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The Appraisal Remedy in Corporate Law:
A Comparative Study

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ABSTRACT

This thesis examines the nature and operation of the appraisal remedy: a feature of corporate law which provides for a minority shareholder to receive payment of the fair value of his shares upon his dissent from certain fundamental changes to the structure and economic orientation of the company. While the introduction in Canada of the appraisal remedy constituted a major change in the policy underlying the regulation of business corporations, such an "exit provision" had existed for many years in American jurisdictions. Accordingly, the thesis adopts a comparative approach. The provisions of the Delaware, New York and California corporate codes and the American Bar Association's Model Business Corporation Act are consulted. The United Kingdom legislation is also examined, since the foundations of Canadian corporate legislation derived chiefly from that jurisdiction.

The thesis focuses on several areas of appraisal:

- *the development of the remedy,*
- *the various transactions which will give rise to the remedy,*
- *the procedural requirements for enforcing the remedy,*
- *the scope of the remedy, and*
- *the determination of the value of dissenters' shares.*

The thesis concludes that appraisal works well in situations where a shareholder voluntarily dissents from the proposed triggering transaction. However, appraisal may be the shareholder's only remedy in certain situations where he is being forced out of the company. In such situations, appraisal effects a "rough justice". To overcome this, the courts have been innovative in developing the concept of fair value.

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Introduction

For many years, the affairs of a corporation were managed by the board of directors empowered by law to do so, while the shareholders were given few powers, apart from the power to elect such directors. This approach worked well for large public corporations with large numbers of shareholders. When a particular shareholder of such a large corporation was not satisfied with a decision of the board of directors, he could easily sell his shares on the stock market and choose another investment.

However, in corporations not listed on a stock exchange - most small and medium-sized corporations - an unsatisfied shareholder had no such simple way of remedying his situation. No market existed for his shares. The dissenting shareholder could not turn to the court for a remedy, for the courts had taken the stance that, except in certain limited circumstances, where fraud or oppression equivalent to fraud could be established, it was not appropriate to interfere in the business affairs of the corporation. In effect, the dissenting shareholder was left without a remedy.

Following upon the recommendations of the Dickerson Report and the experience in other countries, particularly the United States of America, the Canadian government in 1974 amended the Canada Corporations Act to create new remedies for the dissenting shareholder, of which the appraisal remedy, contained in new section 184, is especially significant. For the first time, a shareholder who disagreed with certain fundamental changes in the corporation could extricate himself and the fair value of his investment without resort to the open market.

The purpose of this thesis is to evaluate this new shareholder remedy and the interpretation of the remedy by the courts. To understand fully the importance and implications of this innovation, it is necessary to consider various aspects of the remedy.

An examination of the existing shareholder remedies prior to the introduction of the appraisal remedy and the developments in corporate law which necessitated its introduction, provides a useful perspective and highlights the divergent theoretical analyses of the remedy. The existence of this new remedy raises several major issues, namely, the difficulty in characterizing appraisal as a "shareholder" remedy, the variation from jurisdiction to jurisdiction of the corporate transactions which give rise to appraisal, the labyrinthine procedural requirements and the relationship between the scope of the remedy and the methodology employed in arriving at the "fair value" of the dissenter's shares.

The right of a dissenting shareholder to receive the fair value of his shares arises only upon the occasion of specific events. The various "trigering transactions" which give rise to appraisal in the jurisdictions under discussion are examined. Certain inconsistencies brought about by the arbitrary determination of qualifying transactions - most notably the "*de facto*" merger doctrine, are commented upon. The necessity of a shareholder vote on the transaction from which the shareholder dissents, is emphasized, particularly in view of the structural, as opposed to the economic, rationale underpinning the remedy.

The various procedural requirements of the statutes are outlined and criticized. While the primary purpose of all appraisal procedural requirements is to provide an orderly, regulated exit from the company of the dissenting shareholder, some jurisdictions are more successful than others in encouraging the resolution of disputes as to "fair value" and balancing the interests of the minority shareholder against those of the corporation, by way of these procedural requirements. Case law is examined which highlights various problems engendered by the complexity of procedural requirements. The considerable impact of these problems on the appraisal right of the minority shareholder is examined, particularly in view of the characterization of appraisal as a "shareholder" remedy.

