SHAREHOLDERS' APPRAISAL RIGHTS IN CANADA

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I. Introduction

A. *Nature of Appraisal*

By the old rules of common law, corporations were viewed through the jurisprudential prism of partnership. Unanimity was required for all actions not contemplated by partnership agreements; so too was unanimity required for all fundamental corporate change.[1] Within the limits of business risks, investment in corporate enterprise was antecedently known and certain in that the enterprise could not metamorphose without the shareholders' approval. The unanimity rule vested in each shareholder a veto power over decisions to change the corporation fundamentally.

Veto power is a very fine mechanism for instilling a sense of security. It is also a notoriously unwieldy device. That makes it of dubious value in situations requiring flexibility. By the old common law, a shareholder might well rest secure in the knowledge that no radical change in the corporation could come about without his approval. But such security was purchased at a very high price. The corporation was bound by the business judgment of each single shareholder; the machinery for change was too ponderous to allow the corporation to respond expeditiously to changes in the business environment. In response to this lack of flexibility an early Companies Act in Canada abrogated the unanimous consent rule.[2]

Further flexibility was legislated in the Canada Corporations Act,[3] the immediate predecessor to the Canada Business Corporations Act,[4] in that changes in the objects or powers of the company could be accomplished by a two-thirds vote of shareholders at a special general meeting called for that purpose;[5] conversion from private to public (or *vice versa*) required three-quarters of the votes cast at a special general meeting called for that purpose;[6] compromises and arrangements required a three-quarters vote of the shares of each class represented and voted;[7] amalgamations required a three-quarters vote of each class of shares cast at meetings of the amalgamating companies.[8] In the case of amalgamations, ten per cent of the shares of any class of shares in an amalgamating company could apply to the court to annul the amalgamation agreement.[9]

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[1] Geddes v. Anaconda Copper Mining Co., 254 U.S. 590, at 596, 41 S. Ct. 209, at 211 (1921); Kean v. Johnson, 9 N.J. Eq. 401, at 414 (1853); Lattin, *Minority and Dissenting Shareholders' Rights in Fundamental Changes*, 23 L. & Contemp. Prob. 307, at 308 (1958); *but see contra* Treadwell v. Salisbury Mfg. Co., 73 Mass. (7 Gray) 393, at 404 (1856): 66 Am. Dec. 490.

[2] Companies Act, R.S.C. 1927, c. 27, ss. 144, 145 allowed for compromise or arrangement where the sanction of a three-fourths majority was obtained.

[3] R.S.C. 1970, c. C-32.

[4] S.C. 1974-75-76, c. 33 [hereinafter cited as CBCA].

[5] Canada Corporations Act, R.S.C. 1970, c. C-32, s. 20(1). *See also* ss. 24, 29, 51, 89.

[6] S. 20(2).

[7] S. 134(2).

[8] S. 134(4).

[9] S. 137(5).

Current business conditions do not incline favourably towards a cumbersome decision-making process. A central asset of any effective corporation will be the ability to respond swiftly and flexibly to an altered business climate. Where the nature of the response requires a fundamental change in corporate organization or objects, there will be conflicting interests. The corporation has an interest in realizing the considered business judgment of the majority (expressed through the directors) to meet present and future challenges. Each shareholder has an interest in protecting his capital from loss on integration of the company into a changed corporate enterprise in which he may have no confidence.

Reconciling these conflicting interests has been a central concern of the new Canada Business Corporations Act. So far as concerns fundamental changes in corporate organization the Act has drawn from American sources a powerful device for resolving these conflicts: the statutory right of appraisal.[10] In essence, appraisal allows the shareholder to express a dissent where a fundamental corporate change is resolved. By following the appropriate statutory procedure, a shareholder may demand and receive from the corporation the fair value of his shares.

B. *Policy Considerations*

It might be objected that appraisal rights cut sharply athwart the grain of fundamental corporate law principles. Shareholding, by this line of argument, is not analogous to a bank deposit. It cannot be cashed in whenever the going gets rough. Quite the contrary, shareholding is conceived as participation in an enterprise granted in exchange for capital. That the company should have to part with capital at the instance of a shareholder cannot be reconciled with the elementary idea of a corporation. Since, therefore, appraisal must be considered an extraordinary right — an anomaly in corporate jurisprudence — it should be narrowly confined and strictly construed.

The leading advocate in support of this argument is Professor Manning.[11] Manning sees in the appraisal statutes a retrograde response to the spread of "majoritarianism" throughout the infra-structure of corporate doctrine. His argument proceeds from the view that the trend of the legal order is to accord steadily rising status to the community as against

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[10] The appraisal right has had a long history in American law. The first statute dates from the middle of the nineteenth century: *see* Act of March 3, 1851, s. 1, 49 OHIO LAWS 94; Act of May 1, 1852, ss. 21, 43, 48, 50 OHIO LAWS 279-80, 287, 288 (1852); Act of April 10, 1856, s. 10, 53 OHIO LAWS 145-46 (*cited in* M.A. EISENBERG, THE STRUCTURE OF THE CORPORATION 75 n. 17 (1976)). Appraisal has been considered in countless cases in a myriad of circumstances by the American courts. This fact, coupled with the fact that the CBCA, s. 184 is modeled on the New York statute, means that American jurisprudence assumes a paramount importance in considering the appraisal right in Canada. Accordingly I unabashedly make free reference to such American decisions as are germane.

[11] Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L.J. 223 (1962).

the individual claim. Land use planning, collective bargaining legislation and concern for the *bona fide* purchaser all illustrate this trend. In corporation law, fundamental change in corporate structure or objects by majority will alone is the equivalent. Appraisal favours rights of ownership as against the majority will. As such, it is an anachronistic assertion of individualism serving no economic or jurisprudential purpose. It is rooted in ideology and unsound constitutional ideas[12] respecting the right of property. The right does not respond to sound business planning.[13]

This view seems to me mistaken and for important reasons. First, although appraisal rights arise only following legal, as opposed to economic, changes in the corporation or its prospects, it does not thereby follow that appraisal does not respond to the economics of corporate planning. The legal changes which trigger appraisal[14] contemplate significant change in the nature and risk of the corporate venture. They require, therefore, reassessing the wisdom of the corporation's business policy. Moreover, there is a considerable procedural hurdle that the shareholder must overcome before appraisal actualizes as a demand on the cash of the corporation. It is unlikely, therefore, that the right would be invoked without considerable reflection. That such business judgment is, practically speaking, a prerequisite to an appraisal claim assists in diverting capital away from enterprise that cannot pass muster as economically sound business design. Appraisal, therefore, is not alien to the basic concept of shareholding; it can be rationalized with fundamental corporate law precepts.[15] Appraisal assists in realizing the economically justified, utility-maximizing allocation of capital.

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[12] Manning thought that without appraisal rights, the merger statutes would be found constitutionally objectionable as a deprivation of property without due process. *See id.* at 247.

[13] To the nineteenth century mind . . . a corporate merger . . . involved a species of corporate assassination. . . . A three-dimensional thing, created by the sovereign legislature, had passed away. . . . But something else happened, too. The shareholders of corporation *A* somehow became shareholders of corporation *B* and no longer shareholders of corporation *A*. The mere statement of such a preposterous proposition did violence to fundamental principles. How *could* a man who owned a horse suddenly find that he owned a cow? Furthermore — or perhaps this is but another statement of the same point — even if this transmutation could somehow be brought off, surely it could not constitutionally be done without the owner's consent. . . .

> . . . When commercial pressures forced the enactment of the general merger statutes, the function of the appraisal statutes was clear. They met a conceptual and ideological problem — how to preserve the constitutionality of the merger statutes. The appraisal provisions were calculated to solve a purely conceptual need — to provide something for the shareholder who was about to undergo a *legal* trauma. . . . The appraisal remedy as applied to mergers is a pure anachronism — a residual adaptation to an extinct theological problem.

Manning, *supra* note 11, at 246-48.

[14] *See* CBCA, ss. 184(1) and (2).

[15] *See generally* Eisenberg, *The Legal Roles of Shareholders and Management in Modern Corporate Decision Making*, 57 CALIF. L. REV. 1, at 76-79 (1969).

Secondly, corporate mobility is inevitable in our corporation law.[16] It is crucial, therefore, that the steady flow of venture capital to domestic enterprise not be disrupted by fear of adverse consequences emerging from flexibility. Appraisal is a mechanism for assuring the owners of capital that if capital is invested in a defined enterprise, "majoritarianism" will not run roughshod over the considered business judgment of the shareholder by transforming the enterprise entirely at his expense.[17] An oppression provision[18] (which Professor Manning thinks preferable to appraisal) is incapable of resisting this impediment to an orderly flow of venture capital to domestic enterprise. There is clearly nothing oppressive about simple disagreement in business judgment as to what is in the best interests of the corporation as a whole.

Thirdly, fundamental changes in the enterprise may entail more than a disagreement over business planning. The dissenter may have lost a valuable business opportunity not elsewhere available.[19] Appraisal offers fair compensation for the lost opportunity.

Fourthly, appraisal furthers ideals of fairness in the modern enterprise. Appraisal prevents a shareholder from being forced into a change he thinks ill-considered or unfair. The remedy reconciles potentially conflicting interests. The corporation achieves the maximum in corporate flexibility; appraisal prevents "the minority from being involuntarily dragged along into a drastically changed enterprise in which it has no confidence".[20]

Finally, appraisal rights encourage the appropriate ideal of shareholder democracy. They vest in dissenting shareholders a greater weight in the balance of power. If a sufficient number of shareholders dissent from the proposed action, the move may be blocked by creating a drain on the

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[16] Professor Manning himself agrees: *see supra* note 11, at 230. The need for corporate flexibility was a central concern of the drafters of the CBCA: *see* R.W.V. DICKERSON, J.L. HOWARD & L. GETZ, Vol. 1, PROPOSALS FOR A NEW BUSINESS CORPORATION LAW FOR CANADA 115 (1971) [hereinafter cited as PROPOSALS].

[17] Manning has argued that capital should be protected by a general oppression statute and not by appraisal. I concur. But capital needs encouragement to enterprise as well as protection once there.

[18] CBCA, s. 234.

[19] Rams, *Judicial Valuation of Dissenting Shareholder Interests*, 8 LINCOLN L. REV. 74, at 88 (1973). The author advocates "judicial recognition of the essentially involuntary nature of the sale of dissenting shares, predicated upon the loss of continued investment opportunity in the investment originally chosen. Pre-merger and post-merger risk differences could be important."

[20] Eisenberg, *supra* note 15, at 80. *See also* Lattin, *supra* note 1, at 310. Appraisal involves "[a] delicate balancing of the interests of majority and minority owners . . for the majority owners should not be chained to what they believe to be unsound business judgment; yet, neither should the minority owners be bound to remain shareholders when they have similar misgivings": Voeller v. Neilston & Warehouse Co., 311 U.S 531, at 535-36, 61 S. Ct. 376, at 377-78 (1941); Chicago Corporation v. Munds, 20 Del. Ch. 142, 172 A. 452, at 455 (1934); *In Re* Timmis, 200 N.Y. 177, 93 N.E. 522, at 523-24 (Ct App. 1910).

corporation's cash resources.[21] To my knowledge such a move has never occurred in Canada. It would be highly extraordinary.[22] If incurred, therefore, it would reflect a serious concern by the dissenters of improvident management action. Moreover, the appraisal right attunes management sensibilities to shareholder interests as opposed to those of insiders.[23] Voting requirements[24] and an oppression provision further this end too, but absent an appraisal right, power in the modern corporation is unduly concentrated in the majority.[25] Appraisal creates an additional consideration which the insiders must take into account. "The appraisal right is more than a shield of protection; it is often used as a weapon to gain real advantages for the minority. Without this weapon, there is a deep void in the power relations within the corporation."[26]

Professor Manning's critique of the appraisal remedy is epitomized in the recommendation that the legislatures create, and the courts construe, such rights in a narrow compass. "Appraisal", he states, "should be considered an economic substitute for the stock exchange and its use should be limited to situations in which the exchange, or some kind of a reasonable market, is not available."[27]

Professor Manning's view has been instrumental in persuading legislatures to narrow the availability of appraisal. More than twenty American legislatures have amended their corporation statutes to disallow appraisal where the shares are listed on a recognized stock exchange or are otherwise actively traded.[28] In Canada, the Hodgson Committee asked

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[21] Vol. I, PROPOSALS, *supra* note 16, at 115; Manning, *supra* note 11, at 234-38.

[22] Eisenberg, *supra* note 15, at 74.

[23] F. IACOBUCCI, M. L. PILKINGTON & J.R.S. PRITCHARD, CANADIAN BUSINESS CORPORATIONS 170-71 (1977).

[24] All of the fundamental changes contemplated by Part XIV of the CBCA giving rise to appraisal rights must be approved by two-thirds of the shareholders who voted. Eligibility to vote is extended to normally non-voting shares. There is an exception. An amendment to the articles to remove restrictions on the business the corporation may carry on under CBCA, s. 167(1)(c) does not trigger additional voting rights.

[25] A good American example of this is Barrett v. Denver Tramway Corp., 53 F. Supp. 198 (D. Del. 1943), *aff'd* 146 F. 2d 701 (3d Cir.). Buxbaum, *The Dissenter's Appraisal Remedy*, 23 U.C.L.A. L. REV. 1229, at 1251 (1976), citing the *Barrett* case, makes this observation:

> At the same time, however, the appraisal remedy — *if simply structured* — is a far easier remedy for dissenting preferred shareholders than the heroic one of challenging the basic fairness of the transaction. The latter remedy exists but, as the sorry history of the Delaware cases demonstrates, is almost impossible to attain. The continued viability of this fairness challenge seems desirable, and the appraisal remedy, again, may be the simple answer to assure its continued use as a check on overreaching.

[26] Folk, *De Facto Mergers in Delaware: Hariton v. Arco Electronics, Inc.*, 49 VA. L. REV. 1261, at 1293 (1963).

[27] Manning, *supra* note 11, at 261.

[28] Note, *A Reconsideration of the Stock Market Exception to the Dissenting Shareholder's Right of Appraisal*, 74 MICH. L. REV. 1023, at 1024 n. 4 and 5 (1976). *See also* The Corporations Act, S.M. 1976, c. 40, s. 184; The Business Corporations Act,

itself whether appraisal rights "[s]hould . . . be granted to shareholders of all corporations incorporated in Ontario",[29] thereby extending the remedy in Ontario. It is now limited to shareholders in companies not offering their shares to the public.[30] The Committee decided that it should not recommend broadening the appraisal remedy for the following reasons: (a) American courts generally refuse to go beyond market value in determining fair value of shares (Professor Manning is cited as authority); (b) Canadian courts would likely follow suit; (c) appraisal might cause a severe cash squeeze on the corporation if a sufficient number of shareholders demand fair value.[31]

With respect, reasons (a) and (b) are wrong on the basis of the case law as it currently stands in the United States[32] and Canada.[33] The stock market inadequately protects a dissenting shareholder. The factors to

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1977, S.S. 1976-77, c. 10, s. 184 (however by s. 184(2) the Saskatchewan Act creates a limited stock market exception in the case where the corporation resolves to amend its articles so as to affect shares); Companies Act, S.B.C. 1973, c. 18, *as amended*. The legislation of Alberta, Newfoundland and Nova Scotia differs. It offers a kind of appraisal only in the event of change of objects and voluntary dissolution. But there is no "stock market exception". *See* The Companies Act, R.S.A. 1970, c. 60, ss. 34, 249; The Companies Act, R.S.Nfld. 1970, c. 54, ss. 106, 234; Companies Act, R.S.N.S. 1967, c. 42, s. 17 and the Companies Winding Up Act, R.S.N.S. 1967, c. 47, s. 21. Ontario's legislation includes a "stock market exception": The Business Corporations Act, R.S.O 1970, c. 53, *as amended*. Although there is no appraisal right in the existing New Brunswick Companies Act, R.S.N.B. 1973, c. C-13, in R.W. BIRD, REPORT ON COMPANY LAW 294 (New Brunswick Department of Justice, 1975), the adoption of an appraisal remedy with a stock market exception was recommended. This found expression as Bill 90, Business Corporations Act, 1st sess., 48th Leg., 1975, s. 155(1).

[29] REPORT ON MERGERS, AMALGAMATIONS AND CERTAIN RELATED MATTERS 51 (Ontario Select Committee on Company Law, 1973) [hereinafter cited as the HODGSON COMMITTEE REPORT].

[30] The Business Corporations Act, R.S.O. 1970, c. 53, *as amended*, s. 100(1)

[31] HODGSON COMMITTEE REPORT, *supra* note 29, at 52. Para. 9 on that page is essentially a *précis* of Manning, *supra* note 11, at 234-35.

[32] Chicago Corporation v. Munds, *supra* note 20; Root v. York Corp., 29 Del. Ch 351, 50 A. 2d 52 (1946); Jacques Coe & Co. v. Minneapolis-Moline Co., 31 Del. Ch. 368, 75 A. 2d 244 (1950); Burke v. Fidelity Trust Co., 202 Md. 178, 96 A. 2d 254 (Ct App 1953); American General Corp. v. Camp, 171 Md. 629, 190 A. 225 (Ct. App 1937); Cole v. Wells, 224 Mass, 504, 113 N.E. 189 (Sup. Jud. Ct. 1916); Martignette v Sagamore Mfg. Co., 340 Mass. 136, 163 N.E. 2d 9 (Sup. Jud. Ct. 1959); Application of Silverman, 282 App. Div. 252, 122 N.Y.S. 2d 312 (Sup. Ct. 1953); Application of Shipway, 29 N.Y.S. 2d 590 (Sup. Ct. 1941); Application of Wood, 103 N.Y.S 2d 110 (Sup. Ct. 1951); Application of MacKinney, 116 N.Y.S. 2d 375 (Sup. Ct. 1952), *rev'd on other grounds* 280 App. Div. 723, 117 N.Y.S. 2d 124 (Sup. Ct. 1952), *aff'd* 306 N.Y. 207, 117 N.E 2d 256 (Ct. App. 1954); Tabulating Card Co. v. Leidesdorf, 32 Misc. 2d 720, 223 N Y S. 2d 652 (Sup. Ct. 1961); Vought v. Republic-Franklin Ins. Co., 117 Ohio App. 389, 192 N.E. 2d 332 (Ct. App. 1962); Endicott Johnson Corp. v. Bade, 37 N.Y. 2d 585, 376 N Y.S 2d 103 (Ct. App. 1975).

[33] *Re* Wall & Redekop Corp., [1975] 1 W.W.R. 621, 50 D L.R (3d) 733 (B.C.S.C.); *Re* Canadian Allied Property Inv. Ltd., 3 B.C.L.R. 366, 78 D.L.R. (3d) 132 (S.C. 1977); *Re* Ripley Int'l Ltd., 1 Bus. L.R. 269 (Ont. H.C. 1977); Neonex Int'l Ltd. v Kolasa, [1978] 2 W.W.R. 593, 3 Bus. L.R. 1, 84 D.L.R. (3d) 446 (B.C.S.C)

which it responds do not necessarily correspond with intrinsic value.[34] The Council of the Stock Exchange, London, noted this specifically:

> We desire to state authoritatively that Stock Exchange quotations are not related directly to the value of a company's assets, or to the amount of its profits, and consequently these quotations, no matter what dates may be chosen for reference, cannot form a fair and equitable, or rational, basis for compensation.
>
> . . . [Price is determined] by the actions and opinions of private and institutional investors all over the country and, indeed, the world. These factors and opinions are the result of hope, fear, guesswork, intelligent or otherwise, good or bad investment policy, and many other considerations. The quotations that result definitely do not represent a valuation of a company by reference to its assets and its earning potential.[35]

As to point (c), there is no evidence cited of such an eventuality, nor do I know of any. In any event, as I have noted above, if such a move were to come about, there is every reason to believe that a positive benefit results from according to the shareholder this crisis check on management action.

In Canada, there are additional considerations which militate against legislative adoption of a stock market exception or a narrow application of existing legislation by the courts. Few Canadian corporations have an in-depth market for their securities. A large shareholder in a corporation that offered its shares to the public could not liquidate his shares without depressing the market, except by selling them over an extended length of time.[36] Once having decided to grant appraisal rights, it is inconsistent to allow the private company shareholder "fair value" and not to allow the

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[34] Professor Eisenberg, *supra* note 15, at 84 has compiled a list of fluctuations on the New York Stock Exchange for an eight-month period.

Corporation	*High*	*Low*
Abacus	17 3/4	15 1/2
Abbott Lab.	66 7/8	41 7/8
Abex Co.	42 1/8	28
ACF Ind.	68 3/8	39 1/2
Acme Mkt.	44	36
Adam Ex.	18 7/8	16
Ad Millis	30 5/8	18 3/4
Address	91 1/2	52
Admiral	25 1/8	16 1/2
Aeroquip	77	47 1/4

He comments: "When fluctuations like these occur within a mere eight-month period, it seems arbitrary, to say the least, to remit an enterprise-oriented shareholder to the market for relief, let alone to an over-the-counter market as does the New Jersey Statute." *See also* Note, *A Reconsideration of the Stock Market Exception to the Dissenting Shareholder's Right of Appraisal*, *supra* note 28, at 1026: "[T]he stock market exception inadequately protects the dissenting shareholder, since a market might, for a variety of reasons, price a shareholder's stock at less than its intrinsic value. . . . [A]n appraisal procedure . . . and not the stock market exception, reflects the appropriate balance of corporate and shareholder interests."

[35] *As cited in* T.A.H. BAYNES, SHARE VALUATIONS 23 (1966).

