiduciary duties. With the scale of imposed fiduciary duties, their justification varies too.

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[29] Keay (n 2) 688
[30] Easterbrook and Fischel (n 9) 90; Andrew Keay and Hao Zhang, 'Incomplete Contracts, Contingent Fiduciaries and a Director's Duty to Creditors' (2008) 32 Melbourne University Law Review 141, 162
[31] Keay (n 2) 698
[32] ibid 677
[33] Davies (n 13) 306
[34] Keay Zhang (n 30) 143
[35] ibid 167
[36] See for example Kelly and Parkinson (n 25) 124
[37] Keay Zhang (n 30) 168

## C. Converging the *Contractarians* with the *Fiduciarians*

Despite different approaches of the both mentioned groups of scholars, the author believes that there is possible convergence in their opinions and that, in some cases, their opinions even overlap. Attentive reader surely noted that *law and economics* authors are not present only in the first group. This subpart focuses on explanation of this convergence and aims to facilitate the dialogue of both by appointing on these overlaps.

At first it is to be noted that described theories, to some extent, varies in methodology. The *law and economics* scholars use abstract economic models[38] to model an 'ideal world'. On the other hand, many of the *communitarians* base their opinions on basic observations of the 'real world'.[39] In consequence, we should bear in mind that *law and economics* theories are only intended to underline regulation policy,[40] not to prescribe behaviour of real actors.

Furthermore, I would like to appoint that (i) both theories are at least partly converging at one point, and (ii) at one point the *fiduciarian* theory should give way to *contractarians*.

Firstly, as being only models for ideal world, *contractarians'* texts usually do not handle with the problem of insolvent corporations. Easterbrook and Fischel linked shareholders to directors with fiduciary duties as the former are residual claimants.[41] Should their theory be developed further, we come to the conclusion that in the moment when creditors become residual owners of the corporation, they are (and should be) beneficiaries of fiduciary duties. To say creditors become beneficiaries instead of shareholders.[42] This view is also confirmed by Davies.[43] Furthermore, costs of such mechanism seem to be low as they influence only near-insolvent corporations that comprise a split of all corporations in the economy.[44] The only remaining problem to be solved is at which exact moment these duties are to be triggered.[45]

Secondly, if we argue with unfairness towards unsophisticated creditors as Keay does,[46] we have to consider the benefits that these gain by the way of being co-creditors with banks and other sophisticated. At the end of the day, they are protected by bank's monitoring covenants and corporate

[38] Coase being the clearest expample.
[39] As we can see for example in Dodd's argumentation in Dodd (n 27).
[40] Compare Ronald H. Coase, 'Economics and Contiguous Disciplines' (1978) 7 Journal of Legal Studies 201.
[41] Easterbrook and Fischel (n 9) 67
[42] Kraakman et al. (n 1) 119
[43] Davies (n 13) 313
[44] Kraakman et al. (n 1) 120
[45] Davies (n 13) 317; Keay Zhang (n 30) 147
[46] See text accompanying n 29.

rescue schemes.[47] In consequence even creditors that do not posses bargaining power participate in sophisticated protective contractual devices.

By careful consideration we can conclude that there is an economic explication of imposition of fiduciary duties towards creditors under certain circumstances. This theoretical concept is, however, jeopardized by the uncertainty about the exact point at which law should trigger these obligations. Furthermore, we have to admit that if these are not imposed in other cases than vicinity of insolvency, no unfairness is to occur as unsophisticated creditors can free ride on protection devices of banks. I dare to state that opinions of both discussed groups could be converged at these points. Some radicals from both groups still remain outside of this convergence, but this is probably due to the nature of any academic discourse.

## 3. Canadian Supreme Court Decision *BCE* and the Current State of Law

This Part deals mainly with the recent decision of the Supreme Court of Canada that recently brought some new insights to the discussion on stakeholders' in corporate governance issues. Before discussing the decision itself, we will briefly review the current state of comparative corporate law and its treatment of corporate creditors.

### A. Overview of the Current Law

In the second half of the 20th century, we have observed emergence of court decisions in creditors' protection by means of corporate law as Keay and Zhang demonstrate on English and Australian cases.[48] The original position that if the corporation is insolvent, fiduciary duty is owed to creditors[49] was moved and broadened.