Several substantive issues have arisen in the jurisprudence which affect the scope of the remedy. In addition, judicial attitudes towards certain types of corporate re-organizations also appear to affect the scope of the remedy. The effectiveness of the appraisal remedy is examined in the context of the statutory provisions and other problems inherent in the adversarial nature of the litigation process, such as access to information, the burden of proof and the exclusiveness of the remedy. The operation of the appraisal remedy is contrasted with certain other statutory provisions which involve the purchase of a minority shareholder's interest in the company.

From a practical standpoint, the minority shareholder will be most concerned with the determination of the "fair value" of his shares. Not all jurisdictions employ the some measure of value in their appraisal provisions. Certain fundamental valuation techniques are explained and case law is consulted to illustrate the application of these techniques to the statutorily mandated determination of the "fair value" or "fair market value" of the shareholding. Case law also illustrates the variations in importance in each transaction of the basic valuation approaches. The nature of the corporate re-organization may also impinge upon the value calculation.

The thesis concludes that the appraisal remedy serves a necessary function in corporate law. The mechanism works well in the cicumstances for which it was specifically designed: a voluntary refusal by the shareholder to participate in the newly re-shaped corporate entity. Problems arise, however, when the remedy is applied to situations where the minority shareholder is excluded from participating in the new enterprise.

Chapter 1

History and Background

> "The Appraisal remedy is a mechanism admirably suited to reconcile, in the corporate context, the need to give the majority the right to make drastic changes in the enterprise to meet new conditions as they arise, with the need to protect the minority against being involuntarily dragged along into a drastically restructured enterprise in which it has no confidence."[1]

A. Appraisal Remedy: Minority Shareholder Weapon or Tool for Corporate Flexibility

The appraisal remedy is an important new feature in the revised Canadian Business Corporations Act, introduced in 1974. The description of the remedy as a mechanism is apt, for once the remedy is invoked a complicated process of interdependent stipulations is engaged. The term appraisal remedy is a useful catchphrase but it is also a curious one. Whom does the remedy serve - the disgruntled shareholder or the dynamic corporation?

As a remedy, appraisal functions by not so much slashing as unravelling the Gordian knot of the corporation - shareholder relationship. The procedure laid down by the statutes is complicated, comprising a lengthy process of stipulations - regarding the giving of notice of objection, submission of share certificates, offers of payment of fair value - each of which is generally a precondition for the next step in the appraisal process. The idea of permitting a shareholder who has been outvoted on certain fundamental changes in the company's direction or

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[1] Eisenberg, *The Structure of the Corporation*, 1976., p. 78.

enterprises, to receive the value of his shares in money[2] and thus depart from the company is deceptive in its simplicity. In the practical sphere, a shareholder who manages to traverse the procedural requirements still has to face other problems inherent in the nature of the appraisal remedy. The type of issues raised in appraisal proceedings cannot always be best resolved by the rigid application of formal rules and the traditional adversarial approach of litigation. Decisions on access to information and the onus of proof in the conduct of appraisal litigation have serious ramifications for the dissenting shareholder. The very nature of the proposed corporate reorganization may quite often indicate the appropriate party to bear the burden of proof, although the Act is silent on this point.

A more substantive concern arises from the valuation process itself. The statutes proclaim the shareholder entitled to the value of his holding, but seldom provide any direction to the judiciary as to how such value falls to be determined. In addition, on the theoretical level, the existence of the remedy, a statutory creation, has caused some confusion in attempts to reconcile it with the accepted legal nature of the corporation and the rights and duties held by the company and its shareholders. It is essentially a remedy of compromise. There are advantages to both shareholder and company in its adoption. However, this duality has been a contributing factor in the difficulty of characterizing the remedy.

B. Developments of Corporate Law Necessitating the Introduction of Appraisal

[2]While it has never been disputed in the United States that the shareholder was entitled to receive cash, this *was* a matter of dispute in *Canadian Gas and Energy Fund Ltd. et al. v. Sceptre Resources Ltd.*, (1985) 29 B.L.R. 178 (Alta. Q. B,). The corporation argued that dissenting shareholders should have the fair value of their shares in Francana Oil and Gas Ltd. paid by way of an equivalent amount of shares of Sceptre (the reorganized company). The court reasoned that since the intent of the provision was to enable the shareholder to "walk away" from the corporation undergoing changes, fair value was to be paid in cash. See Pages 187 and 188.