[36] Howard, *The Proposals for a New Business Corporations Act for Canada: Concepts and Policies*, in SPECIAL LECTURES L.S.U.C. 17, at 49 (1972).

public company shareholder the same. The remedy is grounded in fair value — intrinsic worth — and should not be subject to erratic market fluctuations.

The Hodgson Committee's recommendation that the stock market exception to the granting of appraisal rights be retained in Ontario law, accordingly, is in my opinion unsound as legislative policy. It has been totally rejected by Parliament and, with the exception of Ontario, by Canadian legislatures that have enacted an appraisal provision.[37] In my view, it would be inappropriate for the courts to treat appraisal rights under Canadian legislation, with the possible exception of Ontario, as a narrow or technical remedy. Appraisal is entirely rationalizable with corporate jurisprudence and it actualizes many of the desirable ideas of corporate distribution of power and fairness hitherto confined to academic corporate theory. A strict construction of the remedy or a stock market exception would impoverish corporation law. In doubtful cases, the broad policy grounds noted above ought to govern.

C. *To Whom Does the Right of Appraisal Belong?*

There is an additional policy consideration which ought always to influence decisions of the courts. Appraisal is a shareholder's right, and a shareholder's right only. It should never be used to assist management to the detriment of shareholder interests. This is made clear by section 184(3) of the CBCA which creates the right. It provides:

> (3) In addition to any other right he may have . . . *a shareholder who complies with this section is entitled* . . . to be paid by the corporation the fair value of the shares held by him in respect of which he dissents. . . . (emphasis added)

Moreover, the right of appraisal belongs to a *dissenting* shareholder. It should never be used to assist a majority shareholder in gaining an advantage he otherwise would not have had.[38]

Failure to concentrate attention on this fundamental point of policy has already caused problems in the case law. In *Neonex International Ltd. v. Kolasa*[39] Mr. Justice Bouck suggested that CBCA section 184(15) could be used by the corporation as a means of compulsory acquisition of a dissenter's shares in an amalgamation situation. He said:

> Parliament decided to grant a controlling shareholder an easier way to force out the minority than was previously the case. . . . The reason for these new

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[37] CBCA, s. 184(1) makes appraisal available to "a holder of shares of any class of a corporation". *See also* the statutes cited in note 28, *supra*.

[38] Vol. I, PROPOSALS, *supra* note 16, at 115:

> Instead of relying on common law standards to restrict the conduct of majority shareholders who propose to make a fundamental change, the provisions in this Part *confer upon a shareholder who dissents* from the fundamental change the privilege of opting out of the corporation and demanding fair compensation for his shares. (emphasis added)

See also Manning, *supra* note 11, at 229: "Those who have proposed the remedy or its extension have always argued their concern for the lot of the dissident minority."

[39] *Supra* note 33.

> provisions is not clear because it would seem the 90 percent forcing-out method (s. 199) is redundant.
>
> A majority shareholder need not bother using that process when the same result can be achieved with a vote of only 66⅔ percent of those present at a meeting. . . . If a shareholder wants to acquire all the other shares in the company by using the amalgamation sections rather than the forcing-out provisions, then the law will be particularly concerned over the rights of the dissenters. Their property is being expropriated.[40]

With respect, the suggestion that section 184(15) contemplates expropriation at the instance of the corporation misreads the letter and spirit of the new appraisal remedy. Section 184(15) provides:

> (15) Where a corporation fails to make an offer under subsection (12), or if a dissenting shareholder fails to accept an offer, the corporation may, within fifty days after the action approved by the resolution is effective, apply to a court to fix a fair value for the shares of any dissenting shareholders.

This section, in terms, provides only for by whom and when application shall be made to the court to fix the fair value of the shares. It is silent as to any right of the corporation to expropriate, and it is strange to think that such an extraordinary right, so contrary to the scheme of appraisal procedures, should accrue inferentially.

The powers of the court upon an application under section 184(15) are defined by section 184(20). This clearly is a procedural section:

> (20) Upon an application to a court under subsection (15) and (16), the court may determine whether any other person is a dissenting shareholder who should be joined as a party, and the court shall then fix a fair value for the shares of all dissenting shareholders.

No provision is made for allowing the corporation to acquire a dissenter's shares. The only substantive right in the whole of section 184 is at section 184(3) which entitles the shareholder to compel purchase of his shares by the company.

Construing section 184(15) as a forcing-out section upsets the whole structure of the Act. It would mean that section 184(15) duplicates the compulsory acquisition right given to an acquiring company in a take-over bid. More importantly, it would dilute the requirements of that procedure by allowing statutory expropriation upon a two-thirds majority, whereas section 199 plainly requires a bid "accepted by the holders of not less than ninety per cent of the shares of any class of shares to which the take-over bid relates. . . ." In my view the suggestion made in the *Kolasa*[41] case that the company acquires rights under section 184 is unsupportable and ought not to be followed.

D. *Constitutional Considerations*

Section 92(11) of the British North America Act confers on provincial legislatures legislative power in relation to "The Incorporation of

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[40] *Id.* at 599-600, 3 Bus. L.R. at 11-12, 84 D.L.R. (3d) at 551-52.

[41] *Supra* note 33.

Companies with Provincial Objects". Section 91 of the B.N.A. Act contains no corresponding section. Federal power in relation to the incorporation of federal companies has been implied from the exhaustive distribution of powers theory.[42] The phrase in section 92(11) "with provincial objects" appears to be a territorial limitation only; accordingly, no objection ought to lie to incorporation on the ground that the objects of the company, as opposed to its area of operation, do not transcend provincial borders.[43]

The power to incorporate companies embraces the creation of legal personality only; it in no way includes the power to regulate the activities of that personality once created. Regulation of corporate activity must find independent constitutional support. This consideration brings very much into relevance the question as to what areas of corporate structure can be said to be "in relation to" legal personality, for it is those relationships exclusively which find unquestionable constitutional support in the federal incorporation power. If the legal relationship cannot be said to be in relation to corporate personality or status, one must ask whether it is necessarily incidental to personality, or whether, to use the test formulated by Chief Justice Laskin, there exists a "rational, functional connection"[44] between the challenged legal relationship and corporate personality.

It is useful to consider just what juridical personality comprises. A helpful analysis is offered by Professor Hohfeld, who writes:

> When all is said and done, a corporation is just an association of natural persons conducting business under legal forms, methods and procedures that are sui generi. The only conduct of which the state can take notice by its laws must spring from natural persons — it cannot be derived from an abstraction called 'corporate entity' . . . [U]ltimately the responsibility for all conduct and likewise the enjoyment of all benefits must be traced to those who are capable of it, that is, to real or natural persons.[45]

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[42] Citizens Ins. Co. of Canada v. Parsons, 7 App. Cas. 96, at 116-17 (P.C. 1881) *See also* John Deere Plow Co. Ltd. v. Wharton, [1915] A.C. 330, at 340-41, 18 D.L.R. 353, at 359-61 (P.C.).

[43] Lederman, *Legislative Power to Create Corporate Bodies and Public Monopolies in Canada*, in CONTEMPORARY PROBLEMS OF PUBLIC LAW IN CANADA 116 (O.E. Lang ed. 1968): "The phrase 'with Provincial Objects' has territorial connotation only, meaning that the provincial company can operate only within the territory of the incorporating province by virtue of its provincial charter." *See also* P. W. HOGG, CONSTITUTIONAL LAW OF CANADA 350 (1977): "While the law is certainly not as clear as might be desired, in my view there is very strong support for Lederman's view that the phrase 'with provincial objects' in s. 92(11) has territorial connotation only." *See, contra*, McNairn, *Transportation, Communication and the Constitution, The Scope of Federal Jurisdiction*, 47 CAN. B. REV. 355, at 361 especially n. 37 (1969).

[44] Papp v. Papp, [1970] 1 O.R. 331, at 336, 8 D.L.R. (3d) 389, at 394 (C.A.).

[45] Hohfeld, *Nature of Stockholders' Individual Liability for Corporation Debts*, 9 COL. L. REV. 285, at 289-90 (1909).

Juridical personality means the capacity to receive and exercise civil rights.[46] The capacity to receive and exercise rights must be distinguished from the definition of rights or from the regulation of their exercise. The ability to contract flows from juridical personality; the inability to make a contract which offends public policy flows from regulation of the right to contract. By the federal incorporation power, Parliament is competent to confer contractual status on a federal company. Parliament is incompetent, by resort to the incorporation power alone, to prohibit that company from entering into a contract which offends public policy. The regulation of contracts, on this argument, is a provincial matter. Parliament can give a corporation capacity to exercise contractual rights conferred by the legislature; but Parliament cannot amend the local contract law. This distinction was pointed out by Chief Justice Laskin in *Morgan v. Attorney-General for Prince Edward Island*,[47] who said this:

> The case law . . . has established . . . that federally incorporated companies are not constitutionally entitled, by virtue of their federal incorporation, to any advantage, as against provincial regulatory legislation, over provincial corporations or over extra-provincial or foreign corporations, so long as their capacity to establish themselves as viable corporate entities (beyond the mere fact of their incorporation), as by raising capital through issue of shares and debentures, is not precluded by the provincial legislation.[48]

There is not the slightest doubt, therefore, that Parliament is competent to provide, as it has provided, that "[a] corporation has the capacity and . . . the rights, powers and privileges of a natural person."[49] But I am much less sanguine that Parliament constitutionally can provide, for example, as it has provided, that pre-incorporation contracts bind.[50] The reason why pre-incorporation contracts do not bind is that one of the parties to the contract does not exist at the time the contract is made.[51] Provincial contract law requires that both parties be in existence at the date of formation.[52] The federal provisions, therefore, amount to a *pro tanto* amendment of provincial contract law. I can see no "rational, functional connection" between the creation of corporate personality and the validity

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[46] BLACK'S LAW DICTIONARY 1300 (4th ed. rev. 1968):

Artificial persons include a collection or succession of natural persons forming a corporation; a collection of property to which the law attributes the capacity of having rights and duties. . . . Hogan v. Greenfield, 58 Wyo. 13, 122 P. 2d 850, 853.

. . .

A person is such, not because he is human, but because rights and duties are ascribed to him. Pollock, First Book of Jurispr. 110. Gray, Nature and Sources of Law, ch. II.

[47] [1976] 2 S.C.R. 349, 55 D.L.R. (3d) 527.

[48] *Id.* at 364-65, 55 D.L.R. (3d) at 539.

[49] CBCA, s. 15(1).

[50] CBCA, s. 14(2).

[51] Kelner v. Baxter, L.R. 2 C.P. 174, [1861-73] All E.R. Rep. Ext. 2009 (1866).

[52] *See* QUEBEC CIVIL CODE, art. 984.

of pre-incorporation contracts. Accordingly, I am highly *dubitante* that such provisions can withstand constitutional attack on the view that they invade provincial jurisdiction over the regulation of civil rights.[53]

Can it be said then, that a shareholder's appraisal remedy goes to the status and personality of federal corporations, or does it merely go to the regulation of the rights and duties of a shareholder conceived as an independent subject amenable to local private law? There is no hard and fast dividing line between laws "in relation to" corporate personality and laws "in relation to" corporate activity. The relevant cases are few. Without doubt, the leading authority is the Supreme Court's decision in *Esso Standard (Inter-America) Inc. v. J. W. Enterprises*.[54] In that case constitutional attack was made on section 128 of the Companies Act,[55] a section dealing with the right of an acquiring corporation to compulsorily acquire the shares of shareholders in a target company dissenting to a take-over scheme. Mr. Justice Judson, speaking for a unanimous Court, said:

> It is truly legislation in relation to the incorporation of companies with other than provincial objects and it is not legislation in relation to property and civil rights in the province or in relation to any matter coming within the classes of subject assigned exclusively to the legislature of the province. It deals with certain conditions under which a person may become a shareholder or lose his position as a shareholder in such a company. . . .[56]

Section 184 of the present Canada Business Corporations Act involves many of the same considerations. The essence of the section is certainly, as in the *J. W. Enterprises* case, the conditions under which a

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[53] It might be argued that in so far as the contract contemplates relations between citizens of different provinces, the civil right regulated is not "in the province" within the meaning of s. 92(13). This view is supported by Interprovincial Co-Operatives Ltd. v. The Queen in Right of Manitoba, [1976] 1 S.C.R. 477, [1975] 5 W.W.R. 382, 53 D.L.R. (3d) 321. Hertz, in *"Interprovincial", The Constitution, and the Conflict of Laws*, 26 U. TORONTO L.J. 84 (1976) noted that the Supreme Court in a 4:3 decision disentitled Manitoba from creating a statutory tort affecting out-of-province citizens who caused damage in Manitoba by introducing pollutants into rivers which eventually flowed into Manitoba. Further support for this view exists in Burns Foods Ltd. v. Attorney-General for Manitoba, [1975] 1 S.C.R. 494, 40 D.L.R. (3d) 731. This is a novel view, contradicting earlier authority: *see* Ladore v. Bennett, [1939] A.C. 468, [1939] 3 D.L.R. 1 (P.C.). I think it wrong on the theory that interprovincial torts and interprovincial contracts suggest a separate federal private law, a theory that could cause great difficulty in a country striving towards a unified judicial system. Reversing the thrust of the *Interprovincial* decision is, I think, necessary to avoid the federal "diversity" jurisdiction which is causing such prickly problems in the United States.

[54] [1963] S.C.R. 144, 37 D.L.R. (2d) 598.

[55] R.S.C. 1952, c. 53 (*now* CBCA, s. 199).

[56] [1963] S.C.R. 144, at 153, 37 D.L.R. (2d) 598, at 605. This confirms the opinion of Mr. Justice Coady, the trial judge in Rathie v. Montreal Trust Co., 5 W.W.R. (N.S.) 675, at 683-84, [1952] 3 D.L.R. 61, at 69-70 (B.C.S.C.) with whom the Court of Appeal agreed, 6 W.W.R. (N.S.) 652, [1952] 4 D.L.R. 448 (B.C.C.A.) (*rev'd on other grounds* [1953] 2 S.C.R. 204, [1953] 4 D.L.R. 289) that the section is a necessary provision for the proper functioning of a federal company. It overturned an earlier *obiter dictum* in *Re* Canadian Food Prods. and Picardy Ltd., *Re* Gotlieb, [1945] 2 W.W.R. 65, at 68-69,

shareholder may retain or relinquish his status as shareholder. Appraisal is in relation to corporate personality in that it deals with the particular metabolism of the corporate animal which Parliament makes it possible to create. Appraisal puts legs on the corporation, but it does not tell it where it may walk. Appraisal concerns the internal structure of the corporation, the relationship of its various parts to the whole. It does not interfere with the ability of a corporation to carry on, or regulate the conditions under which the corporation may carry on, activities within provincial regulatory jurisdiction. The remedy goes to the form and structure of the corporation as opposed to its function. As such, it is difficult to think that the remedy is beyond Parliamentary competence to bestow.

If the main remedy, the right of the shareholder to require the corporation to purchase his shares, is competent to Parliament, then ancillary procedures to actualize the substantive right ought in principle to fall within Parliamentary competence too. On this theory, section 184(18) (relief from security for costs), section 184(19) (a provision for making a judicial determination of fair value binding on all dissenting shareholders whose shares have not been purchased by the corporation) and section 184(23) (discretionary control over the rate of interest), are equally *intra vires* Parliament as necessarily incidental adjuncts of the substantive appraisal right.

II. Triggering Transactions — Business Combinations

Of central concern to any shareholder will be the many and varied mutations which occur in a business enterprise. Business combinations and divisions not only change the structure of the company and the nature of investment in it, they also radically alter an individual shareholder's position. Legitimate business expectations may be frustrated; the shareholder may be "squeezed out" in that his personal interest in the company is made less desirable by management or majority shareholder design; he may be "locked in" by destruction of the market for the company's shares; he may be expropriated by statutory procedure; he may suffer adverse income tax consequences. By the old rules of common law a shareholder was afforded protection against most of these eventualities by exercise of his veto.[57] The necessity for corporate flexibility has long

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[1945] 3 D.L.R. 287, at 290 (Man. C.A.) that a predecessor section (S.C. 1934, c. 33, s. 124) might be an invasion of property and civil rights. One discordant note as to whether or not the constitutional issue is settled is sounded by McNamara, *Note on Compulsory Acquisition of Shares*, 10 Western Ont. L. Rev. 141, at 148-49 (1971), where the author suggests that John Deere Plow v. Wharton, *supra* note 40 and Lymburn v. Mayland, [1932] A.C. 318, [1932] 2 D.L.R. 6 (P.C.) may be relevant since they involve the jurisdiction of the provinces to enact legislation purporting to affect shares in the Dominion company: "In the absence of a full discussion of those cases, the statement by the Supreme Court of Canada in *International Petroleum* [*sub nom.* Esso Standard v. J. W. Enterprises] should not be taken as a binding statement of the law, but only as an *obiter dictum*." For the reasons I have expressed, I think this entirely untenable and wrong.

[57] *See* my discussion at the beginning of the article.

since eclipsed that avenue of shareholder protection. This brings very much into relevance the position of the appraisal remedy in business combinations.

In Canada business combinations can occur in three ways. Businesses may combine by (a) statutory amalgamation, (b) inter-corporate acquisition or lease of assets, or (c) inter-corporate acquisition of stock.

A. *Statutory Amalgamation*

1. *General*

Statutory amalgamation[58] has become an extremely attractive mode of business combination. The procedure receives preferred treatment under section 87 of the Income Tax Act.[59] This may be done pursuant to an agreement entered into by the amalgamating corporations setting out the terms and means of effecting the amalgamation.[60] The agreement must be approved by two-thirds of the votes[61] cast and, for the purposes of the vote, all shares of the amalgamating corporation, whether or not voting shares, are entitled to vote.[62] By CBCA section 184(1)(c), appraisal rights accrue to a shareholder who dissents from the proposed amalgamation.

Especially relevant are the requirements for specifying in the agreement the manner in which the securities of the amalgamating corporations are to be converted into securities of the amalgamated corporation. Section 176(1)(c) provides that the paradigm transaction contemplates a share-for-share exchange. However, by section 176(1)(d) the agreement may indicate that some shareholders will receive cash instead of shares in the amalgamated corporation. This creates the possibility of "cash-merger-freeze-out".[63]

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[58] CBCA, s. 175.

[59] If the transaction complies with the formalities of s. 87 of the Income Tax Act, S.C. 1970-71-72, c. 63, *as amended*, [hereinafter cited as ITA] all tax values and all tax accounts of the amalgamating corporation "flow through" into the amalgamated corporation: ITA, s. 87(2). There is no liability for capital gains or recapture to either the corporation or its shareholders.

In order to take advantage of s. 87, all the property and liabilities of the predecessor corporations must become the property and liabilities of the new corporation by virtue of the merger, and all the shareholders of the predecessor corporations immediately before the amalgamation must receive shares of the new corporation by reason of the merger: ITA, s. 87(1). It is the Department's view that the receipt by a shareholder of a fractional share will not sterilize the application of s. 87 to the amalgamation: Interpretation Bulletin I.T.-192 (Dec. 23, 1974).

[60] CBCA, s. 176(1).

[61] CBCA, s. 177(5).

[62] CBCA, s. 177(3).

[63] For a detailed analysis, *see generally* Greene, *Corporate Freeze-Out Mergers: A Proposed Analysis*, 28 STAN. L. REV. 487 (1976). *See also* O'Neal, *Squeeze-outs in American Corporations*, [1962] J. BUS. L. 210; Shandling, *Corporate Freezeouts and the Protection of Minority Shareholders in Alberta Companies*, 4 ALTA. L. REV. 395 (1966).

2. *Cash-Merger-Freeze-Out*

A cash-merger-freeze-out occurs in the following situation. Two corporations enter into an amalgamation agreement. The agreement provides that on amalgamation certain minority shareholders of one or both corporations will receive a specified amount of money, in lieu of securities in the amalgamated corporation, upon the agreement becoming effective. The companies amalgamate pursuant to the agreement. It may that the plan contemplates a two-step transaction: the amalgamation agreement provides for the issuance of redeemable securities; the securities are subsequently redeemed by the amalgamated corporation.[64] Cash-merger-freeze-outs amount to private expropriations through the elimination of certain equity participants from the enterprise.

The cash-merger-freeze-out usually serves legitimate business purposes. It could, for example, allow the two corporations to take advantage of economies of scale; it could allow a capital-rich, technologically efficient but poorly managed corporation to acquire a finely-tuned management team; it could assist in the elimination of obstreperous and unreasonable minority shareholders.

Cash-merger-freeze-outs may be effected under the new CBCA. In every case the device is subject to voting and appraisal rights. But voting and appraisal rights may be insufficient protection for minority shareholders. Majority shareholders might attempt, by utilizing a cash-merger-freeze-out, to eliminate minority shareholders and to expropriate for themselves alone the desirable business opportunities available to the amalgamated corporation.

Suppose, for example, that a small, closely held corporation, *A*, has the possibility of succeeding to the benefit of a lucrative contract. The majority shareholders set up a holding corporation, *B*, of which they are sole shareholders and directors. They propose to amalgamate *A* and *B*, utilizing a cash-merger-freeze-out to expropriate the minority shareholders of *A*. The sole reason for the amalgamation is to appropriate to themselves all future benefits flowing from the contract. Can this transaction be attacked?

First, it is crucial to notice that while appraisal rights certainly accrue to dissenters,[65] it is equally obvious that they are insufficient to protect minority shareholder interests. The minority shareholder is interested in realizing the benefit from the business opportunity; he is ill-served by being roughly discarded by the wayside with his cash.