Further, it was confirmed that obligations are owed to the creditors if the corporation is in financial distress,[50] i.e. in *vicinity of insolvency*. The converged position *fiduciarians* and *contractarians* was accepted in the UK as we can observe.[51] Also other European corporate law systems seem to favour directors' duties towards creditors if insolvency is knocking on the door as we

[47] Wood (n 3) at 5-04
[48] Keay and Zhang (n 30) 141
[49] Compare e.g. *Whaley v Doney* [2004] 1 BCLC 217.
[50] *Winkworth v Edward Baron Development Co Ltd.* [1987] 1 All ER 114, 118
[51] Kraakman et al. (n 1) 137

see from a comparative text by Kraakman and others.[52] The same authors also confirmed a similar approach in Japan.[53]

However, this position still has not been upheld in Delaware which we should consider the leading corporate jurisdiction withnin the US.[54] The protection of creditors in the US corporations is deemed to be secured through stricter criminal liability.[55]

The mainstream trend in corporate law seems to be clear – we are drifting towards a stricter imposition of fiduciary duties towards creditors. However, this duty seems to be limited to insolvency and near insolvency situations and therefore does not seem to be a shift towards a general imposition of Parkinson's pluralistic corporation. The decision of the Supreme Court of Canada further confirms this position, but also brings new perspectives on insolvency remote situations.

## B. The *BCE* Decision

The decision of the Supreme Court of Canada in *BCE Inc. v 1976 Debentureholders*[56] (***BCE***) attracted attention of both Canadian corporate law practitioners and scholars as it dealt with issues that always have been controversial in law practice as well as in academic discussions: *take-over*, *leveraged buyout* and dilution of *unsecured creditors'* claims. The facts of the case appeared to be much more controversial then was usual in any previous case, as the court had to handle with a situation where no insolvency was close or threatening.[57]

The *fiduciarian's* hypothesis was put under the microscope in this case as the only harm sustained consisted in decrease of investment rating of publicly traded bonds. As the previously mentioned decisions were testing the creditors' rights from the position of residual claimants, the *BCE* provided some judicial evidence from a completely different situation. Before approaching the court's analysis itself, I will summarize the facts surrounding the business transaction that was put under judicial review in the case.

[52] ibid 134
[53] ibid 136
[54] ibid 135; Keay and Zhang (n 30) 142
[55] Kraakman et al. (n 1) 137
[56] [2008] SCC 69
[57] Compare 3.A *supra*.

### i. Facts of the BCE Decision

To sum up the facts of the *BCE* decision, holders of bonds of Bell Canada sued the issuer and its holding company for disregard of their investor rights during capital structure changes. Initially, the holding company BCE Inc. was subject to a take-over bid by way of leveraged buyout. The take-over bid was probably anticipated as BCE Inc. was struggling under new regulatory issues and cash-flow problems and a change of control was perceived by analysts.[58] As the threat of take-over increased, the directors engaged in attracting more competing bids to prevent the corporation from a situation where it would face only one bidder with no competition.[59] Under the conditions of the auction process circulated between potential bidders, it was made clear that financing arrangements would have to respect legal rights of the corporate group's creditors and bondholders.

At the end of the bidding process, three offers were submitted.[60] All three of them included a substantial raise of new debt in order to secure finance for the transaction and all of them would raise liabilities of the Bell Canada,[61] the Canadian telecommunication giant that was the main asset of the BCE Inc. holding company.[62]

When the final arrangement was announced, rating companies downgraded the credit rating of the previously issued debt of the Bell Canada below the investment grade. Subsequently, the bonds lost 20 % of their market value (by average) and some institutional investors had to close their positions due to investment restrictions.[63] These institutional bondholders then opposed the transaction as their economic interests were harmed and directors failed to protect their interests.