Although new to Canadian corporate law, the appraisal remedy has been a feature of American corporation statutes for several decades. While there is no strict analogy of the remedy in the United Kingdom, the Companies Act of that jurisdiction also provides for the purchase of shares of dissenting shareholders in certain circumstances. By examining the development of the remedy and its more problematical aspects in other jurisdictions it is hoped that the implications for Canadian corporations and their shareholders will become apparent. The pragmatic approach of the remedy is undoubtedly due to the tensions of governance which are unavoidable in the corporate form of doing business. Initially as the corporate form developed, the rules governing partnership were drawn upon as guides to the functioning of the new type of business association. In the early days of unincorporated companies, the law of partnership made it practically impossible for such a company to sue or be sued.[3] An Act of Parliament had to be obtained authorizing the company to sue or be sued in the name of one of its officers.[4] As there were drawbacks to this scheme, further Acts of Parliament were passed, establishing companies where all the members as well as the officers, were liable for company debts. Provision was made for a company register, listing the individuals composing the company. Membership was constantly changing and the courts soon required that even members who had transferred their interest should remain liable, and those who became members would also become liable.[5] Once the courts got used to the idea of the joint stock company, a distinction was drawn:

> "A joint stock company is not an agreement between a great many persons that they will be co-partners, but it is an agreement between the owners of shares, or the owners of stock, that they or their duly recognized assigns, the owners of the shares for the time being, whoever they may be, shall be and continue an

[3] Formoy, *The Historical Foundations of Modern Company Law*, 1923, Sweet and Maxwell Ltd., London, p. 36.
[4] *Ibid.*
[5] *Ibid.*

> association together sharing profits and bearing losses. No shareholder in a joint stock company is, in the legal sense of the word, any more a partner than the owner of bank stock is; he may not have the same limit of liability, but in every other respect he is the same... and if he is liable under any contracts or obligation, or in respect of any act of the body, it is not because they are the contracts obligations or acts of his partners or partner, but because they are the contracts, obligations and acts of the quasi-corporate body by its properly constituted agents."[6]

The early joint-stock associations were usually formed by a Deed of Settlement, which has been described as "in effect, a deed of partnership".[7] The general law of partnership prevailed on matters not covered in the deed, and, notwithstanding stipulations to the contrary in the deed, shareholders stood, as regards third parties, upon the same footing as an ordinary partnership.[8] In the United Kingdom, the Joint Stock Companies Act of 1844 required companies to have a deed of settlement. This deed evolved into the modern articles and memorandum of association. The provisions of the deed were binding unless an alteration was made with the unanimous consent of the "partners".[9]

The United States, at the time of the revolution had the same attitude towards companies as had the United Kingdom. A corporation could only be created by the King, or the State. Generally the corporate charter would be granted for specific purposes. However, the same industrial and economic pressures were present in both countries, leading in time to the enactment of general incorporation statutes following the line of partnership law. Nonetheless, again due to business pressures, the rigidity of the memorandum and articles soon gave way to the principle of majority

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6 *Re Agriculturist Cattle Insurance Co.* L.R. 5 Ch. 725, at 733, quoted in Formoy, supra note 3 at p. 40.
7 Formoy, supra note 3 at p. 40.
8 *Ibid.* p. 41.
9 *Ibid.*

rule, as evidenced by the vote of the shareholders' meeting. While this had obvious commercial advantages for the company, it left the minority shareholder in a precarious position. The contract evidenced by the share certificate, upon which the shareholder entered the company, could be modified. A shareholder was powerless to prevent amendment of the articles, if those in control secured the passing of a special resolution.

With the majority statutorily empowered to bring about fundamental changes in the company, the rights of the minority who opposed such changes were developed by the common law. The principle of majority rule was clearly in the ascendant, however, and was manifest in the limited scope given to the minority to curtail the actions of the majority. The courts were extremely reluctant to interfere in the internal management of a company. The early English decision of *Foss v. Harbottle*[10] severely restricted the occasions upon which a shareholder could sue. The company itself could be the only proper plaintiff for an injury done to it. Since this clearly stymied any possible remedy where the majority was engaged in wrong-doing or some other self-serving deal, certain exceptions to "the rule of *Foss v. Harbottle*" were allowed by the courts. Thus a shareholder had certain equitable rights and would be permitted to sue where the matter involved acts which were *ultra vires* the company, a fraud on the minority, required a special majority by way of authorization, or affected the personal and individual membership rights of a shareholder.[11] A shareholder also had the option of applying to the court to have the company wound up on "just and equitable grounds", a drastic remedy from the company's perspective.[12] Nonetheless, if there were no market for the company's shares, it provided the only means by which a shareholder could withdraw, since another early decision, *Trevor v. Whitworth*[13]

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[10] (1843) 2 Hare 461, 67 E.R. 189 (Ch.).