In *Esso Standard (Inter-America) Inc. v. J. W. Enterprises Inc.*,[66] the Esso Standard Corporation made an offer to the shareholders of

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[64] *See* Flisfeder, *Compulsory Acquisition of the Interest of a Dissenting Minority Shareholder*, 11 ALTA. L. REV. 87 (1973); Grimes v. Donaldson, 392 F. Supp. 1393 (D.C. Fla.1974); Greene & Co. v. Schenley Indus., Inc., 281 A. 2d 30 (Del. Ch.1971); Fillman, *Cash and Property as Consideration in a Merger or Consolidation*, 62 NW. U.L. REV. 837 (1968); Greene, *supra* note 63.

[65] CBCA, s. 184(1)(c).

[66] *Supra* note 54.

International Petroleum Company to purchase all outstanding shares. Esso Standard was a subsidiary of Standard Oil, which owned ninety-six per cent of International Petroleum's shares. Esso's offer advertised this fact, noting that Standard Oil had indicated its intention to accept, and that this would trigger section 128 of the federal Companies Act, a compulsory acquisition section. Esso Standard made an *ex parte* motion under section 128 seeking authorization to acquire compulsorily the shares of dissenters. The authorization was refused on appeal to the Supreme Court. Mr. Justice Judson said this:

> With this identity of interest the whole proceeding as Laidlaw J.A. stated it, is a sham with a foregone conclusion, for the purpose of expropriating a minority interest on terms set by the majority .... A transfer of shares from Standard Oil to Esso Standard is meaningless in these circumstances as affording any indication of a transaction which the Court ought to approve as representing the wishes of 90 per cent of the shareholders. This 90 per cent is not independent.[67]

The holding is of considerable interest. It indicates that following statutory procedure alone will not be sufficient to uphold the validity of unfair transactions. There are additional criteria of fairness which the courts demand.

Does the fact that the new CBCA provides for a statutory remedy in these circumstances override judicial criteria of fairness as expressed in *Esso Standard v. J. W. Enterprises*? CBCA section 184(3) provides that a dissenting shareholder may exercise his right of appraisal "[i]n addition to any other right he may have". There is, accordingly, no doubt that under federal legislation the appraisal remedy is not exclusive.[68] A complaining minority shareholder in a freeze-out situation can seek any other recourse open to him. Common law standards of fairness, as reflected in the *Esso Standard* case, certainly ought to be relevant. An amalgamation whose sole purpose is to freeze out minority stockholders and which is not related to some other "wholesome business goal" has an unlikely prospect of

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[67] *Id.* at 150-51, 37 D.L.R. (2d) at 603-04. *See also* an earlier English appeal, *In re* Bugle Press Ltd., [1961] 1 Ch. 270, [1960] 3 All E.R. 791 (C.A.). The court considered whether a statutory force-out provision could be invoked by a company formed by majority shareholders for the sole purpose of forcing out a minority position through merger. The court stated at 287, [1960] 3 All E.R. at 796:

> [T]he court ought not to allow the section [s. 209 of the Companies Act, (U.K.), the force-out provision] to be invoked — unless at any rate it were shown that there was some good reason in the interests of the company for so doing, for example, that the minority shareholder was in some way acting in a manner destructive or highly damaging to the interests of the company from some motives entirely of his own.

The court approved the statement of Buckley J. below that such facts occasion a reversal of onus such that the majority shareholders must satisfy the court that the scheme is one which the minority shareholders ought reasonably to accept.

[68] This is also the case with Manitoba and Saskatchewan. *See* The Corporations Act, S.M. 1976, c. 40, s. 184(3) and The Business Corporations Act 1977, S.S. 1976-77, c 10, s. 184(3).

success.[69] Additionally, federal legislation offers potentially powerful substantive protection from oppressive or prejudicial action by a corporation or its affiliates that unfairly disregards the interests of any security holder.[70] These considerations ensure that cash-merger-freeze-outs will serve economically justifiable ends, and will not be used as instruments of injustice.

In Ontario and British Columbia, the companies legislation is silent as to whether the appraisal remedy is exclusive.[71] It is strange to think that rights given under common law and statutory oppression remedies[72] should be excluded by negative implication. This certainly runs counter to the rules of statutory interpretation.[73] If appraisal justifies utilization of statutory amalgamation for the purposes of freeze-out, the corporation statutes would have made a major and unwarranted change in minority shareholder protections. General policy considerations, as well as the policy behind the appraisal sections, militate against this conclusion.[74] A rule by which the existence of an appraisal right is conclusive as to the validity of any freeze-out transaction would give the majority, rather than minority shareholders, the right to decide when they must sell; it would cause minority shareholders delay and expense; it would encourage insiders to conceal favourable business prospects; it would serve no economically justifiable purpose.

Any company considering a cash-merger-freeze-out would be well advised to consider the tax implications. By section 87(1) of the Income Tax Act, all of the shareholders of the amalgamating companies immediately before the amalgamation must receive shares of the capital stock of the amalgamated corporation by virtue of the amalgamation in order to qualify for the benefits conferred by section 87(2.1). Those benefits are considerable. They include a complete "flow through" of all

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[69] Vorenberg, *Exclusiveness of the Dissenting Stockholder's Appraisal Right*, 77 HARV. L. REV. 1189, at 1192-93 (1964).

[70] CBCA, s. 234. *See generally* Proulx, *L'action dérivée selon la loi sur les corporations commerciales canadiennes*, 7 R. GEN. 207 (1976).

[71] The Business Corporations Act, R.S.O. 1970, c. 53, *as amended*, s. 100; Companies Act, S.B.C. 1973, c. 18, *as amended*, s. 228. Some American statutes provide that the remedy is not exclusive but most are silent on this point.

[72] CBCA, s. 234; Companies Act, S.B.C. 1973, c. 18, *as amended*, s. 221.

[73] *See* W. CRAIES, CRAIES ON STATUTE LAW 117-22 (7th ed. 1971).

[74] The leading authority used in support of utilizing statutory amalgamation and appraisal for freeze-out is Matteson v. Ziebarth, 49 Wash. 2d 286, 242 P. 2d 1025 (Sup. Ct. 1952). In that case it is clear that Matteson was unco-operative and that his elimination served the best interests of the corporation. *See* Vorenberg, *supra* note 69, at 1196-97:

> [T]he court may have recognized as a secondary, enabling business purpose, the elimination of a troublemaker. Seen as a recognition that such business purposes as these justify — indeed, may require — the elimination of a minority stockholder seeking to use his veto to exact improper concessions from the majority, the decision seems less extreme and shocking than has been suggested.

tax values and tax accounts from the amalgamating corporations to the amalgamated corporations. This allows the amalgamated corporation to avoid liability for capital gains and recapture, and to take advantage of previous net or non-capital losses incurred by the amalgamating corporations.

If the company proceeds to eliminate minority shareholders by means of a cash-merger-freeze-out, it is difficult to think that all of the shareholders of the amalgamating corporation receive shares of the amalgamated corporation as required by section 87(1)(c) of the Income Tax Act. A useful point was made by Mr. Justice Houlden in a fact situation which involved a cash-consolidation-freeze-out. In *Re P. L. Robertson Manufacturing Co.*[75] the applicant asked the court to approve an arrangement under sections 193 and 194 of the Ontario Business Corporations Act. The arrangement provided, *inter alia*, for a reverse stock split in which one new share of the corporation would be issued in exchange for one thousand shares of the pre-arrangement corporation. Fractional shareholders were to be paid off in cash and their shares were to be cancelled. Mr. Justice Houlden held that the arrangement did not give the shareholders the right to a fraction of a share; "under the arrangement, the fraction of a share never comes into existence".[76]

The reasoning ought, in principle, to apply to cash-merger-freeze-outs. It is hard to see that shareholders of the amalgamating corporations forced to liquidate their shares ever receive shares in the amalgamated corporation. But suppose that the shareholder were to receive, instead of cash, a redeemable preference share. Subsequent to the amalgamation the redeemable share is redeemed by the amalgamated corporation. Can it be said that the conditions of section 87(1)(c) of the Income Tax Act are fulfilled? In my view this would be a question of fact to be determined in the circumstances of the case. If it could be established that the intention was to make formal compliance with the Act only, it would appear that the transaction is a sham. The court would be justified in piercing the form of the transaction to reach its substance.

One argument that has been put forward in order to attack the substantive fairness of cash-merger-freeze-out transactions is that the frozen-out former shareholder is denied income tax benefits accruing to the corporation.[77] It may be that in creating a cash or consolidation freeze-out, the corporation denies itself any such income tax consequences. This must be carefully scrutinized by the courts.

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[75] 7 O.R. (2d) 98, 54 D.L.R. (3d) 354 (H.C. 1974).

[76] *Id.* at 101, 54 D.L.R. (3d) at 357. *But see* Interpretation Bulletin I T.-192 (Dec 23, 1974): "However, the Department will not deny the rules of section 87 only for the reason that shareholders of predecessor corporations entitled to less than one share of the new corporation receive cash or other consideration in lieu of that fraction." In my submission the law stands opposed to this view for the reasons laid out in the text.

[77] *Re* Ripley Int'l Ltd., *supra* note 33.

3. *Short-Form Amalgamations*

The CBCA makes provision for short-form amalgamation between a holding corporation and one of its wholly owned subsidiaries,[78] and between two or more wholly owned subsidiaries of the same holding corporation.[79] The articles of the amalgamated corporation must be the same as those of the amalgamating holding corporation.[80] Shares of the subsidiary must be cancelled.[81] No securities may be issued by the amalgamated corporation in connection with the amalgamation.[82] Shareholder approval is not necessary.[83] There are no appraisal rights.[84]

Similar short-form amalgamation provisions are well known in the United States, but they are not limited to amalgamations with wholly owned subsidiaries. This has caused freeze-out problems, which, in turn, have generated a lively case law.[85] The comments of the CBCA drafters indicate that these problems are solved under the new CBCA because of the requirement that the subsidiary be wholly owned.[86] That is why appraisal rights have been withheld in short-form amalgamation transactions under the CBCA.

I am less confident that freeze-out problems cannot occur. Certainly there is no necessity to accord appraisal rights to shareholders of the subsidiary corporation; the wholly owned requirement means there can be no dissenters. But that fact is not conclusive as to whether appraisal rights should be granted to shareholders of the amalgamating holding corporation. This consideration would take on added relevance where the subsidiary and holding corporations are of relatively equal size, or where the amalgamation is "upside down" — *i.e.*, the subsidiary is larger. The emphasis given to business objectives may change; a new management team may be acquired at a stroke; the shareholder may find his personal position in the corporation sharply less attractive; he may become involved in protracted policy disputes. The minority shareholder may be "squeezed" as opposed to "frozen" out in that his salaried position and/or dividend expectations are eroded.

Does the requirement that the articles of the amalgamated corporation remain the same as those of the amalgamating holding corporation entitle one to say in respect of dissenting shareholders of the amalgamating holding corporation: "tough luck; this is all part and parcel of everyday business risk"? That conclusion must proceed from the premise that, for

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[78] CBCA, s. 178(1).

[79] CBCA, s. 178(2).

[80] CBCA, s. 178(1)(b)(ii).

[81] CBCA, s. 178(1)(b)(i).

[82] CBCA, s. 178(1)(b)(iii).

[83] CBCA, s. 178(1)(a).

[84] CBCA, s. 184(1)(c).

[85] *See, e.g.*, Vine v. Beneficial Finance Co., 374 F. 2d 627 (2d Cir. 1967); Voege v. American Sumatra Tobacco Corp., 241 F. Supp. 369 (C.C.D. Del. 1965).

[86] PROPOSALS, *supra* note 16, at 121.

the amalgamating holding corporation, the transaction does not in essence amount to a fundamental change; it is, rather, more akin to the acquisition of an asset.

This view turns a searchlight on the meaning of the concept "fundamental change". There are four possible alternatives. Fundamental change might refer to (a) a change in the ownership interests or control of the corporation, (b) a fundamental change in the business objectives or policy, as where the corporation commits the lion's share of its resources to a newly acquired division having no relationship to existing lines of business, (c) a significant alteration of management profile, or (d) change in the constitutional structure of the corporation by alteration of the position of shareholders to management or of shareholders *inter se*. This last alternative would require amendment of the corporation's articles or a unanimous shareholders' agreement.

It is clear that if alternative (a) be the yardstick by which the concept of "fundamental change" is measured there can be no justification for according appraisal rights to shareholders of the amalgamating holding corporation. Since shares of the amalgamating subsidiary must be cancelled, and no securities of the amalgamated corporation can be issued in connection with the amalgamation, no change in control structure is possible.

If, however, alternatives (b) or (c) be the measure of "fundamental change", strong arguments arise as to why shareholders of the amalgamating holding corporation, subject to a relative size test, should have appraisal rights on short-form amalgamation. If the amalgamating subsidiary is "significant" in terms of the size of operations relative to the amalgamating holding corporation, then, on this view, it is illogical to withhold appraisal rights from shareholders of the amalgamating holding corporation. The transaction, at a stroke, may metamorphose the business profile of the holding corporation; from a small buggy whip manufacturer it might emerge as a medium size computer service network. A wholesale change in management might be effected.

If alternative (d) be the relevant test of "fundamental change", appraisal rights must be withheld from shareholders of the amalgamating holding corporation. The Act specifically requires that the articles of the amalgamated corporation continue the articles of the amalgamating holding corporation without alteration. Accordingly, there can be no "constitutional" change in the amalgamating holding corporation without alteration.

Neither the CBCA nor the *Proposals* makes clear which theory of "fundamental change" underlies the short-form amalgamation provisions. The results achieved by the Act certainly suggest alternatives (a) or (d) and appear to exclude alternatives (b) and (c). Which theory is chosen is crucial; it determines the response to very difficult problems which arise in connection with other forms of business combination. The relevant policy considerations are discussed *infra*.[87]

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[87] *See infra*, "Speculative Rights and Suggestions for Reform"

4. *"Going Private"*

In the bullish stock market of the 1960's many companies "went public" in order to take advantage of the high demand for their shares and high value placed on them.[88] The collapse of market prices in the 1970's has brought about a reverse phenomenon. Many companies now look favourably on "going private".[89] While earnings and prospects remain strong, share prices are depressed. The companies can buy back, at bargain prices, stock sold a few years earlier at handsome premiums.

Corporate reacquisitions of stock thin the market for the company's shares and thereby make it extremely unattractive for minority shareholders to resist a repurchase offer. The repurchase program may be coupled with an amalgamation, take-over bid, sale of assets to dummy corporations, or reverse stock split designed to eliminate all minority interests. The entire transaction can be accomplished in one step by utilization of a cash-merger-freeze-out.

"Going private" transactions raise significant questions of fairness. Minority shareholders find themselves in the position of having to sell at very reduced prices from acquisition cost.[90] The potential for unfairness was underlined by Commissioner A. A. Sommer Jr. in an address at the Notre Dame Law School:

> What is happening is, in my estimation, serious, unfair, and sometimes disgraceful, a perversion of the whole process of public financing, and a course that inevitably is going to make the individual shareholder even more hostile to American corporate mores and the securities markets than he already is.[91]

Moreover, "going private" transactions may in reason appear to be unfair.[92] They have caused a shareholder outcry of unfairness in at least one case:

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[88] Between 1967 and 1972, 3,000 companies filed registration statements with the American S.E.C. for the first time: 'Going Private': A Lesson in Corporate Responsibility (address by A A. Sommer, Jr., Law Advisory Council Lecture, Notre Dame Law School) in FED. SEC. L. REP. (CCH) para. 84-692, at 84-694 (1974-75 Transfer Binder).

[89] *See generally* Salter, "Going Private": Issuer Bids — Insider Bids — Squeeze-Outs (memorandum to O.S.C. May 17, 1978); In the Matter of Cablecasting Ltd., [Feb. 1978] BULL O.S.C. 37; Glover & Schwartz, *Going Private in Canada*, 2 CAN. BUS. L.J. 3 (1978); *Issuer Bid — An Offer By An Issuer To Purchase, Redeem or Retire Its Own Securities: Timely Disclosure*, [Oct. 1977] BULL. O.S.C. 253; Campbell & Steer, *What Price Minority Shares?* 111 CA MAGAZINE, Oct. 1978, at 28. For U.S. developments *see*: Borden, *Going Private — Old Tort, New Tort or No Tort*, 49 N.Y.U.L. REV. 987 (1974); Note, *Going Private*, 84 YALE L.J. 903 (1975); Brudney, *A Note on Going Private*, 61 VA. L. REV. 1019 (1975); Kerr, *Going Private: Adopting a Corporate Purpose Standard*, 3 SEC. REG. L.J. 33 (1975); Jentry, *The Developing Law of Corporate Freeze-Outs and Going Private*, 7 LOY. CHI. L.J. 431 (1976); Narwold, *Going Private — The Need for a Valid Business Purpose*, 10 CONN. L. REV. 511 (1978); Scott, *Going Private: An Examination of Some Going Private Transactions Using the Business Purpose Standard*, 32 SW. L.J. 641 (1978).

[90] *See* Neonex Int'l Ltd. v. Kolasa, *supra* note 33. The minority shareholder was forced out, at $3 per share, of a position acquired at $5 per share.

[91] *Supra* note 88, at 84-695.

[92] Salter, "Going Private", *supra* note 89, at 26.

> The leaders of this country have asked us all to invest in Canada as good citizens. My wife and I took our savings and bought shares in Neonex for over $5.00 each. Now we are told we must sell them for $3.00. We seem to have little choice. Why is this so?[93]

This kind of reaction inhibits investment, and ultimately poisons the country's capacity to attract equity financing. For all of these reasons, "going private" transactions demand the closest scrutiny.

"Going private" transactions raise two substantial questions of law: (a) Is the transaction fair because the minority shareholder, by appraisal proceedings, is assured retrieval from the corporation of the fair value of his shares? (b) If the answer to question (a) is no, can the transaction be said to be fair because in addition it serves some legitimate business purpose?

There can be no question that "going private", in some instances, can serve legitimate business purposes. Most obviously, by "going private" the corporation may qualify for the small business deduction provided by section 125 of the Income Tax Act.[94] A second advantage is that a private company may become entitled to exemption from the Securities Commission distribution requirements. As well, the corporation would save all fees and managerial time associated with filing and compliance requirements under the Ontario Securities Act.[95] The saving is often considerable.

"Going private" within the meaning of securities legislation is much more restrictive than "going private" within the meaning of the Income Tax Act. The former entails total destruction of the market for the company's shares.[96] A company seeking to take advantage only of the small business deduction might well bear less heavily on minority shareholders. An active market, albeit one generated otherwise than by a listed stock exchange, could be maintained in the one case; it could not be maintained in the other. Different considerations, therefore, might apply to each situation.

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[93] Neonex Int'l Ltd. v. Kolasa, *supra* note 33, at 599, 3 Bus. L.R. at 11.

[94] In order to qualify as a private corporation for purposes of ITA, s. 125, the conditions of s. 89(1)(f) must be satisfied. The corporation must be (i) resident in Canada, (ii) not a public corporation, and (iii) not controlled directly or indirectly by one or more public corporations. A "public corporation" is a corporation that has a class of shares listed on a prescribed stock exchange in Canada or which has elected or been designated by the Minister to be a public corporation. Prescribed stock exchanges are listed in s. 3200 of the Income Tax Regulations.

In addition, the corporation must be Canadian controlled. This is defined in s. 125(6)(a) as (i) a resident corporation either incorporated in Canada or resident continuously since June 18, 1971 and (ii) not controlled directly or indirectly by non-residents, public corporations or any combination thereof.

[95] *See* The Securities Act, R.S.O. 1970, c. 426, s. 19(2)9.

[96] The Securities Act, R.S.O. 1970, c. 426, s. 35, *as amended by* S.O. 1971, c. 31, s. 6. The question of whether a company is offering its shares to the public continues to present intractable difficulties. *See* D.L. JOHNSTON, CANADIAN SECURITIES REGULATION 148-50 (1977) (and notes therein cited).

Consider the following example. *A* Co. is a young, successful manufacturing corporation. In 1969 if offers shares to the public at $10 per share, thereby raising $1,000,000. The corporation has never paid a dividend, preferring to reinvest all earnings. In 1978, although earnings have increased, the shares trade on the exchange for $1.50. The directors float *B* Co., a dummy holding corporation. They effect an amalgamation between *A* Co. and *B* Co. The shareholders of *A* Co. get one redeemable preferred share of *B* Co. for every 5,000 shares of *A* Co. After the amalgamation, fractional holders — this means all minority holders — are eliminated.[97] *B* Co. becomes a private corporation. The stated purpose of the amalgamation is to allow *B* Co. to take advantage of the small business deduction.[98]

Common law standards of fairness, as reflected in *Esso Standard v. J. W. Enterprises*,[99] are likely unavailable in this situation. There is a clear business purpose. It is not difficult to imagine that, in competitive circumstances, the tax savings engendered could be critical to the success or failure of the company. Appraisal is available to minority stockholders, but it is likely to be cold comfort. It is very doubtful that any court could be precise, given total market unreliability, in evaluating the risk-reward balance between cash or securities and an equity participation. The speculative variables are too diffuse.[100] In any case, as the commentators have noted, appraisal is at best an imperfect remedy, involving delay and expense.[101] The director of the Ontario Securities Commission, Charles Salter, noted recently that expense and delay reach "the point where a small investor may be inclined to accept the proposal of the controlling shareholder rather than rely on rights given under the Statute".[102] In any event, the significant question does not turn on the precision of valuation. The crucial question is whether the availability of valuation, through appraisal proceedings, is enough.

Appraisal involves only a minimum of fairness, perhaps less than a minimum in some cases. If there is no legitimate business purpose, or if the corporate opportunity can only be obtained by reaching into the pocket

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[97] A corporation cannot eliminate minority shareholders purely by means of a consolidation-freeze-out. This must be done by means of a Part XIV procedure under the CBCA, thereby triggering shareholder protections, notably the appraisal remedy.