At this place, the conditions of the bond issue should be noted. No standard covenants regarding credit rating were included in the issue.[64] Bell Canada was not contractually prohibited to raise or guarantee new debt. The action of the bondholders was based on the assumption that representations previously made by the Bell Canada should have guaranteed protection against actions leading to

[58] *BCE* (n 56) at 9
[59] ibid at 13
[60] ibid at 17
[61] As follows from the nature of leveraged buyouts. Compare Edwin L. Miller., *Mergers and Acquisitions* (John Willey & Sons 2008) 295
[62] Even though both companies were separate legal entities, they shared the same set of directors and senior officers. *BCE* (n 56) at 5
[63] These were mainly institutional investors such as pension funds.
[64] *BCE* (n 56) at 6. For standard covenants in bond isuees see Philip Wood, *International Loans, Bonds, Guarantees Legal Opinions* (2nd edition, Thompson Sweet & Maxwell 2007) at 12-009.

credit rating downgrade and that the take-over finance arrangement comprised an oppression of creditors.[65]

### ii. The Supreme Court of Canada Decision

At the end of the day, the Supreme Court of Canada rejected the arguments of claimants on the basis that directors were not required to prefer the creditor's interests over interests of the corproation. In this section, I will summarize the main arguments of the court to reject the claim.

Firstly, the Supreme Court of Canada resolved the question of corporation directors' duties: fiduciary duties are, according to the Canadian law, owed to the corporation itself and directors should prefer the corporation's best interests in case of conflict of interests.[66] What is more important, the court did not confirm that these are interests of shareholders only. Instead of it the judges in their reasoning followed the decision in *Peoples Department Store v Wise (Trustee of)*[67] and stated that directors may also take into account interests of shareholders and other stakeholders if they deem appropriate.[68]

Secondly, the court acknowledged that while deciding which expectations of stakeholders are reasonable, the fact that interests in corporation are conflicting cannot be disregarded. It is particularly important to bear in mind that the corporation and its shareholders are entitled to maximise the value of the corporation[69] to such an extent as stakeholders are not treated unfairly. Such reasonable expectation is then limited by the fact that stakeholders are supposed to know that fiduciary duties are owed to the corporation. Rise to a reasonable expectation may be given, however, by various matters, i.e. by certain commercial practice, the nature of the corporation, past practice, representations made by the corporation, etc. It follows that leverage buyouts and other dramatic finance structures are not uncommon and that bondholders should have borne this in mind and expect such situations to occur.

Thirdly, the court acknowledged that directors in practice will have to deal with situation when they cannot please all stakeholders' expectations. Surprisingly, it was established that there are no clear rules for resolution of such conflict and that there is no clear principle of shareholder primacy,[70]

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[65] *BCE* (n 56) at 27. According to the claimants, under the Canadian law, a remedy was *inter alia* available under s. 241 of the Canada Business Corporations Act (R.S.C., 1985, c. C-44) (**CBCA**)
[66] BCE at 36, 37 and the s. 122 (1)(a) CBCA
[67] [2004] SCC 68
[68] *BCE* (n 56) at 39
[69] ibid at 64
[70] ibid at 84

apart from the rule of equitable and fair treatment.[71] In effect, the judges rejected the Delaware precedent in *Revlon*[72] that promoted shareholder primacy and also dealt with take-over matters, to say similar situations as directors were facing in the *BCE* case.

Fourthly, a *contractarian* argument was used that bondholders could have protected themselves by negotiating corresponding covenants in the bond issue.[73] As follows from the judgement, the directors considered the position of the bondholders and concluded that contractual promises would not be broken. Furthermore, it is to be borne in mind that all three bids counted on raising new debt. In the opinion of the court, this consideration satisfied duty of directors towards stakeholders.[74] It was concluded that it was in the best interests of the corporation to accept the take-over bid as the Bell Canada needed new capital to improve its melting market position.[75]

Fifthly, the court employed the business judgment rule concluding that acceptance of the offer was within reasonable choices and did not engage in second judgement exercise.[76]

Sixthly, very importantly, the court suggested that in some cases as vicinity of insolvency, even pure economic interests should be considered.[77]

As we have seen, the *BCE* decision brought some insight to the creditors' rights debate. At the one hand, it rejected the shareholder primacy and the Delaware doctrine of focus on shareholders. On the other hand, compulsory consideration of pure economic interests of creditors in insolvency remote situations was not upheld.

## 4. Implications of the *BCE* Decision on the Current Debate

The *BCE* decision being arranged in unusual setting of a colossal transaction of a $ 52 billion leveraged buyout, gave several important lessons to the current debate on *contracntarians* and *fiduciarians* principles analyzed in the Part 2. Although the decision is, of course, binding only in Canada and so far has not been followed in other jurisdictions, I will further analyze whether the principles formulated in the decision case should serve as a model law for further development beyond Canadian borders.