[11] *Edwards v. Halliwell* (1950) 2 All E.R. 1064. The exceptions to the rule in *Foss v. Harbottle* are listed at p. 1067.

[12] Formerly, Companies Act 1948, section 222, now Companies Act 1985, section 517.

[13] (1887) 12 App. Cas. 409 (H.L)

prohibited a company from purchasing its own shares. There remained certain duties owed by those in control of the company. These duties were primarily owed by the directors and officers of the company and flowed "from the fact that they stand in a fiduciary relationship towards the company".[14] Even if the persons in control were not directors, but maintained control through voting power at company meetings, certain duties of good faith were still owed. Unfortunately, the duties were rather ill-defined. In certain circumstances, the court would intervene to annul a resolution of the shareholders' meeting where there was expropriation of the company's property, where ratification was given to acts of directors, if the directors had acted in their own interests, rather than the best interests of the company, or where expropriation of other members' property was attempted.[15] Nonetheless, there was no general principle that the majority when voting, must always exercise their powers "bona fide" for the benefit of the company as a whole.[16]

With the emphasis placed on the "interests of the company as a whole", there was little consideration given by the courts to allegations by a shareholder that his rights were unfairly prejudiced.[17] Although the expression "bona fide for the interests of the company as a whole" was defined by Evershed M.R. in a manner which indicated some concern with minority holdings, as follows,

> "...the phrase "the company as a whole" does not (at any rate in such a case as the present) mean the company as a commercial entity, distinct from the corporators: it means the corporators as a general body. That is to say, the case may be taken of an individual hypothetical member and it may be asked whether what is proposed is,

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14 Gower, *Principles of Modern Company Law* (4th ed) 1979, Stevens and Sons Ltd., London, p. 570
15 *Ibid.*, p. 620.
16 *Ibid.*, p. 623.
17 Dickerson, *Proposals for a new Business Corporations Law for Canada*, 1971, p. 114.

in the honest opinion of those who voted in its favour, for that person's benefit"[18],

in practice it was extremely difficult for the minority to prove that the majority did not ask themselves that vital question.[19]

C. Canadian Acceptance of Appraisal Mechanism

It was against this background that the appraisal remedy was enacted in the Canada Business Corporations Act.[20] A basic change of policy was recommended by the drafters of the Act. Instead of relying on common law standards to restrict the conduct of majority shareholders who proposed to make a fundamental change, it was decided to allow a dissenting shareholder a chance to get out of the corporation, receiving fair compensation for his shares.[21] The minority shareholder would no longer be at the mercy of the majority. If he disagreed with a proposal which fundamentally altered the nature of the business enterprise in which he originally invested, he could withdraw and be paid by the company the "fair value" of his shares. It was noted at the outset that the granting of such a right could in effect bar a proposed change, if sufficient shareholders objected and created an intolerable cash drain on the company.[22] The remedy was perceived as a compromise between protecting the minority interests and providing flexibility within the enterprise. If the majority observes the procedural formalities and pays off dissenting shareholders, it may "effect almost any fundamental change with impunity".[23] Thus a kind of rough equity would be achieved. The dissenting minority takes the "fair value" of its shares and departs, leaving the majority to fashion a new entity to meet changing business conditions.

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18 *Greenhalgh v. Arderne Cinemas Ltd.* (1951) Ch. 286, p. 291.
19 Gower, supra note 14 at p. 627.
20 S.C. 1974-75-76, section 184.
21 Dickerson, supra note 17, p. 115.
22 *Ibid.*
23 *Ibid.*

. Section 184 of the Canada Business Corporations Act has the virtue of dealing with "all variations of fundamental changes in one place, applying consistent rules to each".[24] Briefly the right to dissent can arise in four circumstances: an amendment of the articles that restricts the transfer of shares; amalgamation with another corporation, except a short-form amalgamation; continuance under the laws of another jurisdiction and a sale, lease or exchange of all or substantially all the corporation's property. The changes are denoted as fundamental in the sense that they alter the contract upon which the shareholder entered the company: his standing vis-a-vis other shareholders is affected or the company itself experiences changes to its legal and economic structure.