[98] *See* a similar situation in *Re* Ripley Int'l Ltd., *supra* note 33. Also Mr. John Howard, Assistant Deputy Minister of the Department of Consumer and Corporate Affairs testified before the Standing Senate Committee on Banking, Trade and Commerce that a consolidation-squeeze-out could not be effected by means of a reverse stock-split alone. "If the corporation wanted to effect a squeeze-out it would have to go the way of the amalgamation procedures and use an amalgamation squeeze-out or by using the article amendment procedure. When they do that they must give the right of dissent and appraisal to the shareholders." PROCEEDINGS OF THE STANDING SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE 28 (Nov. 23, 1977) [hereinafter cited as PROCEEDINGS].

[99] *Supra* note 54.

[100] *See* Brudney, *supra* note 89, at 1024 n. 22.

[101] *See* Vorenberg, *supra* note 69, at 1201-05; Brudney, *supra* note 89, at 1025-26.

[102] The Globe and Mail (Toronto), May 31, 1978, at B-7.

of a shareholder, appraisal amounts to procedural fairness in a transaction unfair in substance. In these cases something else in addition to appraisal is required. That "something else" must be a weighing of interests as between the corporation and its shareholders by judicious use of the oppression remedy at CBCA section 234.

Under section 234 the court must examine whether the business transaction is one that "is oppressive or unfairly prejudicial or that unfairly disregards the interests of any security holder". The availability of appraisal sheds no light on that determination. A precondition to an affirmative finding would be that the corporation is pursuing a legitimate business purpose in the interests of the company as a whole.[103] But that is a precondition only. A broad judicial review of the substantive fairness of the transaction ought to be forthcoming under section 234.

In those provinces where a wide-ranging oppression remedy is not part of the local corporation law, "going private" is cause for serious concern. This has already been noted by the director of the Ontario Securities Commission.[104] The Commission has adopted interim rules respecting "going private" transactions designed to achieve fairness to all shareholders, and not only to those who survive as equity participants. The rules embrace (a) approval by fifty per cent of the minority shareholders, (b) appraisal (in the case where the mechanism of "going private" is an arrangement),[105] (c) evidence of a valid business purpose, (d) independent valuation unless an exemption is obtained, (e) a waiting period of sixty days to facilitate other offers, (f) provision for a warrant giving the right to minority shareholders to reacquire an equity share if the corporation subsequently goes public, (g) provision for continuation of financial disclosure to the minority shareholder, (h) provision for passing on to minorities any premium received from sale of corporate assets within a five year period, and (i) a detailed information circular.[106]

5. *Tax Implications*

Business combination by statutory amalgamation, unlike certain other forms of business combinations, creates appraisal rights in dissenting shareholders. This raises significant problems from an income tax point of view where the combining corporations desire to avoid appraisal rights.

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[103] Outwater v. Public Service Corp., 103 N.J. Eq. 461, 143 A. 729 (Ch. Div. 1928); Eisenberg v. Central Zone Property Corp., 306 N.Y. 58, 115 N.E. 2d 652 (Ct. App. 1953).

[104] The Globe and Mail, *supra* note 102. The O.S.C. has intervened in several "going private" transactions. It has become clear that the Commission will use its power under The Securities Act to prohibit specific unfair stock transactions. This is an effective remedy. *See* In the Matter of Cablecasting Ltd., *supra* note 89.

[105] The Business Corporations Act, R.S.O. 1970, c. 53, *as amended*, s. 194

[106] Some of these suggestions were made and developed in Note, *Going Private*, *supra* note 89, at 924 ff. *See also* Salter, "Going Private", *supra* note 89, at 60-62, where the proposals are developed.

Suppose that *A* Co. has substantial net and non-capital losses in years previous to the proposed amalgamation, but has turned around. *B* Co. has profits. It wishes to offset these by *A* Co.'s losses. If the combination is effected by means of statutory amalgamation, all net and non-capital losses of the amalgamating corporations flow through into the tax accounts of the amalgamated corporation.[107] There is no liability for capital gains or recapture.

If the combination is effected by sale, lease or exchange of substantially all of one combining corporation's assets, the advantages of flow-through into the tax accounts of the combined corporation are lost. Appraisal rights accrue to dissenting shareholders under CBCA section 184(1)(e). There is liability for capital gains and recapture on the sale of the assets for the vendor corporation.

If the combination is effected by means of a take-over bid, appraisal rights are avoided but significant tax benefits are lost. If the take-over bid amounts to a change of control within the meaning of the Income Tax Act,[108] net capital losses for preceding years may not be deducted by the target corporation for the year in which the change of control occurred.[109] Non-capital losses may be deducted if the corporation continues to carry on the target corporation's business during some part of the year.[110] Furthermore, before the recent repeal of Parts VII to IX of the Act, post-1949 earned surplus became "designated":[111] pre-1971 undistributed income on hand could be distributed as a dividend to the acquiring corporation on payment of a fifteen per cent tax;[112] post-1971 surplus could not be distributed as a tax-free inter-corporate dividend, but was subject to a special twenty-five per cent tax.[113]

The new provision, whereby the amalgamated corporation can carry forward net and non-capital losses of the amalgamating corporations,[114] has the possibility of generating an active trade in tax loss amalgama-

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[107] ITA, s. 87(2.1). This is a new provision enacted in S.C. 1977-78, c. 1, s. 42(6). It overtakes case law to the contrary: Allendale Mut. Ins. Co. v. The Queen, [1973] C.T.C. 494, 73 D.T.C. 5382 (F.C. Trial D.). It also overtakes the relevant Interpretation Bulletin I.T.-302, paras. 3 and 4 (Apr. 6, 1976).

[108] The ITA speaks in terms of "change of control". This may differ from a take-over bid under the CBCA, s. 187. Under the ITA a change of control occurs when there is a change in the ownership of the majority of voting shares: M.N.R. v. Dworkin Furs (Pembroke) Ltd., [1967] S.C.R. 223, at 227-28, 67 D.T.C. 5035, at 5036; M.N.R. v. Sheldon's Engineering Ltd., [1955] S.C.R. 637, 55 D.T.C. 1110.

[109] ITA, s. 111(4).

[110] ITA, s. 111(5).

[111] ITA, s. 196(4).

[112] ITA, s. 196(1).

[113] ITA, s. 192(1). These provisions have been repealed as of Dec. 31, 1978.

[114] ITA, s. 87(2.1).

tions.[115] Statutory amalgamation between "winning" and "losing" corporations may be effected. Shortly thereafter the amalgamated corporation may liquidate the assets of the losing corporation. On the assumption that these assets were acquired at market value plus a "tax-loss premium", the transaction may have tax benefits to the amalgamated corporation, subject to disallowance on the sham transaction theory.

However, on the assumption that the transaction is not a sham, the "winning corporation" subjects itself to appraisal rights on amalgamation at the instance of dissenting shareholders. Appraisal rights in the losing corporation are also generated but these are highly theoretical. Since the transaction is beneficial to the losing corporation, there is an unlikely prospect of significant dissent. Appraisal rights could be avoided by adopting another mechanism of business combination, but only at the price of sacrificing tax benefits.

Whether or not the transaction is motivated by tax loss trading, the new tax provisions, whereby loss carry-forward may be effected, put combining corporations to a choice. The corporations must choose either to forego the tax advantages of loss carry-over, or to submit to appraisal rights. It is an either/or proposition; there is no way the corporations simultaneously can avoid appraisal claims and obtain loss carry-forwards on combination.

B. *Inter-Corporate Acquisition or Lease of Assets*

1. *General*

The second significant means of effecting a business combination is by the sale, lease or exchange of all or a significant part of a corporation's assets to another corporation. The vendor (lessor) corporation may receive securities of the purchaser corporation, securities of a third corporation controlled by the purchaser, or cash. Following the transaction, the vendor corporation can be wound up and its assets distributed to stockholders. Alternatively, it can be continued as a holding corporation, distributing its assets in the form of dividends. Under the CBCA, shareholders of the vendor corporation, so far as concerns sale, lease or exchange of all or substantially all assets, must approve the transaction by special resolution.[116] Voting rights, in respect of the resolution, accrue to normally non-voting shares.[117] Some provincial corporation acts march in step with

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[115] This is common. For example, here is an advertisement which appeared in The Globe and Mail (Toronto), Aug. 12, 1978, at B-4:

> *Tax Loss Position for Sale* A limited General Contracting Co. with a 1978 tax loss position of $250,000 is for sale. Year end is Sept. 30/78. Call. (416) 675-2083.

I telephoned the number and spoke with the president. He described a general contracting corporation with a $350,000 loss. He said that he would sell the shares, of which he was sole stockholder, for $35,000. There were approximately $6,000 in assets.

[116] CBCA, s. 183(7).

[117] CBCA, s. 183(5).

the federal shareholder approval requirement while others allow the sale on simple majority vote. Appraisal rights accrue to shareholders of the vendor corporation.[118]

2. *Appraisal Rights in the Vendor Corporation's Shareholders*

In order for the vendor corporation's shareholders to be entitled to appraisal rights under the CBCA, three conditions must be fulfilled: (a) the transaction must amount to a sale, lease or exchange; (b) the property that is sold, leased or exchanged must be "all or substantially all" of the vendor corporation's property; and (c) the sale, lease, or exchange must be other than in the ordinary course of business.[119]

(a) *Sale*

Difficulties sometimes arise in distinguishing between a sale and a merger. Suppose that the vendor corporation agrees with another corporation that each shall transfer assets to a third corporation, created specially for that purpose, in exchange for stock in the third corporation. The purpose of the transaction is not disposition of the assets; it is to retain them jointly in order to exploit the new enterprise. In other words, the transaction is properly described as a business combination; it is not properly described as a sale because the combining units are disposing to themselves. Does the existence of a third corporate shell make such a transaction a sale?

This situation was considered by the Minnesota Supreme Court in *Paterson v. Shuttuck Arizona Copper Co.*[120] The court declined to hold that the transaction constituted a sale:

> In no proper view were the two Minnesota copper companies selling the Arizona copper mines. Their intention was to keep them and develop the Shattuck Denn. In effect the property of the Shattuck Arizona was to furnish the means of financing. No money passed or was intended to pass.[121]

Theoretically, the concept of sale, in a business combination setting, outstrips common law understanding. *A* Co. may "sell" for cash its assets to *B* Co.; *A* Co. subsequently dissolves and distributes the cash to its shareholders on dissolution. All would agree that *A* Co. "sold" its assets, in that it disposed of all interest in them for monetary consideration. But if *A* Co. "sells" its assets to *B* Co. for eighty-five per cent of *B* Co.'s stock, the conceptual distinction between sale and merger blurs. The reason is indicated in *Paterson*; there is no disposition of interest, only retention. *A* Co. retains its interest in the assets through the medium of the corporate

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[118] CBCA, s. 184(1)(e).

[119] CBCA, s. 183(2).

[120] 186 Minn. 611, 244 N.W. 281 (Sup. Ct. 1932).

[121] *Id.* at 288 (N.W.). Several cases have found stock-for-assets combinations to be reorganizations and not sales: Farris v. Glen Alden Corp., 393 Pa. 427, 143 A. 2d 25 (Sup. Ct. 1958); Rath v. Rath Packing Co., 257 Iowa 1277, 136 N.W. 2d 410 (Sup. Ct. 1965). The cases are discussed in EISENBERG, *supra* note 10, at 218-23.

fiction. The substance of the transaction is belied by the existence of two separate corporate shells. Assets-for-stock combinations frequently raise problems of this nature; assets-for-cash transactions do not.

Professor Eisenberg, in considering the position of the vendor corporation's shareholders in an assets-for-stock combination, has taken the view that a distinction must be drawn between "sales" and "mergers" based on a relative size test: "[I]f the transferor's shareholders receive less than a 15-20 percent stake in the reconstituted enterprise the transaction would be deemed a sale within the meaning of the statute; if more, a merger."[122] Professor Eisenberg is there responding to statutes which distinguish between sales and mergers in terms of the conferral of appraisal rights; the statutes provide for appraisal rights in the case of merger but deny them in the case of assets sale. Moreover, he is responding to case law which generated a *de facto* merger doctrine — *i.e.*, if a transaction resembles a merger, it is one[123] — precisely because the appraisal statutes failed to embrace sale of assets transactions.[124]

The thrust of Professor Eisenberg's argument is that shareholders of the vendor corporation ought in principle to have appraisal rights in a relatively large assets-for-stock transaction. This follows from his view that such a transaction constitutes a "fundamental change". The mechanism which he invites the courts to utilize in accomplishing this result is characterization of the transaction as a merger. Mergers fall within the embrace of most American appraisal statutes; assets-for-stock combinations do not.

Professor Eisenberg's position directs attention once again to the question as to what constitutes fundamental change sufficient to generate appraisal rights; is it (a) change in control, (b) change in business, (c)

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[122] EISENBERG, *id.* at 231.

[123] Applestein v. United Board & Carton Corp., 33 N.J. 72, 161 A. 2d 474 (Sup Ct 1960), *aff'g* 60 N.J. Super. 333, 159 A. 2d 146 (Super. Ct. Ch. Div. 1959); Farris v Glen Alden Corp., *supra* note 121. The *Farris* case succinctly outlines the *de facto* merger theory at 432, 143 A. 2d at 28:

> To determine properly the nature of a corporate transaction, we must refer not only to all the provisions of the agreement, but also to the consequences of the transaction and to the purposes of the provisions of the corporation law said to be applicable. We shall apply this principle to the instant case.

In Hariton v. Arco Electronics Inc., 41 Del. Ch. 74, 188 A. 2d 123 (Sup. Ct. 1963), the Delaware court challenged the *de facto* merger doctrine with the view that the following of the statutory formalities in the sale of assets transaction could not be impeached; the merger and sale of assets statutes were of "equal dignity". *See generally* Folk, *supra* note 26.

[124] In Applestein v. United Board & Carton Corp., 60 N.J. Super. 333, 159 A. 2d 146, at 152-53 (1960), the court stated:

> It would be strange if the powers conferred by our Legislature upon corporations . . . for a purchase of the property and shares of another corporation and . . . for the merger of a parent corporation with a wholly-owned corporation can effect a corporate merger *de facto*, with all the characteristics and consequences of a merger, without any of the legislative safeguards and rights afforded to a dissenting shareholder in a *de jure* merger

change in management, or (d) change in the corporation's constitution? The view for which he contends is that fundamental change contemplates situation (b), change in business, as measured, in the case of a stock-for-assets combination, by acquisition of a fifteen to twenty per cent security stake in the purchaser corporation by the vendor.

The theory behind the CBCA appears to differ. By section 184(1)(e), appraisal rights arise only on a sale of "all or substantially all" assets. There is no relative size test. Sale of less than "substantially all" assets (which, if "significant", Professor Eisenberg thinks likewise should generate appraisal rights) cannot, by the application of the maxim, *inclusio unius est exclusio alterius*, generate appraisal rights. There is no distinction between sale of assets for stock and sale of assets for cash. Clearly, the CBCA does not contemplate that fundamental change sufficient to trigger appraisal rights includes significant business changes. But what exactly does it contemplate?

In my view the CBCA contemplates only what it says: it is not theoretically consistent. The drafters were faced with one of those intractable difficulties woven throughout the fabric of all legal systems. They had to choose between a remedy which is doctrinally uniform but practically unworkable, and one that is administratively efficient, but which lacks a consistent approach to the problem. They could have chosen Professor Eisenberg's position — significant business changes trigger appraisal. That is theoretically consistent, but it is also practically uncertain and difficult to administer in that there is no hard and fast dividing line between business changes which are "significant" and those which are not. Alternatively, the drafters could have chosen the position they did: sale of "substantially all assets" alone generates appraisal. This position is certain and easy to administer, but theoretically inconsistent.

The lack of consistent policy behind the sale of "substantially all assets" provision might tempt some courts to blaze through statutory formality and adopt a *de facto* merger approach. It is not inconceivable that a Canadian court would say that if the transaction involves less than a sale of "substantially all assets", but is economically significant to the vendor corporation, appraisal rights are still generated by CBCA section 184(1)(c) on the theory that such a business combination constitutes in fact, and in law, a merger. Such a position is the full bloom of alternative (b) (significant business change) as to what constitutes fundamental change sufficient to generate appraisal rights.

There is an initial hurdle for this approach. The CBCA speaks of amalgamations, not mergers. Although amalgamations are not defined, one would have thought that the concept embraced only that transaction contemplated by the statutory procedure found in section 175 and following. A court intoxicated with the *de facto* merger approach would have to negative this view. It would have to hold that an amalgamation within the meaning of section 184(1)(c) is to be tested by result, not by procedure.[125] A significant business alteration by sale of less than "substantially all assets" would not fit within the procedural definition.

There would be, *inter alia*, no amalgamation agreement as required by the Act.

There is a second hurdle which is more weighty and which ought to signal caution to the courts. The *de facto* merger doctrine, although permeated with formidable conceptual difficulties, is known, and was known to the framers of the CBCA.[126] They specifically did not adopt it. Instead they adopted the conferral of appraisal rights in the sale of "substantially all assets" situation only. Adoption by the courts of *de facto* merger would be an usurpation of the legislative function. The legislature, utilizing its considerable resources, studied this problem; it recommended; it enacted. Unless a court could show compelling reasons for adopting *de facto* merger — which I doubt — other than a preference for a legislatively rejected policy (alternative (b)), it ought not to interfere with Parliament's discretion by applying the doctrine to extend appraisal rights.

As a third hurdle, it is my opinion that alternative (b) is unsound as legal policy. This is discussed *infra*, under the heading "Speculative Rights and Suggestions for Reform".

The problem takes on added subtlety under Ontario legislation. It becomes necessary there to distinguish between "sales" and "reorganizations". The Ontario Business Corporations Act makes specific provision for reconstructions by section 193(1)(d). The section contemplates effecting reconstructions, *inter alia*, by assets-for-stock combinations. Section 193(1)(d) provides, in terms, that a corporation may reconstruct by selling to another body corporate "the whole or a substantial part of its undertaking". It is not necessary that the reorganization include the sale of "all or substantially all assets". Appraisal rights are not accorded.

Suppose, therefore, that *A* Co., in order to effect a reconstruction of its enterprise, sells a substantial part (as opposed to "substantially all") of its assets to *B* Co. There is no doubt that shareholders of *A* Co. do not have appraisal rights. The Ontario reconstruction section withholds the right to

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[125] This view could gather some strength from the fact that the draft proposals speak of "statutory amalgamation"; the Act speaks of "amalgamation" *simpliciter*. Although the latter term is potentially wider, still the support is slight. But there is no rule of statutory interpretation to assist in reaching the conclusion towards which such textual exegesis strains.

[126] This is made clear by the PROPOSALS, *supra* note 16, at 123:

> In several U.S. jurisdictions, where no right to dissent is granted in respect of the sale of assets but is granted in respect of an amalgamation, management has frequently characterized an acquisition as a purchase of assets instead of an amalgamation to avoid any possible right of dissent. In some states, the common law developed a '*de facto*' merger doctrine which compelled a corporation to grant appraisal rights even in the case of a sale of assets. By specifically covering the extraordinary sale, lease or exchange of assets in this section, we include what are considered to be the fairer common law precedents.

dissent, and the terms of the appraisal section[127] — "all or substantially all" — are not met. But suppose that in order to effect reconstruction *A* Co. sells substantially all of its assets to *B* Co. The enterprise, including persons interested in it, remains fundamentally the same. The transaction fits squarely within the definition of reconstruction in section 193(1)(d). But it also fits within the terms of a sale "of substantially all assets" in section 100(1)(a). Section 193(1)(d) makes no provision for appraisal; section 100(1)(a) accords it specifically. Which governs?

The English Court of Appeal considered a similar situation in *In re Canning Jarrah Timber Co.*[128] Where a scheme of arrangements was sanctioned by the court, under which all of the assets and liabilities of *C* Co. were transferred to *C-J* Co, and members of *C* Co. received a share-for-share exchange in *C-J* Co., the court required that provision be made for dissentient members to have the same rights they would have had, had the sale been effected under what is now section 287 of the Companies Act, 1948.[129] Section 287 triggers appraisal but a court-sanctioned arrangement does not. In Ontario, there is even greater reason to accord appraisal rights in a reconstruction of this type. Unlike the transaction considered by the court in *In re Canning Jarrah Timber Co.*, specific provision is made in section 100(1)(a) of the Ontario Act for appraisal rights if a sale of "substantially all assets" occurs without court approval. It is hard to accept that the mere fact that the reconstructing corporation seeks the court's approval under section 194 should have the effect of eliminating shareholder appraisal rights, when a basically similar statutory sale of all assets would unquestionably generate them.

At present, federal legislation makes no provision for statutory reconstruction similar to section 193 of the Ontario Act. This has caused problems, particularly respecting the unwinding of an unsuccessful amalgamation or inter-jurisdictional transfer.[130] In order to overcome these difficulties, and to give the corporation more flexibility in business reorganizations, the Department of Consumer and Corporate Affairs has sponsored new legislation[131] modelled largely on the Ontario section.[132] The question of appraisal rights under the proposed "arrangement" amendment received detailed consideration:

> In putting in this arrangement provision, we were somewhat uneasy that it might be used by corporations to avoid the shareholders' right to dissent. We wanted to give this flexibility to the corporation and its management, but, at the same time, adequately protect the shareholders.

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[127] The Business Corporations Act, R.S.O. 1970, c. 53, *as amended*, s. 100(1)(a).

[128] [1900] 1 Ch. 708, at 716-17, 69 L.J. Ch. 416, at 419 (C.A.).