[71] ibid at 82
[72] *BCE* (n 56) at 85; *Revlon, Inc. v MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986)
[73] ibid at 98
[74] ibid at 104
[75] ibid at 112 and 145
[76] ibid at 112
[77] ibid at 134

The most important feature of the *BCE* decision is the rejection of the Delaware doctrine in favour of a model typical for European corporate governance regimes.[78] The judges ruled favouring the corporation itself as being beneficiary of directors' fiduciary duties to foster the long-term goals. It seems inevitable that, under such conditions, the *nexus of contracts* theory is of little use. In the light of the *BCE* decision, we can see how important and useful it is to perceive the corporation as a central point to which the duties are bound to facilitate balancing of conflicting interests.

On the other hand, it cannot be argued that the *BCE* decision would favour a model of pluralistic corporate law. Even though certain discretion to consider interests of other constituencies is given to creditors, or even imposed as an obligation in insolvency close cases, the long-term interests of the corporation still prevail. This principle can be seen as a tool to avoid short-terminism that is linked to shareholder primacy models of corporate governance. Furthermore, it is a big "no" to wider stakeholder model of corporate governance as proposed by Dodd or Parkinson.[79] As consequence, the Canadian Supreme Court in the *BCE* decision seems to prefer the enlightened shareholder model of corporate governance as proposed for example by Davies.[80]

Some of the *contractarians* views are being affirmed as creditors should rely only on their legal rights until a threat of insolvency comes around the corporation. Costs of such rule should not be high as creditors are preferred in insolvency proceedings over shareholders and are therefore usually not affected by downturns in economic performance of the corporation until such a moment. Furthermore, deliberate decisions of directors are not the only occurrences that can result in credit rating downgrade. Also poor economic performance as an exogenous event can result into downgrade into speculative rating zone.[81] Under such unfortunate event, creditors also have no protection unless they bargained for one. It would also give less incentives to creditors to bargain for sophisticated covenants and diminish their monitoring role.

At last but not at least, it is affirmed that in the vicinity of insolvency, creditors' economic interests should be considered. As was argued before, this is a position upheld by majority of scholars. Under the threat of approaching insolvency, enforcement of the shareholders' economic interests can bring huge costs as they encourage excessive risk taking. Therefore, the interests of the corporation (and its creditors) do conflict with the shareholders' interest and the costs are borne by the former ones only. The focus on balancing the interests of the corporation can help to bridge the gap created by the uncertainty about the exact moments in which creditors become residual owners of the corporation.

[78] Kraakman et al. (n 1) 135
[79] Dodd (n 27), Parkinson (n 24)
[80] Davies (n 13) 2
[81] Fischel (n 14) 134

Generally, it follows that the *BCE* decision efficiently dealt with some issues that has been academically discussed before on the level of scholarships,[82] but it was unsure if law is able to follow the academics. As the setting of the *BCE* decision is unusual to appear before courts (creditors sustained only economic loss, no covenant was breached), some new exciting light was shed on the rights of creditors and duties of directors towards them.

## 5. Conclusion

Even though the *BCE* decision did not receive wider popularity outside of Canada, I am of the opinion that it can serve as model to shape modern corporate law. The decision deals efficiently with a leveraged buy-out situation when economic rights of creditors are harmed, however, no legal rights are infringed. It appears that the Supreme Court of Canada follows the current scholarship implementing converging points of current debate between *contractarians* and *fiduciarians*. On the level of corporate creditors' right, it explains us that special consideration to creditors is owed by directors only in the vicinity of insolvency as in other cases it is up to them to balance the interests of all stakeholders to benefit the corporation itself in long term.

Furthermore, it remains clear that we cannot further engage in pure shareholder or pure stakeholder models as this is subject to variation in time. Duties of creditors are owed to the corporation itself and therefore the ultimate economic beneficiaries of these duties will vary in time. This view on the corporation and its long-term interest can be a strong tool to avoid short-terminism connected problems while minimising costs linked to wide communitarian models of corporations.

[82] See Part 2 *supra*.

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