The appraisal remedy has been a feature of American corporate law since the mid-nineteenth century.[25] Indeed, the procedural provisions of section 184 are an adaptation of similar provisions contained in the New York Business Corporation law.[26] Corporate statutes are a matter for state jurisdiction in the United States and while almost all states have adopted the appraisal remedy, there are variations on the conditions upon which the remedy is granted and the measure of value to be employed in appraising the shares. The United States thus presented a wealth of precedent to the framers of the Canada Business Corporations Act.

D. Characterization of Appraisal Remedy in the United States

Initially, the introduction of the appraisal remedy in the United States was designed to soften the rigor of the judicial rule which protected the shareholder by requiring unanimous shareholder approval for the sale of assets or a merger.[27] When commercial pressures forced the enactment of general merger statutes and sale

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24 *Ibid.*
25 Eisenberg, supra note 1, p. 75, note 17.
26 Dickerson, supra note 17, p. 124.
27 Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker* (1962) 72 Yale L.J. 223 at 228.

of assets statutes, the appraisal remedy was seen as a way of preserving the constitutionality of such statutes, which might otherwise operate as an expropriation of private property. In *Chicago Corp. v. Munds*, the Delaware Court commented on the historical purpose of the appraisal remedy:

> "At common law it was in the power of any single stockholder to prevent a merger. When the idea became generally accepted that, in the interest of adjusting corporate mechanisms to the requirements of business and commercial growth, mergers should be permitted in spite of opposition of minorities, statutes were enacted in state after state which took from the individual stockholder the right theretofore existing to defeat the welding of his corporation with another. In compensation for the lost right a provision was written into the modern statutes giving the dissenting stock holder the option to completely retire from the enterprise and receive the value of his stock in money".[28]

Despite the fact that the appraisal remedy was introduced many years ago, there is a continuing analytical struggle in the United States to define the nature and rationale of the remedy and relate it to modern developments in corporate law. Although it was initially introduced as a method to allow greater flexibility to the corporate majority, it has also come to be regarded as one of the weapons in the arsenal of the minority shareholder. If a shareholder is unsuccessful in seeking to enjoin a proposed transaction, he may, by complying with the specified procedure, claim the fair value of his shares from the corporation. The caveat, of course, is that the shareholder must pay particular attention to the various time limits imposed for giving notice of objection and sending his certificates to the company for endorsement as dissenting shares. A slip up at this stage will prevent the shareholder from pursuing his appraisal option.

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[28] 20 Del. Ch. 142 at 149, 172 Atl. 452 at 455 (1934), quoted by Manning, supra note 27, p. 247 note 38.

One of the reasons for the difficulty in coming to terms with the remedy lies in the different triggering provisions.[29] All of the statutes include a merger as a transaction which gives rise to appraisal rights for some or all of the shareholders involved. Other common triggering provisions are charter amendments which affect the purpose and powers clause of the articles, alter stock preferences or reclassify shares, and sales of company assets. Various states have adopted different combinations of triggering provisions, and in several states, the appraisal remedy is granted solely upon mergers and consolidations.[30] It has been frequently pointed out that the appraisal statutes "are internally inconsistent" in allowing the remedy for some transactions but not for others which have a similar effect upon minority shareholders.[31]

The situation has been explained as a product of nineteenth century ideology.[32] The corporation as a legal entity was viewed quite separately from the economic enterprise. The concern with the issues of corporate power, franchises and the doctrine of ultra-vires influenced the transactions which would give rise to appraisal. Quite simply, when certain fundamental changes were put to the shareholders vote, when these changes involved the corporate identity and shareholder's contractual rights, then the nineteenth century conceptual analysis of the corporation demanded some remedy for a shareholder who experienced this fundamental legal change, regardless of the economic consequences for him.