[129] 11 & 12 Geo. VI, c. 38.

[130] CONSUMER AND CORPORATE AFFAIRS CANADA, DETAILED BACKGROUND PAPER FOR AN ACT TO AMEND THE CBCA 17 (1977); PROCEEDINGS, *supra* note 98, at 30.

[131] An Act to amend the Canada Business Corporations Act, S.C. 1978-79, c. 9 (formerly Bill S-5, 30th Parl., 4th sess., proclaimed in force Dec. 27, 1978, except s. 1).

[132] PROCEEDINGS, *supra* note 98, at 31.

> We have developed a very flexible concept arrangements [*sic*], but we constrain its use by saying one can only use the arrangement provision where it is not practicable to effect the transaction otherwise, and that the court will have to be convinced of that, otherwise the section would not apply.[133]

Under the new amendment, appraisal rights cannot be avoided by using the arrangement procedure when other routes exist for effecting fundamental changes. If the arrangement procedure is warranted, the court has discretion, by the recently enacted section 184.1(4)(c), to make an order permitting a shareholder to dissent under section 184. When should the court affirmatively exercise its discretion to award shareholder appraisal rights? In my view, if the transaction effected under the proposed arrangement is substantially similar to a Part XIV transaction (fundamental change), it would be improper for a court, in the absence of compelling reasons, to exercise its discretion against making an order permitting shareholders to dissent.

(b) *"All or Substantially All"*

Whether a corporation has sold, leased or exchanged "substantially all" of its assets is a question of fact which must be left to the courts. To date, no Canadian court has had an opportunity to consider the meaning of the phrase.

American courts, however, have considered this wording in a variety of contexts. In *Application of Thomas S. Lee Enterprises*[134] a transfer comprising 86.11 per cent of operating assets was found not to be a transfer of "all or substantially all the assets". In *Ridge Lumber Products Inc. v. Nelson*[135] the court found the words "substantially all" to mean "all but what should be disregarded under the *de minimus* rule".[136] "It must be tantamount to the winding up of a going business operation", said the court in *Good v. Lackawanna Leather Co.*[137]

Phrases like the one under consideration never admit of mathematical precision, nor can they be applied other than to concrete facts. In my view what is contemplated by the phrase "all or substantially all" is a test that goes beyond quantum measurement. It must be shown, in addition, that

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[133] Mr. John Howard, Assistant Deputy Minister, Department of Consumer and Corporate Affairs, in testimony before the Senate Standing Committee on Banking, Trade and Commerce, in PROCEEDINGS, *id.* at 31.

[134] 280 App. Div. 676, at 678, 117 N.Y.S. 2d 257, at 259 (1952).

[135] 213 F. 2d 451 (N.Y. Ct. App. 1954).

[136] *Id.* at 453.

[137] 96 N.J. Super. 439, 233 A. 2d 201, at 210 (Ch. Div. 1967). *See also* Story v. Kennecott Copper Corp., 90 Misc. 2d 333, 394 N.Y.S. 2d 353 (Sup. Ct. 1977); Prince George's Country Club Inc. v. Edward R. Carr Inc., 235 Md. 591, 202 A. 2d 354 (Ct. App. 1964) (sale of 98.5 per cent of assets that destroys completely the corporation as a country club); Stiles v. Aluminum Products Co., 338 Ill. App. 48, 86 N.E. 2d 887 (1949); Keck Enterprises Inc. v. Braunschweiger, 108 F. Supp. 925 (D.C. Cal. 1952); Moore, *The Sale of All or Substantially All Corporate Assets Under Section 271 of the Delaware Code*, 1 DEL. J. CORP. L. 56 (1976).

the corporation, by the sale, lease or exchange, has destroyed its capacity to continue pursuing that undertaking to which its assets relate. It must metamorphose wholly the nature of the enterprise in which it has been engaged or it must cease pursuing that enterprise and become a holding or investment corporation.

(c) *Other Than in the Ordinary Course of Business*

By referential incorporation of CBCA section 183(2) into CBCA section 184(1)(e), the sale, lease or exchange of property must be "other than in the ordinary course of business". This is a question of fact which must be determined in the concrete circumstances of each case. The meaning of the phrase was illuminated in *Re Bradford Roofing Industries Property Ltd.*[138] in which the court had to consider section 207(1) of the New South Wales Companies Act (1961). That section prohibits official managers from disposing of any of a company's assets, without leave of the court, "save in the ordinary course of the company's business". The court stated:

> Perhaps a satisfactory working phrase to describe the particular concept enacted in S. 207(1) is that the transaction must be one of the ordinary day-to-day business activities, having no unusual or special features, and being such as a manager of a business might reasonably be expected to be permitted to carry out on his own initiative without making prior reference back or subsequent report to his superior authorities such as, for example, to his board of directors. Borrowing, with minor adaptations, from the judgment of Rich J. in the *Downs Distributing* case, the requirement is that the transaction must fall into place as part of the undistinguished common flow of the company's business, that it should form part of the ordinary course of the company's business as carried on, calling for no remark and arising out of no special or particular situation.[139]

Suppose that all or substantially all of the property of a corporation is sold to a subsidiary or to a sister subsidiary of the same parent corporation for tax avoidance purposes. Can such a transaction be said to be "other than in the ordinary course of business" such that appraisal rights are generated?

This question was considered by a Minnesota court, in a sale of division situation, in *Aiple v. Twin City Barge & Towing Co.*[140] The court said this:

> Under the circumstances in this case the defendant corporation has attempted to split itself into two corporations for the obvious purpose of increasing the capital stock of the parent company without complying with the provisions of

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[138] [1966] 1 N.S.W.R. 674, 84 W.N. (N.S.W.) 276 (S.C.).

[139] *Id.* at 681, 84 W.N. (N.S.W.) at 285. *See also* Huntsville Industrial Assocs. v. Cummings, 292 Ala. 391, 295 So. 2d 251 (Sup. Ct. 1974) where the court stated at 255 (So.): "Regular course of business . . . must find its meaning in the inherent nature of the business in question and in the methods systematically employed for the conduct of the business as a business."

[140] 143 N.W. 2d 374 (Sup. Ct. 1966).

> the statute governing that subject. The parent corporation has divided its assets with its own creature, capitalized a portion at a fixed valuation, and received back all of the shares of the stock issued by the subsidiary. If this can be done, the provisions [governing amendment of certificates] may be circumvented to the point where a corporation might fragment itself into any number of divisions, thus leaving minority stockholders without the protection that the statute was designed to give them.[141]

The court indicated that subsidiary purposes — subsidiary to the purpose of maximizing revenues and tax savings — will be closely scrutinized in order to determine whether shareholders are being unfairly treated. If such a subsidiary purpose is evident, the court would be astute to accord appraisal rights, despite the ordinary business mode in which the transaction appears to be cast.

3. *Appraisal Rights in the Purchaser Corporation's Shareholders*

(a) *Rights given by the CBCA*

By the old Canada Corporations Act[142] and the theory upon which it was based, a corporation was an undertaking launched for a specific purpose. It had power, accordingly, to carry on only those businesses for which its articles made provision.[143] That position has been overtaken by corporation theory,[144] as well as by the new CBCA. Under the new Act, a corporation has all the capacity of a natural person,[145] with no limits on the nature of business it may undertake. There is one exception. The articles may impose a restriction.[146] Where such a restriction exists, it must be removed by amendment of the articles prior to acquisition of any assets in respect of the prohibited business.

This change means that the purchaser corporation may conduct any type of business without consulting the shareholders. The theory of the Act is that the directors shall manage the business; business decisions — such as asset purchase, short of "all or substantially all" — are not to be submitted to the shareholders.[147] Management's business discretion may be fettered by unanimous shareholders' agreement[148] but in the absence of such, management's business discretion is plenary.

It may be that the exception applies; the corporation's articles prohibit carrying on precisely that business which the corporation contemplates acquiring. If this is the case, the corporation may resolve to amend the

[141] *Id.* at 378-79.

[142] R.S.C. 1970, c. C-32, *as amended*.

[143] S.16(1)(a.1). This is the present position under The Ontario Business Corporations Act, R.S.O. 1970, c. 53, *as amended*, s. 15(2)2.

[144] The HODGSON COMMITTEE REPORT, *supra* note 29 puts the point succinctly at 5: "Because the objects for which a corporation is incorporated seem to be assuming less and less importance, the Committee considers that this limitation in section 15(2)2 serves no useful purpose and should be deleted."

[145] CBCA, s. 15(1).

[146] CBCA, s. 16(2).

[147] CBCA, s. 97(1).

[148] CBCA, s. 140(2). This is a reversal of the common law rule.

articles, thereby removing the restriction.[149] An amendment of this nature triggers appraisal rights for shareholders who dissent to the amendment.[150]

The purchaser corporation has great flexibility in cash-for-assets transactions. It may sell, lease, or exchange some of its own assets in order to raise cash for an asset acquisition. Save the case in which the purchaser sells substantially all its assets, it does not thereby bring into existence appraisal rights.

The situation may differ in a stock-for-assets transaction. If the stock exchanged for assets is authorized but unissued stock, no appraisal rights are generated. But if the stock exchanged is unauthorized stock, an amendment to the articles by special resolution is a condition precedent to issuance.[151] This creates appraisal rights for dissenting shareholders.[152]

(b) *Speculative Rights and Suggestions for Reform*

In the ordinary cash-for-assets or stock-for-assets transaction the vendor corporation will be relatively small in relation to the purchaser corporation. Generally speaking, the asset acquisition will amount to an expansion of the purchaser's business or to the addition of a new division. The decision by the purchaser corporation to make the asset acquisition is, in these circumstances paradigmatically "managerial" under the theory of the CBCA.[153] There is, accordingly, no rational policy upon which to submit the transaction to the purchaser's shareholders or to accord them appraisal rights.

But it may well happen that the vendor corporation is, in relation to the purchaser corporation, relatively large, or larger. The asset acquisition may involve debt or equity financing. Authorized but unissued stock of the purchaser corporation may pass to the vendor corporation sufficient to give the latter *de facto* control of the purchaser. The sale may be no less than a *de jure* take-over or change in control of the purchaser corporation by the vendor corporation. In substance, the transaction may overstep essentially managerial functions; the enterprise may be fundamentally changed.

If the vendor corporation is rèlatively large in comparison to the purchaser corporation, nice questions arise respecting the desirability of according voting and appraisal rights to the shareholders of the purchaser

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[149] CBCA, s. 167(1)(c).

[150] CBCA, s. 184(1)(b).

[151] CBCA, s. 167(1)(d).

[152] CBCA, s. 184(1)(a) and (2).

[153] CBCA, s. 97. *See also* Eisenberg, *supra* note 15, at 121:

> Where, however, the transferor is small in relation to the survivor, the matter appears appropriate for board decision, and should not give rise to appraisal rights: Such transactions are unlikely to have a high degree of economic significance, and in many cases they are more likely to resemble expansion of the enterprise along existing lines than a restructuring of the enterprise; furthermore, the reallocation of ownership interests would not be, by hypothesis, significant.

corporation. In considering these questions, it is helpful to recall the policy behind appraisal rights. Appraisal rights are accorded in the case of fundamental change to corporations. The rights assist in maximizing the allocation of capital along economically justified lines by offering compensation for the expropriation of property and opportunity.

Does it therefore follow that a relatively large asset acquisition should trigger appraisal rights in the purchaser corporation's shareholders? If an affirmative answer to this question is forthcoming, it must proceed from one of three theories of what constitutes fundamental change: (a) change in control of the corporation, (b) change in the nature of business, or (c) change in management.

(i) *Change in Control*

Professor Eisenberg is the leading advocate in support of the view that change of control is a sufficient foundation upon which appraisal rights can be based. He takes the position that regard ought to be had to the amount of stock issued by the purchaser corporation. If the amount of stock issued is significant, in terms of previously outstanding stock, and causes change in the control structure of the legal entity in which the purchaser's corporate enterprise is enveloped, then the stock-for-assets combination has a fundamental legal-economic impact on the purchaser's shareholders. As such, it ought fairly to require their approval and create in them appraisal rights.[154]

This argument seems to me overly extravagant. It confuses the concept of fundamental corporate change with that of change of ownership. Change of ownership or control may involve no fundamental or structural change at all. The personalities occupying managerial and directorial positions may continue undisturbed; hitherto articulated corporate objectives may be affirmed; nothing in fact, may change except ownership profile. What is "fundamental" about that?

The taking of control may, through the voting and proxy machinery, give the acquiring group power to make fundamental changes in the corporate structure. It may give the owners power to effect policy changes through the introduction of new directors or managers, may allow them to change the nature of the business, and may allow them to alter the articles. But these effects are merely hypothetical and may never happen. It does not seem warranted to accord appraisal rights for contingent events only. In any case, should the contingencies occur, then, pursuant to statutory provision, a right of appraisal could be available.

Change in control, jurisprudentially speaking, is a political change. It goes to the identity of the group in power. It is not a "constitutional" change, nor does it go to the structure of the corporate organism. Structural changes lie on a different level, and involve different considerations.

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[154] EISENBERG, *supra* note 10, at 218-23.

In any case, neither the CBCA, nor any of the provincial corporations statutes, accord full appraisal rights to dissenting shareholders on a take-over bid. The Hodgson Committee considered whether a right, in a take-over situation, to require the corporation to purchase one's shares should be accorded to dissenting shareholders.[155] The Committee concluded in the affirmative, but this was on completely different grounds, and in a particular situation only. The Committee thought that in order to prevent a dissenter from being "locked in" in a take-over bid, the dissenter should have a compulsory purchase right where ninety per cent of the shareholders had accepted the offeror's tender. This is an entirely different phenomenon than that of allowing full-blown appraisal rights where fifteen per cent of the shares changes hands. Neither in fact nor in theory can the Hodgson Committee's conclusion be used to buttress the Eisenberg proposal. In my view, that proposal is unsound in theory, and cannot be rationalized with the basic policy objectives of the appraisal remedy.

(ii) *Change in the Nature of the Enterprise*

If a small retail shoe corporation issues very substantial debt obligations or stock in order to acquire the assets of a relatively large buggy whip manufacturer, ought appraisal rights to arise in dissenting shareholders of the shoe corporation?

By older companies Acts, the objects of the company's existence had to be set down. The company's business existence was to be confined by the parameters set out in the objects clause. Expansion of corporate activity has exerted continuous centrifugal pressure on the objects clause concept,[156] in consequence of which newer Acts have dispensed with the necessity of confining corporate capacity to specific undertakings.[157] In Newfoundland,[158] Alberta,[159] and Nova Scotia,[160] however, the older theory of corporate powers has been retained. If, in any of those provinces, an amendment should be made to the objects clause, as is required in order to change the business which the corporation may carry on, appraisal rights of a sort arise in dissenting shareholders.[161] The

[155] HODGSON COMMITTEE REPORT, *supra* note 29, at 43-46. A compulsory purchase right along the lines described by the Hodgson Committee is in force in British Columbia: *see* Companies Act, S.B.C. 1973, c. 18, *as amended*, s. 276(9).

[156] In Bell Houses Ltd. v. City Wall Properties Ltd., [1966] 2 Q.B. 656, [1966] 2 All E.R. 674 (C.A.), the Court of Appeal sustained the validity of an objects clause which included power "to carry on any other trade or business whatsoever which can, in the opinion of the board of directors, be advantageously carried on by the company in connection with or as ancillary to any of the above businesses or the general business of the Company".

[157] CBCA, ss. 15, 16.

[158] The Companies Act, R.S.Nfld. 1970, c. 54, s. 8(b).

[159] The Companies Act, R.S.A. 1970, c. 60, s. 16(1)(b).

[160] The Companies Act, R.S.N.S. 1970, c. 42, s. 9(1)(b).

[161] The Companies Act, R.S.Nfld. 1970, c. 54, s. 106; The Companies Act, R.S.A. 1970, c. 60, s. 34; The Companies Act, R.S.N.S. 1970, c. 42, s. 17.

Alberta/Newfoundland/Nova Scotia approach to corporate objects and powers is largely *passé*. Under the theory found in the new CBCA, by which a corporation has all the powers and capacities of a natural person,[162] significant problems arise in determining when a corporation's business, in fact, has changed. This consideration points toward a further question: does it follow that change in the objects and powers theory implies change in the theory of what circumstances should trigger appraisal rights?

The answer pivots on the correctness of the following proposition: a corporation's undertaking never changes "fundamentally" (in the sense in which voting and appraisal rights should be accorded) by addition or subtraction of a particular business, even if significant in terms of relative size, because the corporation is in the business of doing business. By this view, "fundamental change" implies structural change as contrasted with change in objects and purposes. A "fundamental change", in this sense, goes to "constitutional" change in the relation of the corporation's organs — *i.e.*, directors, owners, and shareholders — to each other and *inter se*. It does not go to change in business policies or investment decisions. If this view be correct, then there is no basis upon which it could be contended that appraisal rights ought to accrue to the shoe corporation's shareholders in the example contemplated above. If this view be incorrect, then it becomes relevant to ask whether the corporation statutes should be amended, or the courts should intervene, to accord appraisal rights to dissenting shareholders on the happening of certain "fundamental changes" in business policies and investment decisions.[163]

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[162] CBCA, s. 15(1).

[163] It might be objected that a relatively large business change, such as the addition of a significant division, is structural in the sense I have indicated If the corporate combination or division is by issuance of stock-for-assets, the minority shareholder's equity participation in the combined enterprise may be diluted: *see* Farris v Glen Alden Corp., *supra* note 121.

This objection gathers strength from the fact that corporate control is an asset; it is a "thing of value". *See* Jones v. H.F. Ahmanson & Co., 1 Cal. 3d 93, 460 P 2d 464 (Sup. Ct. 1969). A significant shareholding less than control — say 10 per cent of outstanding stock — may also be an asset, a "thing of value" in the sense that the shareholder so situated can command the ear of management: he may on occasion make them dance to his tune. On a relatively large stock-for-assets combination, such a shareholder may find himself reduced from 10 to 0.5 per cent. He may lose management's ear; they may refuse to dance; he may, accordingly, have lost a thing of value. The substance of the objection, thus, is that a relatively large stock-for-assets combination or division is structural in that it changes the relation of the shareholder to management and to other shareholders *inter se*

The objection is hollow. First, consider the position in a cash-for-assets combination There is no dilution. The 10 per cent shareholder still owns 10 per cent of the combined enterprise, although the enterprise is larger and may carry a larger debt The shareholder's position *vis-à-vis* management and other shareholders is unaltered; there is no structural change.

What is the position in a stock-for-assets combination? Here it becomes necessary to distinguish between a 10 per cent shareholder of the outstanding stock and a 10 per cent shareholder of the authorized stock. Absent an amendment of the articles to increase the

In the United States there is wide divergence of opinion amongst courts,[164] legislatures[165] and academic commentators[166] as to the correct view. It is thought, on the one hand, that:

> [o]ne does not invest in a unique corporate entity or even a particular business operation, but rather in a continuous course of business which changes over a long period of time . . . [C]losely held corporations aside, an investment in a corporation is really an investment in the judgment, business acumen, integrity, and vigor of management, whose personnel and policy change over time . . . '[F]undamental corporate change' is too undiscriminating a basis on which to adopt a *de facto* merger concept. . . .[167]

It is said, on the other hand, that if the result of a transaction is identical, economically and legally, with a merger, the form used to reach that result should not be relevant in determining the legal rights accorded to dissenting shareholders:

> If consolidation or merger is permitted through a pretended sale of assets or dissolution, minority stockholders may be frozen out of their legal rights of appraisal. . . .
>
> It would be strange if the powers conferred by our Legislature upon corporations...for a purchase of the property and shares of another corporation and . . . for the merger of a parent corporation with a wholly-owned corporation can effect a corporate merger *de facto*, with all the characteristics and consequences of a merger without any of the legislative safeguards and rights afforded to a dissenting shareholder in a *de jure* merger. . . .[168]

In *Farris v. Glen Alden Corp.*,[169] Glen Alden agreed to acquire all assets and assume all liabilities of List Industries in exchange for roughly

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authorized stock, the position of the latter is unaltered in a "structural" way; he still holds 10 per cent. If the articles are amended the change is certainly structural; voting and appraisal rights ought to be generated. They are: *see* CBCA, ss. 184(1)(a) and (2).

A 10 per cent stockholder of the outstanding stock may well find his equity ownership diluted and his position altered on issuance of authorized but unissued stock. But I do not see that he has cause for complaint. He knew or ought to have known that the corporation had authorized stock it could issue. He assumed his stock position under those circumstances. His position is not "structurally" altered; the corporation is simply operating within the structure that exists. It does not alter that structure by issuing stock it is authorized to issue.

In my view, the substance of any complaint arising from issuance of authorized stock is that the action is unfair. The complaint ought to sound in the oppression provisions. It is illogical to give the shareholder a quasi-management voice, by giving him voting and appraisal rights, to test the validity of such a complaint.

[164] *Compare* Farris v. Glen Alden Corp., *supra* note 121 *and* Applestein v. United Board & Carton Corp., *supra* note 123 *with* Hariton v. Arco Electronics Inc., *supra* note 123 *and* Orzeck v. Englehart, 41 Del. Ch. 223, 192 A. 2d 36 (1963).

[165] *Compare* PA. STAT. ANN. 1967, tit. 15, s. 1311(f) *and* OHIO REV. CODE ANN. 1974, tit. 17, ss. 1701.01(Q), (S), 1701.83(A), 1701.84(D) *with* DEL. CODE ANN. 1968, tit. 8, para. 262. The latter is reprinted in E.L. FOLK III, THE DELAWARE GENERAL CORPORATION LAW 369 ff. (1972).