> "By ideological assumption, no one but a shareholder could suffer this trauma; only other shareholders could inflict it; and damages were irrelevant".[33]

Another view of the appraisal statutes posits a concern for the economic enterprise, not simply the legal structure of the

29 Manning, supra note 27, Appendix.

30 For example, Delaware and California.

31 Vorer.berg, *Exclusiveness of the Dissenting Stockholder's Appraisal Right,* (1964) 77 Harv. L. Rev. 1189, p. 1190.

32 Manning,, supra note 27, p. 244 et seq.

33 *Ibid.*, p. 247

corporation. The purpose of the statutes "was to govern structural changes in the enterprise and...they dealt in terms with changes in the legal structure only because such changes provided a convenient and readily identifiable handle for latching on to changes in the enterprise".[34] However, whether or not the origin of the appraisal remedy in the United States was a constitutional and ideological one, or was derived from notions of fairness to compensate for an unrestricted power in the majority to make structural economic changes, certain inroads have been made on the universality of the remedy. Where once appraisal rights were accorded shareholders of each corporation in a merger, some states have now withdrawn the right from the survivor's shareholders in small-scale mergers which do not require the approval of those shareholders.[35] A common exception is to refuse the appraisal right to stock which is part of a class listed on a national securities exchange, quoted on the "over-the-counter" market or held by a designated number of shareholders. This evidences the general consensus that if a market for the shares exists, a shareholder can divest himself of his interest in the company via the market, without the necessity of a judicial valuation.[36]

E. United Kingdom - An Alternative Approach

In the United Kingdom, the corporate legislation has likewise sought a balance between the principle of majority rule and dissentient

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34 Eisenberg, *The Legal Roles of Shareholders and Management in Modern Corporate Decisionmaking*, (1969) 57 Calif. L. Rev. 4, p. 72. For comment on the theoretical underpinnings of appraisal with reference to the C.B.C.A., see Magnet, J., *Shareholders' Appraisal Rights in Canada*, 11 Ottawa L. Rev. 98. Prof. Magnet asserts appraisal rights are granted upon the possibility of structural/constitutional change. With respect, it is submitted that to leave the analysis at that point is too simplistic. While it can be argued that, in a legal sense, appraisal arises upon certain "structural" changes, the practical effect of these changes goes to the root of corporate control or the nature of the economic enterprise. See page 135, where Prof. Magnet acknowledges that change of control "may give the owners power to effect policy changes ... to change the nature of the business and ... to alter the articles. But these changes are *merely hypothetical* (emphasis added) and may never happen."

35 Eisenberg, *supra* note 34, at p. 72.

36 *Ibid.*

rights of the minority. Section 459 of the Companies Act 1985[37], is known as the "alternative remedy". A shareholder may petition the court for relief under section 459 if the affairs of the company are being or have been conducted in a manner which is unfairly prejudicial to the interests of some of the members including himself or in anticipation of any proposed act or omission of the company which would be so prejudicial.[38] The court may make an order as it thinks fit to give relief in respect of the matters complained of, including an order directing the purchase of the shares of any members of the company by other members or by the company itself.

A similar order may be made by the court under section 427 of the Companies Act 1985.[39] The court has power to approve and facilitate certain corporate arrangements and reconstructions and may provide for shareholders who dissent from the compromise or arrangement. Section 582 of the 1985 Act governs the situation where a company is being voluntarily wound up. Where part or all of its business or assets are transferred to another company and shares of that company are received as consideration, a shareholder who did not vote in favour of the special resolution authorizing the liquidator to accept shares of the transferee company, may require the liquidator either to refrain from carrying out the resolution or purchase his shareholding in the transferor company.[40]

At first glance it would seem that Canada and the U.S. jurisdictions afford greater protection and flexibility to minority shareholders. An appraisal may be sought as of right in a number of situations, whereas in the United Kingdom for the most part, such a result is a matter of judicial discretion. Where an appraisal of right is allowed

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37 The Companies Act, 1985, c.6. The 1985 act is a consolidation of United Kingdom company law statues from 1948 onwards. The predecessor of section 459 was section 75 of the Companies Act, 1980, c. 22.

38 Schmitthoff, *Palmer's Company Law* (23rd ed) , 1982, Stevens and Sons, London, 791.

39 The Companies Act 1985, c. 6. The predecessor of section 427 was section 208 of the Companies Act 1948, 11 and 12 Geo.6. c.30.