[166] *Compare* EISENBERG, *supra* note 10, at 224-37 *with* Folk, *supra* note 26, at 1278-81.

[167] Folk, *id.* at 1280-81.

[168] Applestein v. United Board & Carton Corp., *supra* note 124, at 152-53 (A.).

[169] *Supra* note 121.

fifty per cent of outstanding Glen Alden stock. The assets of Glen Alden and List were approximately equal, but List carried seven times Glen Alden's debt. The businesses of the two corporations were unrelated. By a "reorganization agreement", List was to dissolve, the stock of Glen Alden was to be distributed to List's shareholders and the directors of the two companies were to become directors of a "reorganized" List Alden Corporation. On suit by a Glen Alden shareholder to enjoin the transaction, the Pennsylvania Supreme Court held first, that the transaction was *de facto* a merger which failed to comply with the requirements of the merger statute, and secondly, that in any event, Glen Alden was not in fact a purchaser at all; it was a seller. The shareholders of Glen Alden, accordingly, had to be accorded appraisal rights under either the merger or sale of assets statutes.

The *Farris* case is the high-water mark of the American *de facto* merger doctrine. It is easy to imagine the shock-waves it must have sent through the Pennsylvania corporate law bar. Inevitably, it produced considerable uncertainties. Any sale of assets transaction could be subject to attack, despite scrupulous compliance with statutory formalities. The breadth of the court's holding — the court noted six major factors by which it tested this transaction for necessary compliance with merger or sale of assets provisions[170] — opened a gaping hole in the precision of business combinations statutes. The entrance of judicial standards, in supplement of statutory requirements, made objective planning in advance impossible. Potentially every business combination was subject to lengthy proceedings, uncertain as to result. The Pennsylvania legislature responded rapidly by re-enacting objective standards.[171] By a 1959 amendment to the corporation law, the legislature accorded appraisal rights to dissenting shareholders of the purchaser corporation where fifty per cent of the corporation's voting stock was issued in connection with an asset acquisition.[172]

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[170] *Id.* at 29-30:

(a) change in the nature of the corporation's business,
(b) doubling in size of the reorganized corporation,
(c) change in control of the purchaser corporation to the vendor corporation,
(d) assumption of the vendor corporation's liabilities by the purchaser corporation,
(e) drop in the book value of purchaser corporation's shareholders' shares in the reorganized corporation,
(f) drop in the interest held by purchaser corporation's shareholders in the reorganized corporation,
(g) dissolution of the vendor corporation.

[171] PA. STAT. ANN., 1967, tit. 15, s. 1311(f).

[172] Professor Eisenberg is highly critical of the statutory solution adopted, although he favours a more sophisticated *de facto* merger theory, *supra* note 15, at 124-25

> But on the whole the statute is woefully inadequate and gives rise to highly anomalous results. For example, suppose *P* issues 55 per cent of its stock for the assets of *S*. Then one set of shareholders will end with 45 per cent of the stock of the reconstituted corporation, and one set with 55 per cent Both sets will have appraisal rights — *S*'s shareholders under the traditional sale-of-substantially-all-assets provision, and *P*'s shareholders under the 1959

To my mind, the uncertainty caused by a judicially created and administered *de facto* merger test is a sufficient objection to its desirability. Objective standards and certainty are crucial; the expense and delay generated by broad criteria of *de facto* merger inhibit business combinations and the economies of scale thereby generated. Business planning would be set back and the statute books would be permeable to rewriting by the courts.

In any event, uncertainty is not the only objection to the *de facto* merger doctrine. It serves no independent corporation law value; it adds nothing whatsoever to the ideal of shareholder protection. If the policy behind *de facto* merger is to prevent unfairness to minorities, insider dealing, or recklessness in business decision, shareholders already have very substantial protection currently available under oppression statutes,[173] directors' and officers' liability for due care and good faith in the exercise of duties,[174] fiduciary duties of directors,[175] and fiduciary duties of majority shareholders.[176] The addition of appraisal, through a *de facto* merger doctrine, accomplishes nothing. In fact, appraisal inhibits full development of these latter methods of minority shareholder protection. It suggests approval of the transaction — which *ex hypothesi* is unfair — by offering tit-for-tat compensation to the prejudiced majority. At the very least, the existence of appraisal is an additional circumstance to which the court has to respond in weighing the fairness of the transaction.

A judicially supervised *de facto* merger doctrine is, in my view, an improper remedy for shareholder protection. It is also administratively

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> amendments. So far, so good. But now suppose *P* issues only 45 per cent of its stock. Economically the case seems identical: The two sets of shareholders will end up with 55 and 45 per cent of the stock of the reconstituted corporation, respectively. But now only one set (*S*'s) will have appraisal rights, because the 1959 amendments are inapplicable. This is carrying form to a fare-thee-well.
>
> The amendments also present a difficult problem of interpretation. They say nothing about voting rights. Do they nevertheless affect such rights? If so, how? It can be argued that the amendments exclude voting rights to the survivor's shareholders by negative implication. . . .

Professor Eisenberg favours according voting and appraisal rights in stock-for-assets combinations to both vendor and purchaser corporations' dissenting shareholders. This should be done, in his view, when the amount of common stock issued by the survivor is significant in relation to its stock then outstanding. A 40 per cent test he thinks too high; a 15-20 per cent test satisfies the requirement of significance: EISENBERG, *supra* note 10, at 236-37. No distinction should be drawn between voting and non-voting shares: Eisenberg, *supra* note 15, at 130.

[173] CBCA, s. 234.

[174] CBCA, s. 117.

[175] Canadian Aero Service Ltd. v. O'Malley, [1974] S.C.R. 592, 40 D.L.R. (3d) 371.

[176] This last protection is at present uncertain in Canadian law, although the doctrine is secure in the United States. *See* Farnham v. Fingold, [1973] 2 O.R. 132, 29 D.L.R. (3d) 156 (C.A.) and Goldex Mines Ltd. v. Revill, 7 O.R. (2d) 216, 54 D.L.R. (3d) 672 (C.A. 1974) for *obiter* remarks concerning the majority's fiduciary duty. *See generally* Gibson, *The Sale of Control in Canadian Company Law*, 10 U.B.C.L. REV. 1 (1975). In the United States, a useful statement of the doctrine is to be found in Singer v. Magnavox, 380 A. 2d 969 (Del. Sup. Ct. 1977).

unworkable. The real objection to *de facto* merger lies deeper, however, and applies equally whether the doctrine springs from the courts, with all its attendant uncertainties, or from the legislature with precise criteria of application. The true objection to *de facto* merger is that the doctrine implies an archaic and unwarranted restriction on the exercise of business judgment by corporate managers. The central jurisprudential idea behind corporate personality is that it dispenses with the immediate process of consulting what may be a wide array of owners each time a business decision is taken: "Their [the corporations'] existence is necessary to avoid the tedious and cumbrous processes which would otherwise be required for the carrying on of joint undertakings in which a large number of citizens are or may be interested."[177] The effect of a *de facto* merger doctrine, by generating voting and appraisal rights, is to bring shareholders directly into the business management process. It becomes necessary for management to consult them and allow them to cash in their participation if they disagree. This happens when the transaction *ex hypothesi* is fair, and when the shareholders' structural position in the enterprise is unaltered. It happens as the result of a purely business decision. Jurisprudentially, *de facto* merger misconceives the proper division of functions between owners and managers in situations where their interests are not opposed. It impairs corporate flexibility and creates economic inefficiency. Professor Posner makes this point succinctly:

> The law may thus be faulted for paying insufficient attention to the role of transactions and the market in assuring that corporations are controlled by those who can use that control most productively. Too much emphasis has been placed on creating 'corporate democracy' and not enough on creating an efficient market in corporate control.[178]

The reason voting and appraisal rights are accorded under the merger statutes in Canada and the United States is because such transactions create the possibility of structural or constitutional change in the corporation. Where such changes are accomplished the shareholder may find his liquidation or dividend priority altered, his shareholdings diluted or paid off in cash, his voting rights interfered with, and the by-laws of the corporation changed. Moreover, he could find himself holding a fractional share subject to being void if not exchanged for a full share. Indeed, *Farris v. Glen Alden*[179] may be explained as a "constitutional" change case; the reorganization there caused dilution of interest and reduction in the book value of shares. But it would be wrong, in my view, to blur the distinction between "constitutional" change and change in the nature of business. Voting and appraisal rights are justifiable in the former case in that the fundamental position of the shareholder is or may be altered; in the latter case there is no justification as voting and appraisal rights become an undue interference by shareholders with management's business discretion.

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[177] F. POLLOCK, A FIRST BOOK OF JURISPRUDENCE 117 (3d ed 1911).
[178] R.A. POSNER, ECONOMIC ANALYSIS OF LAW 183 (1972).
[179] *Supra* note 121.

Professor Eisenberg's view proceeds from an overly zealous concern with ownership interests and control.[180] He draws a distinction between "investment decisions" and "business decisions" on the view that formulation of decisions involving investment as opposed to purely business skills should be submitted to shareholders. Professor Eisenberg's view[181] really comes to this: in any situation where control changes *de jure* or *de facto*, voting and appraisal rights should be accorded.[182]

With respect, I fail to see the merit in a distinction between investment and business decisions. It is, to my mind, a distinction without a difference. An investment decision is no more than an important business decision. In my view the important distinction is between changes which affect the legal position of shareholders (constitutional changes) and changes which do not affect the legal position of shareholders (business changes). Control does make constitutional change in the corporation possible, but, in itself, it is not constitutional change, nor, in my view, should it be treated as such. If, however, control is used to alter the conditions under which a shareholder invested in the corporation — conditions going to his relationship to other shareholders or to the corporate officers — then different considerations arise. Voting and appraisal rights are effective remedies to guarantee a secure seat on the corporate ship to its owners, but the rights should not allow such entry into the wheelhouse as will hinder the captain in navigation.

Under the recent federal legislation,[183] provision for effecting statutory arrangements has been added to the category of fundamental changes that may be accomplished under the CBCA. By section 185.1(4), in connection with application for approval of an arrangement (which arrangement does not require shareholder approval), the court has a discretion to accord appraisal rights to shareholders. Criteria for the exercise of that discretion are not specified in the amendment. It is highly relevant to inquire, as a consequence, what factors a judge properly might weigh in deciding whether to grant or withhold appraisal rights under this section.

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[180] "It would seem sounder to adopt a test [for *de facto* mergers] based on ownership interests. . . ." Eisenberg, *supra* note 15, at 130.

[181] Certain statutes have been modelled on Professor Eisenberg's view. *See, inter alia*, OHIO REV. CODE ANN., 1974, tit. 17, ss. 1701.01 (Q), (S); N.J. REV. STAT. ANN. 1974, s. 14A:10-12. The Ohio statute is discussed by Parrish in Note, *Corporations — Stockholders' Appraisal Rights — Dissenting Stockholders of Purchasing Corporation Protected by Ohio Statute*, 35 U. CINN. L. REV. 704 (1966).

[182] The test which Professor Eisenberg adopts to accord voting and appraisal rights is that of the NEW YORK STOCK EXCHANGE COMPANY MANUAL A-284(3) (1968). By that test shareholder approval is required in connection with:

> [t]he acquisition, direct or indirect, of a business, a company, tangible or intangible assets or property or securities representing any such interests. . . . [w]here the present or potential issuance of common stock or securities convertible into common stock could result in an increase in outstanding common shares approximating 20% or more.

[183] An Act to amend the Canada Business Corporations Act, S.C. 1978-79, c. 9.

The arguments I have considered above lead inexorably to the conclusion that the court must draw a distinction between structural or "constitutional" changes and business changes in deciding whether to grant shareholders the right to dissent from the proposal arrangement. Structural changes, affecting the legal position of shareholders, ought not to be approved under the proposed legislation without ordering appraisal rights. Arrangements which effectuate changes in business policy only, without affecting shareholder rights, may be approved with a minimum of effort and expense to the corporation.[184] The shareholder's interest in such an arrangement differs radically. Appraisal rights ought to be withheld.

(iii) *Change in Management*

If one accepts the view that investment in a corporation is essentially investment in the judgment, business acumen, integrity, and vigour of management, does it thereby follow that appraisal rights ought to be accorded to dissenting shareholders on a wholesale change of management?[185] The paradigm transaction contemplates an assets-for-stock or cash transaction, followed by fusion of the management teams.[186]

The short answer to this question is that the integration of a new management team is quintessentially a business decision. It in no way affects the legal or "constitutional" position of shareholders. Further, it would be an extraordinary fetter on management if, each time a new president or group of senior officers was appointed, the shareholders could cash in their stock. On those considerations, there is no justification for according appraisal rights in this situation.

C. *Inter-Corporate Acquisition of Stock*

1. *General*

Businesses very frequently combine by an exchange of stock, or by an exchange of cash for stock. Control is acquired through stock voting rights; it often occurs, in fact, at ownership of roughly fifteen to twenty per cent of a corporation's outstanding voting shares. Acquisition of a controlling block of shares entitles the acquiring corporation to elect its own nominees to director posts in the target corporation, and thereby to determine the target corporation's business policies. It can make the target corporation orbit around the acquiring corporation's axis. With a limited

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[184] PROCEEDINGS, *supra* note 98, at 32.

[185] A management team may be integrated without shareholder approval on a business combination under CBCA, s. 116:

> Subject to the articles, the by-laws or any unanimous shareholder agreement,
> (a) the directors may designate the offices of the corporation, appoint as officers persons of full capacity, specify their duties and delegate to them powers to manage the business and affairs of the corporation, except powers to do anything referred to in subsection 110(3). . . .

[186] This was the situation in Farris v. Glen Alden Corp., *supra* note 121.

exception in British Columbia,[187] inter-corporate acquisition of stock does not generate appraisal rights in either the acquiring or target company's shareholders.

2. *Appraisal Rights in the Target Corporation's Shareholders*

(a) *"Force-Out" and Reciprocal Appraisal Rights*

By the take-over bid legislation in force in most Canadian jurisdictions, where an offer is made for all the shares of a class of shares, a right to acquire the shares of a non-accepting shareholder accrues to the offeror if the offer is accepted by the holders of not less than ninety per cent of any class of shares to which the take-over bid relates.[188] That right is English in origin;[189] save in New Jersey,[190] there is no American counterpart.[191]

The compulsory acquisition section raises a significant problem when viewed from the perspective of appraisal rights. Can it be said that justice requires that the minority shareholder be accorded a right to require the acquiring corporation to purchase his shares where the shareholder initially refused the acquiring corporation's offer for the entirety of that class of shares to which he belongs?

The dissenting shareholder may well have a good reason for declining to accept the acquiring corporation's offer. His refusal amounts to a vote. By "voting no" — *i.e.*, refusing the offer for his shares — he may hope to reflect the majority view and thereby defeat the take-over bid. Of course, he may be wrong; the vast majority may accept, leaving him holding an extremely small minority position. The bid for all shares, if accepted by most of the other shareholders, will undoubtedly thin, and perhaps destroy the market for the corporation's shares. In short, the dissenter may find himself "locked in" to a situation of which he disapproves and from which he cannot escape. The result flows from no more than the exercise of his undoubted right to "vote no".

Principles of fairness dictate that dissenters be accorded appraisal rights in this situation.[192] On the hypothesis that the acquiring corpora-

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[187] Companies Act, S.B.C. 1973, c. 18, *as amended*, s. 276.

[188] *See generally* Flisfeder, *supra* note 64; P. ANISMAN, TAKEOVER BID LEGISLATION IN CANADA: A COMPARATIVE ANALYSIS (1974). For the English position see M. A. WEINBERG, WEINBERG ON TAKEOVERS AND MERGERS 189-211 (3d ed. 1971).

[189] Companies Act, 1929, 19 & 20 Geo. 5, c. 23, s. 155 (*now* Companies Act 1948, 11 & 12 Geo. 6, c. 38, s. 209). The section was based on the REPORT OF THE COMPANY LAW AMENDMENT COMMITTEE (Greene, W. Chairman 1925-26) [hereinafter cited as THE GREENE REPORT].

[190] Business Corporations Act, N.J. REV. STAT., s. 14A:10-9.

[191] A comparable result may be achieved by short-form amalgamation. *See* DEL. CODE ANN., 1968, tit. 8, c.1, s. 253 (reprinted in FOLK, *supra* note 165, at 349). *See* Professor Folk's comments at 351 ff.

[192] A similar conclusion was reached by the Cohen Committee in its study of compulsory acquisition legislation in England. *See* GREAT BRITAIN BOARD OF TRADE, REPORT OF THE COMMITTEE ON COMPANY LAW AMENDMENT 89 (Cohen, L. Chairman 1945) [hereinafter cited as THE COHEN REPORT]. The Hodgson Committee agreed. *See* HODGSON COMMITTEE REPORT, *supra* note 29, at 45-46.

tion's bid is accepted by an overwhelming majority of the target corporation's shareholders, then, by its actions, the acquiring corporation will have destroyed the market for that particular class of shares to which the bid relates. The value of the dissenter's property will have been impaired, leaving him with stock that, from the point of view of yield or liquidity, is worthless.

What proportion of shareholders must have accepted the acquiring corporation's offer for all of a class of the target corporation's shares before appraisal rights should be accorded to dissenters? Preliminarily, it is useful to notice the inexactitude of referring to any right of a shareholder to require the corporation to purchase his shares as a "reciprocal right". It is by no means reciprocal to the right of the acquiring corporation to expropriate. The rights are accorded for different reasons. Expropriation is accorded to the acquiring corporation in order to allow it to make a fresh start and clean up the books.[193] The right to require purchase is (or would be) accorded to dissenting shareholders in order to relieve against the injustice of such "lock-in" as may result from the corporation's actions.[194]

British Columbia is the only Canadian jurisdiction which presently accords such a right to dissenting shareholders. Under the British Columbia statute, the right to require the corporation to purchase, like the corporation's right to expropriate, arises at the ninety per cent acceptance level.[195] In my view this is adequate as a legislative standard, but it should be supplemented by judicial standards. In any case in which the dissenter affirmatively proves that the corporation's actions, in making the take-over bid, have effectively destroyed the market for that particular class of the target corporation's shares to which the take-over bid relates, the remedy should be forthcoming from the courts. Judicial supplement is needed in order to assure that the policy behind the right is actualized in practice. No substantial uncertainty will be caused by judicial intervention as the corporation has bid for all or nearly all of the shares in the first place. It is not unduly harsh to subject it to the possibility of ultimately having to make good its offer. Great hardship may be prevented, in this manner, to the "locked in" offeree.

If it be accepted that a "lock-in" situation caused by a take-over bid should trigger rights in dissenters to require the corporation to purchase their shares, does it necessarily follow that such rights should be full-blown appraisal rights, that is, involving an independent assessment of fair value? Ought the dissenters to have the right only to receive the amount accepted by other offerees?

British Columbia has taken the view that the shareholder's right to require purchase must be for the price and on the terms originally offered.[196] But this provision overlooks the fact that the compulsory

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[193] THE COHEN REPORT, *id.*

[194] *Id. See also* Flisfeder's brief analysis of THE GREENE REPORT in Flisfeder, *supra* note 64, at 91-92.

[195] Companies Act, S.B.C. 1973, c. 18, *as amended*, s. 276.

[196] S. 276(10).

purchase right is given as *compensation* for destruction of the market for the dissenter's shares. The dissenter elected "no" on the first offer as an exercise of his property right, and in hopes of blocking the take-over. But in consequence of his "vote" on the take-over, he may and probably does find his position in the corporation untenable. In essence, he is "forced" to liquidate his position in the corporation. The right to require purchase by the corporation is statutory provision for a mechanism of liquidation; it is the "key" to a "lock-in". It is only just that the dissenter receive fair value as compensation. It is no answer to his claim for fair value that others have elected to accept less.

(b) *Step Transactions*[197]

Suppose a corporation, by a take-over bid for all the shares of a class of shares, acquires ninety per cent of the class. Pursuant to CBCA section

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[197] "Step transaction" is a doctrine used in tax litigation in the United States. By the doctrine, "[t]he tax consequences of business transactions are properly determined by their substance and not by the form in which they are cast . . . [T]he essence of the step transaction doctrine is that an integrated transaction must not be broken into independent steps or, conversely, that the separate steps must be taken together in attaching tax consequences." King Enterprises Inc. v. U.S., 418 F. 2d 511, at 515-16 (Ct. Cl. 1969). Two tests were cited for determining whether the court properly ought to apply the step transaction doctrine:

> 'The interdependence test' requires an inquiry as to "whether on a reasonable interpretation of objective facts the steps were so interdependent that the legal relations created by one transaction would have been fruitless without a completion of the series". The 'end result' test . . . establishes a standard whereby . . . purportedly separate transactions will be amalgamated into a single transaction when it appears that they were really component parts of a single transaction intended from the outset to be taken for the purpose of reaching the ultimate result.

Id. at 516.

The essence of the doctrine is to ensure that the substance and not the form of the transaction governs. The doctrine has been widely applied to the case of corporate reorganizations and mergers. *See generally* Sapienza, *Tax Considerations in Corporate Reorganizations and Mergers*, 60 Nw. U.L. REV. 765, at 783-84 (1966); Vesely, *"A" Reorganizations — Statutory Mergers and Consolidations*, 19 W. RES. L. REV. 975, at 981-84 (1968).

There ought, in principle, to be no objection to the application of the step transaction theory outside of tax situations in Canada. In essence it is no more than a particular application of general equitable principles at the centre of English law since the fifteenth century. As was noted by Romilly M.R. in Parkin v. Thorold, 16 Beav. 59, at 66-67, 51 E.R. 698, at 701 (Rolls Ct. 1852):

> Courts of Equity make a distinction in all cases between that which is matter of substance and that which is matter of form; and if it find that by insisting on the form, the substance will be defeated, it holds it to be inequitable to allow a person to insist on such form, and thereby defeat the substance.