40 Companies Act 1985, Section 582(7).

under section 582 of the 1985 Act, any dispute over value is settled by arbitration. However, the bulwark of protection for British minority snareholders is to be found not in the Companies Acts, but in the City Code on Take-overs and Mergers. The Code is a collection of extra-legal rules and principles governing the conduct of mergers, which sets out the type of information to be made available to shareholders and also insists that all shareholders of the same class of an offeree company be treated similarly. This latter position effectively prevents the occurrence of the "freeze-out" merger where the minority is refused further participation in the remodelled company. Such mergers are commonplace in the United States and are becoming more frequent in Canada. Yet this topic received no attention from the framers of the revised federal business corporations act. The Act itself technically permits such corporate manoeuvres. It would be preferable to have the freeze-out technique dealt with specifically in the Canadian statute, after a debate on the ethics and economic merits or expediency of this type of merger. To date it would appear that Canada is following the American approach by default.

Chapter 2

Triggering Transactions and Restrictions on Dissent

Upon examination of the appraisal provisions of the various jurisdictions it is apparent that while there is no consensus on which particular changes will allow the shareholder to dissent and leave the company, taking with him the value of his shares, there is agreement on a number of factors. The change in the essential nature of the company must be brought about by a stockholder vote. Furthermore, the right to dissent is only available to shares which carry the right to vote. Shares which do not normally have voting rights may frequently have such rights conferred by the statute in the event of a proposal of a fundamental change which would radically alter the rights of those shares vis-a-vis the company or the remaining shareholders.

These preconditions echo the law of partnership, wherein each partner had power to veto any changes in the scope of the partnership business. In line with the movement towards allowing companies greater flexibility in the conduct of business, it was generally agreed that some provision should be made for the shareholder who, having invested in one type of company, suddenly found himself participating in a radically altered enterprise.

A. Triggering Provisions Under the Canada Business Corporations Act

The policy of Part XIV of the Act, which deals with fundamental corporate changes, is to give management flexibility in the running of the business. If a shareholder objects strongly to a proposed course of action, the statute provides for his opting out of the company, with the fair value of his shares, rather than locking management into a "rigid" structural design.[41] Section 184 of the Act sets forth the circumstances under which a dissenting shareholder is entitled to demand the "fair value" of his shares from the corporation:

- an amendment of the articles of incorporation under section 167 or 168 to add, change or remove any provisions restricting or constraining the issue, transfer or ownership of shares.[42]

- an amendment of the articles of incorporation under section 167 to add, change or remove any restriction upon the business that the corporation may carry on.[43]

- a resolution to continue the corporation under the laws of another jurisdiction under section 182.[44]

- the sale, lease or exchange of all or substantially all[45] of the corporation's property, under subsection 183(25).

- the amalgamation with another corporation (otherwise than under section 178).[46]

A further right to dissent is provided in section 184(2) to a holder of shares of a particular class or series, if the corporation resolves to amend its articles pursuant to section 170. This latter section authorizes a class vote where the corporation proposes to amend the articles allowing a change in the maximum number of authorized shares of that class, or increase the number of authorized shares of a class having superior rights to the class in question. Other amendments to the articles which may be affected by way of section 170, are the exchange, reclassification or cancellation of shares of

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[41] Dickerson, *Proposals for a New Business Corporations Law for Canada, Vol. 1.* (1971), p. 120. See generally, Theberge, R., "L'exercice du droit de dissidence en vertu de l'article 184 de la nouvelle loi sur les corporations commerciales canadiennes", (1977) 8 Revue Generale de Droit 33.

[42] C.B.C.A., section 184 (1)(a).

[43] C.B.C.A. section 184 (1)(b).

[44] C.B.C.A. section 184 (1)(d).

[45] C.B.C.A. section 184 (1)(e). See also Saskatchewan Court of Appeal decision *85956 Holdings Ltd. v Fayerman Brothers Ltd.* (1985) 32 B.L.R. 204, for a judicial interpretation of the phrase "sale of all or substantially all" of the assets of a business.

[46] C.B.C.A. section 184 (1)c).

a particular class, and alterations to the rights and privileges attaching to these shares. These amendments will likewise give rise to the appraisal remedy for a dissenting shareholder. Generally, such amendments tend to prejudice the minority shareholder's position by diluting the value of his shares through an increase in the authorized number of shares of that class or perhaps by eliminating him from the company altogether by a share consolidation.