It is a maxim of equity that "[e]quity looks to the intent rather than to the form": E. SNELL, SNELL'S PRINCIPLES OF EQUITY 39 (27th ed. R. Megarry & P. Baker 1973).

Although the doctrine, in all its pristine purity, has not been applied in Canada, it is now clear that the Department of National Revenue will not hesitate to resort to it:

> This policy has not yet been clearly enunciated by the Department in an

199, it expropriates stock of the non-accepting offerees. Both transactions are done with the intention of melding the corporations together by short-form amalgamation, thereby avoiding voting and appraisal rights arising in either the target or the acquiring corporation's shareholders. Can the integrated series of transactions be attacked?

A complaint might be made that the take-over bid and expropriation are but the beginning steps in what is, in gross, an amalgamation. The substance of the complaint is that employment of several steps, rather than a single one, to reach a pre-intended result ought not to defeat the rights of dissenting share-holders. If the objection holds, dissenting shareholders should have voting and appraisal rights.[198] Can the three-step transaction — take-over, force-out, short-form amalgamation — sterilize such voting and appraisal rights as arise in a one-step transaction under CBCA section 175?

The first point to notice is that within the three-step transaction, step two, expropriation of minority shares, triggers limited appraisal rights for the minority shareholders. By CBCA section 199(3)(c)(ii), a dissenting offeree may elect to refuse the corporation's force-out terms. He is entitled to demand payment of fair value, a demand which includes the right to an independent assessment of fair value by the court. However, the procedures under section 199 differ from appraisal procedures under section 184. The crucial difference is that under section 199, the onus of proving that the corporation's offer is unfair falls squarely on the dissenter's shoulders,[199] while under section 184, the corporation has the onus to prove its offer is fair.[200]

> interpretation or information bulletin, but the Department's willingness to apply the doctrine, in at least some circumstances, has been made clear to the writer and to others who have been discussing corporate reorganizations and other transactions with departmental officials.

Silver, *Step Transactions*, 22 CAN. TAX J. 213, at 214 (1974). Mr. Silver suggests that an amalgamation under s. 87 of the ITA is a likely place for the application of the doctrine

[198] CBCA, ss. 175, 184(1)(c).

[199] *Re* Hoare & Co., [1933] All E.R. Rep. 105, at 107, 150 L.T. 374, at 375 (Ch.) (Maugham J.):

> I think, however, the view of the legislature is that where not less than nine-tenths of the shareholders in the transferor company approve the scheme or accept the offer, prima facie, at any rate, the offer must be taken to be a proper one, and in default of an application by the dissenting shareholders, which includes those who do not assent, the shares of the dissentients may be acquired on the original terms by the transferee company. Accordingly, I think it is manifest that the reasons for inducing the court to 'order otherwise' are reasons which must be supplied by the dissentients who take the step of making an application to the court, and that the onus is on them of giving a reason why their shares should not be acquired by the transferee company

In *Re* Sayvette Ltd., 11 O.R. (2d) 268, 65 D.L.R. (3d) 596 (H.C. 1975), Mr Justice Grange, in relying on *Re* Hoare, said at 269, 65 D.L.R. (3d) at 597: "[I]t is firmly established that the dissenting shareholder seeking an order otherwise assumes a heavy burden." The matter has been summarized in F. PALMER, PALMER'S COMPANY LAW 691 (20th ed. C.M. Schmitthoff 1959) in a passage approved by the Supreme Court of Canada in Esso Standard (Inter-America) Inc. v. J. W. Enterprises Inc., *supra* note 54, at 144, 37 D.L.R. (2d) at 601-02:

In *Re Canadian Allied Property Investments Ltd.*[201] dissenting shareholders brought an application under section 276(3) of the British Columbia Companies Act[202] to resist compulsory acquisition of their shares. They argued, *inter alia*, that the take-over bid and notice of compulsory acquisition were the first steps in an amalgamation. This procedure, they continued, unfairly deprived them of voting and appraisal rights. In considering this submission, Mr. Justice Hutcheon said this:

> The second point of the argument was that this offer was the first step in an amalgamation and that the shareholders were deprived of rights that they would have had under the amalgamation procedures. The amalgamation of Capil and Laing is a possibility since it has been recommended by Mr. Scott, the president of Capil. No formal decision has been taken by the directors of either company and there is no evidence to suggest that the proceedings taken under s. 276 were a device to deprive the shareholders of rights they may have had if some other procedure had been followed. In the absence of bad faith an 'acquiring company' such as Laing is entitled to invoke the acquisition procedure provided in s. 276.[203]

Mr. Justice Hutcheon implied that "bad faith" might trigger a step transaction attack on an integrated take-over/expropriation/amalgamation transaction. It is difficult to know whether "bad faith" goes beyond the *Esso Standard*[204] criteria of fairness. Does it encompass an intention to adhere to statutory formalities in order to avoid voting and appraisal rights? Does "bad faith" embrace acquisition of the shares at lower prices than would be available under amalgamation proceedings,[205] even though the letter of the law is rigorously observed? Does bad faith mean good faith plus a result that is harsh on minorities?

Here is a possible instance of unfair advantage gained by following statutory "steps". *A* Co. and *B* Co. decide to amalgamate. Each has one minority shareholder owning eight per cent of the outstanding stock. The corporations know that, due to the passage of An Act to amend the Canada

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> When an application is made to the court by a shareholder who alleges that the terms are not fair, the onus is upon the applicant to establish his allegation. The court will attach considerable weight to the fact that the large body of shareholders have accepted the offer. An application by a shareholder must allege unfairness: it is not sufficient merely to say that insufficient information was given: discovery will not be allowed, upon such an application, to enable the shareholder to establish his case.

For the most recent version of this passage *see* F. PALMER, PALMER'S COMPANY LAW 870 (22nd ed. C.M. Schmitthoff 1976).

[200] Neonex Int'l Ltd. v. Kolasa, *supra* note 33. Although I have strong reservations about the correctness of this decision, I agree with it on this point.

[201] 3 B.C.L.R. 366, 78 D.L.R. (3d) 132 (S.C. 1977).

[202] S.B.C. 1973, c. 18, *as amended*.

[203] *Supra* note 201, at 371, 78 D.L.R. (3d) at 137.

[204] *Supra* note 54.

[205] This is now possible under An Act to amend the Canada Business Corporations Act, S.C. 1978-79, c. 9.

Business Corporations Act,[206] the advantages to be gained by virtue of the amalgamation (tax loss carry-over,[207] for example) must be calculated in appraising the fair value of dissenting shares. To avoid paying this amount, the corporations agree that one corporation shall first take over the other with the minority shareholder being eliminated by expropriation under section 199. By that section, the minority shareholder does not receive the anticipated higher value for his shares which would result if the amalgamation advantages were calculated in the assessment. In other words, by using the three-step transaction, take-over/force-out/short-form amalgamation, the minority shareholder is denied compensation for the increased value of his shares, accruing by reason of amalgamation, to which he would be entitled if the corporations were to amalgamate under CBCA section 175.

The crucial inquiry, thus, is into whether a step transaction theory or general equitable principles[208] ought in fairness to be applied to this situation in order to accord voting and appraisal rights to the minority shareholder. In my view the application of such a theory is unwarranted, and for three principle reasons. First, an analysis of transactions in terms of substance only involves undue judicial tinkering with the statutory precision of the fundamental change procedures of CBCA Part XIV. Judicial intervention jeopardizes the security of all transactions so accomplished, and introduces uncertainty into a branch of the law where certainty ought to be highly valued. Secondly, if the point be to prevent the corporations or majority shareholders from taking unfair advantage of dissenting minorities, Canadian corporation law already has devised adequate and appropriate remedies. Under CBCA section 234, the court is empowered, on a complaint of unfairness, to make "any interim or final order it thinks fit . . .". It is more appropriate that standards of unfairness be formulated and articulated under section 234, than by a judicially-created permeability of statutory procedure. Finally, although not decisive to a claim under section 234, it is hard to see that legislative sanction of compulsory acquisition would allow for consideration of intent simply because the acquisition is followed by a similarly sanctioned short-form merger.

(c) *Change in the Nature of the Business*

There is no doubt that inter-corporate acquisition of controlling blocks of shares enables the acquiring corporation to radically reformulate the business policies and objectives of the target corporation. But that fact alone is not consonant with the policy for according shareholders'

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[206] S.C. 1978-79, c. 9. This Act amends CBCA, s. 184(3) in this respect. This is already the law in Saskatchewan and British Columbia. *See* The Business Corporations Act 1977, S.S. 1976-77, c. 10, s. 184(3), and the Companies Act, S.B.C. 1973, c. 18, *as amended*, s. 228(5).

[207] ITA, s. 87(2.1).

[208] *Supra* note 197.

appraisal rights. This point has been discussed at length above, under the heading "Speculative Rights and Suggestions for Reform".

3. *Appraisal Rights in the Acquiring Corporation's Shareholders*

(a) *Upside-Down-Lock-In*

It may happen that in a share-for-share exchange sufficient numbers of the acquiring corporation's shares are issued to the target corporation so as to congest unduly the market in the acquiring corporation's shares. The market may be thinned and liquidity may be impaired. Minority shareholders of the acquiring corporation may find themselves "locked in" as a result of the transaction. Although such a situation does not appear to warrant statutory treatment, the courts should be receptive to a complaint of prejudice from a minority shareholder. The complaint properly could be made under the oppression provisions.

Under the CBCA, if the court is satisfied that any act of the corporation effects a result that is oppressive, the court has wide jurisdiction to respond; "[it] may make any interim or final order it thinks fit".[209] An order permitting a shareholder to dissent under CBCA section 184, would be an appropriate remedy in this case. Creation of a judge-made market would be just compensation to the "locked in" minority stockholder for destruction of market opportunity.

(b) *Step Transactions*

If the acquiring corporation effects a three-step amalgamation — take-over bid accepted by ninety per cent of the offerees, force-out of the remaining minorities under CBCA section 199, and short-form amalgamation — it has, *ex facie*, denied to its own shareholders the voting and appraisal rights they would have had were the transaction completed in one step under section 175. Ought the three-step transaction to be subject to attack on equitable principles or under the step transaction theory by a complaining shareholder of the acquiring corporation?

The first point to notice is that by CBCA section 178(1)(b)(ii), the articles of the amalgamated corporation, subsequent to short-form amalgamation, will be the same as those of the amalgamating acquiring corporation. That fact ensures that no "constitutional" change will affect shareholders of the acquiring corporation. The core of a step transaction objection to this form of combination would appear to be a complaint as to take-over occurring without the possibility of shareholder approval. But the statutes allow take-over bids without shareholder consultation or appraisal rights, and for sound reasons: such transactions involve quintessentially "business" as opposed to "structural" decisions. As I have argued above, this is sensible policy. If the transaction causes prejudice to a minority shareholder of the acquiring corporation, recourse lies under the oppression provisions.

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[209] CBCA, s. 234.

D. *Conclusions*

How strange it is that voting and appraisal rights are so fragile. They can easily be avoided by utilizing a three-step transaction: take-over, force-out, short-form amalgamation. It might be thought that no corporation ever would allow voting and appraisal rights by utilization of long-form amalgamation in the case where ninety per cent acceptance of a take-over bid might be expected from at least one of the two corporations' shareholders. The only inducement to follow the long-form amalgamation route would be that, in contrast to other forms of business combinations, flow-through of net capital losses is thereby created. But this is unlikely to be of great significance. In effect, the three-step transaction effects the same result as the American short-form merger. It is more than smugness which draws our attention to the fact that this is precisely the result which the drafters of the CBCA had hoped to avoid, and thought they had avoided.[210] One irony to be noted in this respect is that Delaware and New York,[211] the two most important American corporate law jurisdictions, offer appraisal rights to dissenters from a short-form merger.

I said that it is more than smugness which draws my attention to this fact. It is the view, rather, that this result is exactly as it should be. It follows logically from the basic policies underlying appraisal rights. Appraisal rights offer protection from structural changes in the business enterprise — from changes in the relations of directors and shareholders, and amongst the shareholders *inter se*. Appraisal rights ought not to be granted to shareholders in the event of dissatisfaction with business decisions. If there are complaints of unfairness or oppression resulting from business decisions, other, and more appropriate recourses, are available. The three-step transaction — far from constituting a loop-hole in the Act by which appraisal rights may be avoided — is consistent with the policy behind the existence of the appraisal remedy.

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[210] *See* PROPOSALS, *supra* note 16 where, in reference to the short-form merger provisions in the Draft Proposals it was stated, at 121:

> Similar provisions are commonplace in U.S. state laws, but considerable difficulty has arisen in respect of these provisions because they are not limited to amalgamations of wholly-owned subsidiaries. The result is that they have been used as a technique to squeeze out minority shareholders. . . . The United States federal law, in particular Rule 10b-5 under the Securities Exchange Act, 1934, has been successfully invoked to prevent such squeeze-outs: *Vine v Beneficial Finance Co.* 374 F. 2d 627; *Voege v. American Sumatra Tobacco Corp.* 241 F. Supp. 369. Since the short-form amalgamations contemplated by s. 14.11 can affect only wholly-owned subsidiaries, the problems revealed in the United States cannot arise when a short-form amalgamation is effected under the Draft Act.

Part of the explanation for this result is that the draft CBCA did not include a compulsory acquisition section. This is now embodied at CBCA, s. 199. Without the compulsory acquisition section, the three-step transaction would have been more difficult to achieve 100 per cent of the corporation's shareholders would have had to accept a take-over bid

[211] General Corporation Law of the State of Delaware, DEL. CODE ANN., tit. 8, s 253(d); N.Y. BUSINESS CORPORATION LAW, s. 910.

That policy demands the withholding of the aid of appraisal in situations that do not interfere with the shareholders' "constitutional" position in the corporate order.

III. TRIGGERING TRANSACTIONS — AMENDMENTS TO THE CORPORATE CONSTITUTION

A. *General*

By earlier corporations acts, majority shareholders were entitled to effect corporate charter amendment by special resolution. It was not fatal to a charter amendment's validity that the rights, privileges, or conditions attaching to any series or class of shares were thereby prejudiced. There were no appraisal rights. Charter amendments which derogated from stockholder rights could be attacked by dissenters in court. In order to determine the validity of a challenged amendment, the courts asked this question: "whether [the proposed alteration] is for the benefit of the company as a whole".[212] The answer depended on two tests: (a) was the majority's power exercised *bona fides* in that it honestly believed the resolution to be for the corporation's benefit (a subjective test); (b) was the effect of the resolution discriminatory in fact as between majority and minority shareholders (an objective test).[213]

The cases in which these tests have been applied are unsatisfactory;[214] they offer minorities scant protection. Few attacks on charter amendments have ever succeeded.[215] The tests are unworkable for two principal reasons: first, it is difficult to psycho-analyse the "intent" of a majority shareholding. This has debilitated the subjective test. Secondly, the courts are reluctant to interfere with a corporation's management. They take the view that "[i]t is not the business of the Court to manage the affairs of the company" or to "take upon itself the management of concerns which others may understand far better than the Court does".[216] In practice, therefore, the objective test cannot and does not support suitable criteria of fairness.

There is a third difficulty with common law doctrine. It is very difficult to say what is "prejudicial" to a minority shareholder when the

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[212] Brown v. British Abrasive Wheel Co., [1919] 1 Ch. 290, at 295, [1918-19] All E.R. Rep. 308, at 310.

[213] Greenhalgh v. Arderne Cinemas Ltd., [1951] 1 Ch. 286, at 291, [1950] 2 All E.R. 1120, at 1126 (C.A.). *See generally* Bretten, *Alteration of Articles and Protection of Minorities*, [1970] J. BUS. L. 185; L. GOWER, THE PRINCIPLES OF MODERN COMPANY LAW 570-78 (3d ed. 1969).

[214] Allen v. Gold Reefs of West Africa Ltd., [1900] 1 Ch. 656, 69 L.J. Ch. 266 (C.A.); Brown v. British Abrasive Wheel Co., *supra* note 212; Sidebottom v. Kershaw Lease & Co., [1920] 1 Ch. 154, 89 L.J. Ch. 113 (C.A.); Dafen Tinplate Co. v. Llanelly Steel Co. (1907) Ltd., [1920] 2 Ch. 124, 89 L.J. Ch. 346; Shuttleworth v. Cox Bros., [1927] 2 K.B. 9, 96 L.J.K.B. 104 (C.A.); Greenhalgh v. Arderne Cinemas Ltd., *id.*

[215] Brown v. British Abrasive Wheel Co., *supra* note 212; Dafen Tinplate Co. v. Llanelly Steel Co. (1907) Ltd., *id.*

[216] Shuttleworth v. Cox Bros., *supra* note 214, at 23-24, 96 L.J.K.B. at 111.

corporation is in hard circumstances.[217] Is it prejudicial to him, for example, to eliminate dividend arrearages in order to obtain new capital to keep the corporation alive long enough to make a good effort at obtaining a very profitable contract? Further to these administrative difficulties, the broad fabric of the rules is objectionable; it does not provide sufficient substantive protection. It allows the corporation to weather its financial difficulties for a time, but the individual shareholder may be ruined.

Newer Canadian corporation statutes allow for wide flexibility in effecting amendments to the corporation's constitution.[218] Amendments may be proposed by either directors or shareholders.[219] To hold in balance the clash of interests that arise, the statutes require approval by shareholders of each class or series of shares affected. Dissenters in the class or series affected are given appraisal rights.[220]

B. *Substantive Fairness of Charter Amendments*

Legislative provision for voting and appraisal rights undoubtedly will go a long way towards ensuring that charter amendments are fair towards all members of the corporation. But it would not be realistic to expect any instant justice from voting rights. They are rarely used wisely by the average stockholder. Usually the proxy machinery is his substitute for judgment. Professor Jerome Frank has remarked on this in a manner that is as caustic as it is true: "[Courts should] protect the average security holder who is otherwise helpless. Courts of equity have a tradition of aiding the helpless, such as infants, idiots and drunkards. The average security holder in a corporate reorganization is of the like kind."[221]

This view of voting rights turns a spotlight on the appraisal remedy. Can it be said that because a dissenter to a charter amendment has recourse to appraisal, the transaction is thereby immune from judicial review for substantive fairness under the oppression provisions? *Prima facie* this conclusion seems unwarranted. In any event, CBCA section 184(3) provides that the appraisal remedy is "[i]n addition to any other right he [the dissenter] may have". Parliament has decisively negatived the view that the existence of appraisal prohibits further judicial scrutiny. The courts are directed to test the transaction for substantive fairness by CBCA section 234.

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[217] Manning, *supra* note 11, at 3.

[218] CBCA, s. 167; The Corporations Act, S.M. 1976, c. 40, s. 167; The Business Corporations Act 1977, S.S. 1976-77, c. 10, s. 167.

[219] CBCA, s. 169; The Corporations Act, S.M. 1976, c. 40, s. 169; The Business Corporations Act 1977, S.S. 1976-77, c. 10, s. 169.

[220] CBCA, ss. 170, 184; The Corporations Act, S.M. 1976, c. 40, ss. 170, 184; The Business Corporations Act 1977, S.S. 1976-77, c. 10, ss. 170, 184 (where such a right is provided for in the articles). The specific charter amendments giving rise to appraisal rights contemplated by the CBCA are described in Théberge, *L'exercice du droit de dissidence en vertu de l'article 184 de la nouvelle loi sur les corporations commerciales canadiennes*, 8 R. GÉN. 33, at 53-54, 60-70 (1977).

[221] Frank, *Some Realistic Reflections on Some Aspects of Corporate Reorganization*, 19 VA. L. REV. 541, at 569 (1933).

What criteria should be used in determining whether charter amendments, pursuant to CBCA sections 167 and 170, are fair within the meaning of section 234?[222]

One essential prerequisite is that there exist a legitimate business purpose pursuant to which any charter amendment is effected. This requirement, which may be deduced from both Anglo-Canadian[223] and American case law,[224] must survive, in principle, legislative enactment of sections 167 and 170. It would be shocking to think that majority shareholders could use the charter amendment provisions with impunity (save appraisal) to gain an unfair advantage. Charter amendments are quintessentially "a question of fair dealing"[225] and must be subject to judicial standards of fairness elaborated under the oppression provisions.

One difficulty presented by the legitimate business purpose requirement is the necessity of deciding whether the test is subjective or objective.[226] It is hard to think that an honest belief by the majority that corporate exigencies require a charter amendment would suffice. The imprecisions in scrutinizing such an intent are too great. Even if these were overcome, the consequences which charter amendments can wreak on minorities are too severe not to merit independent juridical review.[227] A charter amendment, challenged on grounds of unfairness, ought to be supported by affirmative evidence of a pressing corporate necessity such as

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[222] *See generally* Note, *Limitations on Alteration of Shareholders' Rights by Charter Amendment*, 69 HARV. L. REV. 538 (1956); Halloran, *Equitable Limitations on the Power to Amend Articles of Incorporation*, 4 PAC. L. J. 47 (1973); Becht, *Alterations of Accrued Dividends, Parts 1 and 2*, 49 MICH. L. REV. 363 and 565 (1951); Latty, *Fairness — The Focal Point in Preferred Stock Arrearage Elimination*, 29 VA. L. REV. 1 (1942); Note, *Protection for Shareholder Interests in Recapitalizations of Publicly Held Corporations*, 58 COLUM. L. REV. 1030 (1958). For the Australian position, *see generally* Baxt, *The Variation of Class Rights*, 41 AUST. L.J. 490 (1968). A useful article on the federal oppression provision is Proulx, *supra* note 70.

[223] *Supra* note 214.

[224] In De Mello v. Dairyman's Co-operative Creamery, 73 Cal. App. 2d 746, 167 P. 2d 226 (1946) the following test was applied at 751, 167 P. 2d at 228:

> Mr. Ballantine in his California Corporation Laws (1938 Ed.) at page 9, in section 7, comments on the right of a corporation to change its financial structure as follows: 'Changes in the rights of outstanding shares may be valid if they can be justified as an exercise of fair business discretion in meeting the needs and exigencies of the corporate enterprise. The more urgent the need or the emergency the more drastic the amendment or adjustment which fairness will permit . . .'.

See also State v. Bechtel, 239 Iowa 1298, 31 N.W. 2d 853 (Sup. Ct. 1948); Faunce v. Boost Co., 15 N.J. Super. 534, 83 A. 2d 649 (Ch. Div. 1951).

[225] Kamena v. Janssen Dairy Corp., 134 N.J. Eq. 359, 35 A. 2d 894 (Ct. Err. & App. 1944), *aff'g* 133 N.J. Eq. 214, 31 A. 2d 200 (Ch. 1943).

[226] *Supra* note 213.

[227] Bretten, *supra* note 213, at 196:

> The primary deficiency of the common law lies in the fact that the judges have construed the phrase 'bona fide for the benefit of the company as a whole' so as to make the subjective good faith of the majority of the shareholders conclusive of the validity of the alteration. If the phrase were interpreted objectively . . . it would be in fact very close to application of the test of reasonableness.

imminent bankruptcy[228] or tax savings.[229] Of course, an objective standard does involve the court in substituting its judgment for that of commercial men, an exercise for which the courts have exhibited a marked reticence. But Parliament, by enactment of section 234, has demanded that the courts do no less.

An objective business purpose test is certainly a minimum requirement of substantive fairness, but it is likely not enough. A minority shareholder may lose a valuable advantage by charter amendment. The paradigm situation is something like this: a corporation gets into financial difficulty. Dividends are eliminated. Arrears accumulate on preferred stock. An injection of equity cash is needed but is unobtainable as no investor will come in junior to the preferred arrearages. The articles are amended, eliminating preference rights to arrearages.[230] Jurisprudentially, the corporation is expropriating the minority's property to relieve its own difficulties.

One solution to this difficulty is to hold that since the minority has appraisal rights, it therefore, necessarily, has the right to fair compensation.[231] That solution has the advantage of being easily administrable and certain. But that does not ensure that the solution is fair. The corporation may have substantial prospects (too speculative to merit consideration in appraisal proceedings) if only the capital can be raised. It may be close to winning a substantial and profitable contract. The minority is being forced out at the lowest ebb of corporate fortunes, and probably at the lowest price.

A second solution is that, on motion by the dissenter, courts should consider his alternative proposals for corporate reorganization. Just because there is a pressing corporate need to do something — *i.e.*, a legitimate business purpose — courts need not refrain from scrutinizing the fairness of management's exercise of business discretion. It ought to be open to the dissenter to prove affirmatively, under section 234, that there exists a solution more in accord with justice, which effectively responds to the corporate crisis.

In other words, I am suggesting that to meet a threshold of substantive fairness, it is not sufficient to demonstrate that a corporate necessity exists: it must be shown, additionally, that the challenged amendment is capable of meeting the crisis, and that business judgment was fairly exercised in selecting the response. Courts ought to review for fairness the exercise of business discretion. At the instance of a complaining minority stockholder, courts should ensure that there was not available another equally effective, but fairer, response to the crisis.

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[228] Blumenthal v. Di Giorgio Fruit Corp., 30 Cal. App. 2d 11, 85 P. 2d 580 (Ct App. 1938).

[229] De Mello v. Dairyman's Co-operative Creamery, *supra* note 224

[230] *In Re* Kinney, 279 N.Y. 423, 18 N.E. 2d 645 (Ct. App. 1939) *See generally* Note, *A Standard of Fairness for Compensating Preferred Shareholders in Corporate Recapitalizations*, 33 U. CHI. L.J. 97 (1965). The procedure is specifically mandated by CBCA, s. 170(1)(c)(i) and (iii).

[231] CBCA, ss. 170, 184(2).

Assume that corporate necessity is established and that business judgment was fairly exercised in amending the articles to meet that necessity. Still, appraisal might bear heavily on a dissenting minority shareholder. His position in the corporation may be made so unattractive by the amendment that effectively he is forced out. If the corporation's fortunes are low, but great potential lies ahead, appraisal may be incapable of doing precise justice. That very speculative events do not invite evaluation does not mean they do not exist. Under the oppression statutes one possible remedy in this situation is to order, in addition to appraisal, that the dissenter receive a warrant that will allow him to regain an interest in the corporation, subject to the amendment, at the time the speculative opportunity either comes to fruition or withers. The ideal of fair value may be thus refined.

C. *Fiduciary Duty of Majority Shareholders?*

There is further scope for judicial intervention by which any challenged charter amendment may be reviewed for fairness: the hypothetical existence of a fiduciary duty owed by majority shareholders to minority shareholders.

There is no doubt that charter amendments can work great hardship on a minority shareholder. He may be forced out of the corporation. At that point he may become subject to capital gains tax otherwise deferrable. His exit from the corporation may be at a time when fair value is low and speculative potential (below the threshold cognizable by appraisal) is high. If he must resort to litigation in order to be fairly treated, he will encounter substantial expense and delay.

Of course, all of this is taken to have been contemplated by the drafters of the CBCA. There can be no complaint from the dissenting shareholder that the statute, in terms, causes him hardship. It may be, however, that the statute causes him hardship because of the special circumstances surrounding him and his company. The question then arises as to whether the majority shareholders owe him a fiduciary duty which embraces minimizing any such adverse impact.

In the United States there is a clear fiduciary duty owed to the minority shareholder by the majority shareholder.[232] This duty has been judicially considered with apparent approval in Ontario, but it has never been applied directly in Canada.[233] In a very recent American decision the Delaware Supreme Court held that the fiduciary duty owed to the minority shareholders by the majority is of sufficient amplitude to offer protection

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[232] Perlman v. Feldmann, 219 F. 2d 173 (D.C. 1955); Brown v. Halbert, 76 Cal. Rptr. 781, 271 Cal. App. 2d 252 (1969); Jones v. H.F. Ahmanson & Co., *supra* note 163 (corporate control); Donahue v. Rodd Electrotype Co. of New England, Inc., 367 Mass. R. 578, 328 N.E. 2d 505 (Sup. Jud. Ct. 1975) (close corporations resembling partnership). *See also* Note, *The Fiduciary Relation of the Dominant Shareholder to the Minority Shareholders*, 9 HASTINGS L.J. 306 (1958).

[233] *Supra* note 176.

in a cash-freeze-out-merger situation. Mr. Justice Duffy put the point this way:

> We hold the law to be that a Delaware Court will not be indifferent to the purpose of a merger when a freeze-out of minority stockholders on a cash-out basis is alleged to be its sole purpose. In such a situation, if it is alleged that the purpose is improper because of the fiduciary obligation owed to the minority, the Court is duty-bound to closely examine that allegation even when all of the relevant statutory formalities have been satisfied.[234]

Of course, Canadian courts long ago held that mergers solely for the purpose of freezing out minority shareholders would not be tolerated.[235] However, given the doctrinal basis upon which the American court has put this situation, it becomes relevant to inquire whether the fiduciary duty is of sufficient intensity as to assist the minority shareholder when his inconvenience is caused by less than an intention to merge solely for the purpose of freezing him out. In other words, if the majority shareholders recklessly damage the interests of the minority shareholder by virtue of a charter amendment which is not solely for the purposes of freeze-out, can the court intervene under the doctrine of a majority shareholder's fiduciary duty? The question is relevant, but it is important to note that no American or Canadian court has yet gone that far.[236]

D. *Consolidation-Squeeze-Out*

It is clear that fractional shares may be acquired compulsorily at the instance of the corporation. By CBCA section 45(12) script certificates may be issued in place of fractional shareholdings. By section 45(13) the directors may provide that the script certificates become void if not exchanged for a share certificate representing a full share before a specified date. A corporation may make use of these provisions to force out a minority shareholder by means of a "reverse-stock-split". The corporation may consolidate its stock by issuing, for example, one share for every 1,000 outstanding. Minority shareholders have considerable disincentives not to "round up" their new fractional share by acquiring

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[234] Singer v. Magnavox Co., *supra* note 176, at 979. *See also* Tanzer v. Int'l Gen. Indus. Inc., 379 A. 2d 1121 (Del. Sup. Ct. 1977).

[235] Esso Standard Inc. v. J.W. Enterprises Inc., *supra* note 54.

[236] However, in Singer v. Magnavox Co., *supra* note 176, at 980, the court did go on to say, *obiter*, that the mere existence of a valid business purpose *simpliciter* will not validate the challenged transaction. The comment is wide and path-breaking:

> This is not to say, however, that merely because the Court finds that a cash-out merger was not made for the sole purpose of freezing out minority stockholders, all relief must be denied to the minority stockholders in a . . . merger. On the contrary, the fiduciary obligation on the majority to the minority stockholders remains and proof of a purpose, other than such freeze-out, without more, will not necessarily discharge it. In such cases the Court will scrutinize the circumstances for compliance with the . . rule of 'entire fairness' and, if it finds a violation thereof, will grant such relief as equity may require.

others to total a full share: it may be very expensive; liquidity is certain to be impaired; the consolidation may deprive the shareholder of disclosure protections under the Securities Acts by qualifying the corporation to cease compliance — *i.e.*, the corporation "goes private". Those minority shareholders who do not want, or cannot afford, to consolidate their holdings into full shares may be eliminated by use of CBCA section 45(13).

But the Act disentitles the corporation to effect a consolidation-squeeze-out by means of a reverse-stock-split *simpliciter*. In order to effect a reverse-stock-split there must be an amendment of the articles under section 167(1)(g). This must be done by special resolution. Moreover, such an amendment of the articles is stated by section 167 to be subject to section 170. Section 170(1) entitles the holder of shares of the class or of the series to vote separately as a class or series upon a proposal to amend the articles to "effect an exchange, reclassification or cancellation of all or part of the shares of such class". By section 184(2) an appraisal right accrues to a shareholder who dissents from a proposal to amend under section 170. Consolidation-squeeze-outs, therefore, are subject to voting and appraisal rights.[237]

Consolidation-squeeze-outs are serious matters. They can be disastrous for minority shareholders:

> Damage to a minority shareholder caught in a squeeze-play may be catastrophic. He may lose any effective voice in making business decisions. He may be denied access to information on business affairs and decisions. If he has put practically everything he owns into the business and expects to support himself from the salary he receives from the company — as is frequently the case — he may find that he has been deprived of his principal means of livelihood by discharge from company employment.[238]

That statutory provision is made for effecting a consolidation-squeeze-out should not of itself be conclusive as to the validity of a particular challenged transaction. The transaction still must be fair within the meaning of CBCA section 234. The criteria which courts might use in reviewing consolidation-squeeze-outs for fairness are those outlined above: (a) there must exist a valid business purpose; (b) the consolidation-

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[237] This was noted specifically by Assistant Deputy Minister John Howard in PROCEEDINGS, *supra* note 98, at 28:

> However, if that corporation were under this act, the procedure you are describing is known as a share consolidation squeeze-out, which is an attempt to get rid of minority shareholders by consolidating shares into larger share units and getting rid of all the fractional shares by enforced buy-backs of fractions. This is precluded under this statute and is one of the things we just have to bar against. We do not preclude squeeze-outs or freeze-outs, but we do preclude that particular type of strategy under, I believe, Sec. 46. . . .
>
> We must look at Sec. 45(14). The purpose of this provision is to stop exactly this share consolidation squeeze-out. If they wish to do a squeeze-out they must go through one of the Part XIV institutions; that is amalgamation, or something of that type.

[238] O'Neal, *supra* note 63, at 211.

squeeze-out must be capable of serving that business purpose; (c) the shareholder must not have affirmatively proved the existence of another method of serving that purpose that is equally effective and fairer; and (d) a warrant may be issued, in addition to appraisal, to compensate for any speculative opportunity which falls below the threshold of appraisal proceedings.

E. *Can the Appraisal Right be Excluded?*

Corporate charters are contracts. They set the terms of the relations between the corporation and the state, the corporation and its shareholders, and the shareholders *inter se*.[239] The articles of a corporation may set out anything which the law does not specifically prohibit.[240]

By the civil law of the Province of Quebec, supplementary legislative provisions may be overtaken by contract, but "[n]o one can by private agreement, validly contravene the laws of public order and good morals".[241] It is not easy to say which statutory provisions are of public order. The concept is flexible and variable. If there is doubt, it is necessary to consider the motive of the legislation. If the motive is to protect a public interest, the statute is of public order; if the motive is to protect a private interest, the statute is not of public order.[242] At common law, the doctrine is similar. It is possible to contract out of rights given by statute that are not in terms made indefeasible.[243]

Is the shareholder's right of appraisal of public order such that the articles of incorporation may not abridge or eliminate it? This question has been considered in reference to section 161 (now section 287) of the English Companies Act[244] on several occasions. Section 161 enabled liquidators, on a winding-up, to sell assets for shares instead of money. In order to afford protection against that power, and against the possibility of thereby imposing a liability in respect of partly paid shares, the section entitled a dissenter to be paid in money. Authority is unanimous that the right to dissent under section 161 cannot be excluded by the articles of association.[245] In *Payne v. Cork Company Ltd.*[246] Stirling J. said this:

> The Legislature has conferred on voluntary liquidators a power of selling in a particular way, and it has attached to that power provisions which constitute a

[239] Teschner v. Chicago Title and Trust Co., 59 Ill. 2d 452, 322 N.E 2d 54, at 57 (Sup. Ct. 1975):

> This court . . . observed:
> "The charter or articles of incorporation of an Illinois corporation is a contract of a three-fold nature. It is operative as between the corporation and the State and it creates rights and duties as between the corporation and its shareholders, as well as between the shareholders themselves."

[240] CBCA, s. 6(2).

[241] QUEBEC CIVIL CODE, art. 13 (1978).

[242] Mongrain v. Auger, [1967] Que. B.R. 332 (C.S.).

[243] CRAIES, *supra* note 73, at 74.

[244] Companies Act 1862, 25 & 26 Vict., c. 89.

[245] Bisgood v. Henderson's Transvaal Estates Ltd., [1908] 1 Ch 743, at 758, [1908-10] All E.R. Rep. 744, at 748-49 (C.A.), *relying on* Baring-Gould v Sharpington

safeguard for the protection of dissentient shareholders, and in my opinion it is not competent for the company by articles framed in this way to deprive the shareholders of that protection.[247]

However, a civilian commentator, in considering the appraisal right under the new CBCA, has come to the opposite conclusion:

Cependant est-ce-qu'il s'agit d'un droit fondamental auquel un actionnaire ne peut renoncer à l'avance, par contrat? A mon avis, je crois qu'une telle renonciation est possible: Ce droit n'est sûrement pas plus important que le droit de vote afférent aux actions et l'actionnaire a la liberté de modifier par contrat la façon d'exercer ses droits de vote, y compris le pouvoir d'aliéner ses droits de vote ou de les suspendre.[248]
[Trans: However, is it to be considered as a fundamental right which a shareholder cannot renounce in advance by contract? In my view, such a renunciation is possible: This right is surely not more important than the voting right in respect of shares and shareholders. It is not more important than the freedom to modify by contract the manner of exercising voting rights, including the power to exclude or suspend them.][249]

With respect, Mr. Crevier's argument misses the mark. Although class voting rights certainly may be fixed or varied by the articles, where the rights of a class or series of shares are affected by charter amendment, special voting rights accrue to all shareholders of that class or series despite the fact the articles may dictate that in other cases they have no vote. It has never been suggested that this special voting right can be altered by contract. Mr. Crevier's point, therefore, takes us no further than directing inquiry as to whether these special voting rights may be excluded. But that is the same inquiry as whether appraisal may be excluded by a like contract.

In my view appraisal rights reflect the legislature's appreciation of minimum standards of justice for the protection of minority shareholders. If the majority prejudicially affects the minority's position in the corporation, at the minimum voting and appraisal rights will accrue. It is strange to think that this minimum standard of protection is subject to derogation by contract, in advance, when the circumstances and the personalities who will be in need of protection are unforeseeable. The right reflects the legislature's concern to protect those who are not in a position to protect themselves. This is often the case with minority shareholders caught in a fundamental change situation.

The real objection to the exclusion of appraisal rights flows from practical considerations. The average shareholder never reads the articles and, even were he to do so, it is unlikely that he would appreciate the full

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Combined Pick and Shovel Syndicate, [1899] 2 Ch. 80, 68 L.J. Ch. 429 (C.A.); Payne v. Cork Co., [1900] 1 Ch. 308, 69 L.J. Ch. 156; Welton v. Saffery, [1897] A.C. 299, 66 L.J. Ch. 362 (H.L.).

[246] Payne v. Cork Co., *id.*

[247] *Id.* at 315, 69 L.J. Ch. at 159.

[248] Crevier, *Les Actionnaires Minoritaires*, in MEREDITH MEMORIAL LECTURES 1975 81-82.

[249] Author's translation.

significance of appraisal. It is precisely here — the point at which the analogy between articles of association and contract breaks down — that the inability of articles to exclude statutory protections assumes a paramount importance.

There is no similar objection to the expansion of appraisal rights by the articles. No protections are being whittled away; no informed consent is necessary for the conferral of a right that need not be exercised. Expansion by the articles of appraisal rights into, for example, situations involving the addition or subtraction of a division — *i.e.*, business changes — may provide for flexibility in the planning of certain corporations.[250] Corporate planners have every reason to add this possibility to their design inventories.

F. *Transitional Provisions*

A corporation incorporated under the Canada Corporations Act[251] must apply, subject to minor exceptions, for a certificate of continuance under the Canada Business Corporations Act within five years of the coming into force of the new Act.[252] By CBCA section 261(1)(a), the shareholders of a special act or of a letters patent corporation under the old Act may authorize by special resolution the directors to apply for a certificate of continuance under the CBCA. By section 261(1)(b), the same shareholders' resolution may make any amendment to the act of incorporation or letters patent that is allowed by the CBCA. Appraisal rights are specifically withheld from dissenters by section 261(2).

Section 261(2) is of potentially great importance. It allows for consolidation-squeeze-outs or elimination of dividend arrearages on a two-thirds majority vote if done by the resolution at the meeting authorizing application for continuance. If that majority waits until after the certificate is granted, any such charter amendment will be subject to voting and appraisal rights under the new Act. Section 261(2) gives the majority a last opportunity to effect these transactions easily, subject only to the test that the amendment be *bona fide* in the best interest of the corporation.[253] This test, as noted above, is not very effective in protecting minorities.

IV. CONCLUSION

The appraisal remedy is a mechanism of minority shareholder protection. It is not the only mechanism, and there are many things it cannot do. It cannot ensure that transactions are fair. That can only be

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[250] Iacobucci, *Shareholders Under the Draft Canada Business Corporations Act*, 19 McGILL L.J. 246, at 264 and n. 67 (1973).

[251] R.S.C. 1970, c. C-32.

[252] CBCA, s. 261.

[253] Greenhalgh v. Arderne Cinemas Ltd., *supra* note 213. *See generally* notes 212 and 214, *supra*.

done by an oppression provision or broad judicial criteria of fairness. But appraisal can assist a shareholder to weather the storms brought on by corporate metamorphosis. As such, appraisal heightens corporate flexibility. Structural changes in the corporation in furtherance of legitimate business purposes become more readily reconcilable with justice to minorities. Corporate law badly needs such flexibility; accordingly, Canadian corporate statutes ought to give the appraisal right a warm reception. As explained above, there is every reason to expand legislatively the situations in which the right is available.

Yet it is clear that appraisal looks remarkably as if it accomplishes other purposes. In common with voting rights, appraisal often appears as if it involves shareholders in the internal governance of the corporation. So the claim has been made that appraisal rights ought to be available when the shareholder dissents from fundamental business decisions. The attempt has been made to assimilate the appraisal right to the claims made by expansive "corporate democracy". By this view, appraisal is but one technical means of furthering the case of shareholder democrats for a greater say in corporate decision-making.

It may happen that appraisal in fact assists in directing corporate management to economically sound business design. In the rare instance appraisal demands might divert capital away from inefficient enterprise. Such a case is entirely theoretical; it has never happened in fact. Thus it would be a spin-off effect of the right, very much a second or third order phenomenon. It is much too haphazard a basis for justifying the existence of appraisal rights.

The shareholder democracy view has been extremely damaging to our corporate law theory. It has made certain legislatures hostile to the appraisal right; it confuses the courts. Exposing the premises behind the "one man, one vote" idea of corporate governance reveals its absurdity. If appraisal be linked to this, it too appears absurd.

But appraisal is not at all related to the corporate democracy theory. If anything, detailed examination of the appraisal right deflates the claims of shareholder democrats. Study of appraisal focuses attention upon the need for corporate mobility. It underlines the significance of management freedom of action. The appraisal right appears not as something which hedges-in management's business decisions but rather as a *quid pro quo*. It is a means of keeping the shareholder's head above water when the seas get rough. If such protection could not be devised, then the success of our corporate enterprise would be diminished, inasmuch as management neither could justify fundamental change nor attract capital in the face of increased shareholder risk. It is in this context, and not that of a "one man, one vote" corporation, that the appraisal right needs to be appreciated and proposals for its legislative or judicial change conceived and executed.