All of the above events, which "trigger" appraisal rights require the passing of a special resolution. Subsection 2(1) of the Act defines special resolution as one which requires a majority of not less than two-thirds of the votes cast by the shareholders who voted in respect of that resolution. While the Act thus reinforces the principle of majority rule, the requirement of a two-thirds majority may be viewed as an attempt to mitigate the possibly harsh effects of corporate democracy in action.

Equally significant from the premise of the theoretical underpinnings of the remedy, are the shareholder resolutions which do not give rise to the appraisal process. Section 167 sets forth various alterations to the Articles which a corporation may make, such as changing the corporate name or place of business, creating new classes of shares or consolidating existing shares. The only alterations which will trigger appraisal are those which are listed both in section 167 and subsection 184(1), namely changes to restrictions on the issue, transfer or ownership of shares, and changes to restrictions on the business which the corporation may carry on.[47] Section 168 deals with constraints on share ownership and transfer, in order to qualify for licences to carry on business under federal or provincial laws, or permits grants and payments based upon the degree of Canadian ownership or control.

While statutory amalgamation normally triggers the appraisal remedy, amalgamations authorized by section 178 do not. Directors

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[47] I.e. C.B.C.A. section 167 (g), section 184 (1)(a), section 167 (c), section 184 (1)(b).

may amalgamate a wholly owned subsidiary with its holding company[48] or amalgamate two or more wholly owned subsidiaries,[49] without referring the matter for shareholder approval. It was thought by the framers of the Act that the requirement of one hundred percent ownership of the subsidiary would ensure that no injustice was done. The use of the "short-form" amalgamation in the United States as a means of "squeezing out" minority shareholders had been noted. However, in the United States, a short form amalgamation can proceed with the the "parent" corporation owning a minimum of 90 percent of the shares of the subsidiary.[50] In effect, the short-form amalgamation in the U.S. operates in much the same way as does the compulsory acquisition section of the Canadian and British Acts. While by definition there will be no dissenting shareholders in the subsidiary, section 178 operates to deprive shareholders of the holding company of the right to dissent to such an amalgamation.

The effect upon the right to dissent by a unanimous shareholders' agreement has yet to be judicially clarified. Such an agreement may form part of the Articles of Incorporation under subsection 6(2)(b). The agreement will be regarded as valid, even though it may limit the powers of the directors to manage the affairs of the corporation, if it is "an otherwise lawful written agreement".[51] The agreement may set out "any provisions permitted by the Act or by law to be set out in the by-laws of the corporation". It would be possible for the agreement to exclude the operation of section 184. Indeed the purpose of the legislative sanction of the use of a shareholder's agreement is to allow the closely-held corporation to avoid much of the formalism that is not appropriate to it and to operate, in effect, as a partnership with limited liability.[52]

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48 C.B.C.A. section 178 (1), vertical short-form amalgamation.

49 C.B.C.A. section 178 (2), horizontal short-form amalgamation.

50 See post.

51 C.B.C.A. section 140 (2).

52 Supra, note 1 at 11. A recent Ontario decision, *Mica Management Centre Inc. v Lockett* (1988) 37 B.L.R. 209, held that section 184 did not contain a provision preventing the contracting-out of rights or obligations conferred by the section. Section

Once the right to dissent has been exercised the process thus commenced need not inexorably progress to a judicial valuation. Subsection 184(11)(c) provides that a shareholder may have his rights as a shareholder re-instated where the directors in their discretion, decide to revoke the resolution from which the shareholder originally dissented. The resolution may be revoked in this manner without shareholder approval before it has been acted upon. This is one of the "flexibility" provisions. It allows the directors to assess the situation. Although a resolution may obtain the required special majority it may be that if a sufficient number of shareholders dissented, the drain on the corporation's resources would leave the business in a precarious position. Accordingly the directors have the power to cancel the transaction.

A final limitation upon the right to receive fair value for a dissenting shareholding exists in subsection 184(2)(a). No payment may be made to a dissenting shareholder if such a payment would render the corporation unable to pay its liabilities as they become due, or if the corporation's assets would thereby be less than the aggregate of its liabilities.

B. Triggering Provisions Under the Delaware Corporate Code

The Delaware Corporate statute allows shareholders the appraisal right only in the case of a merger or consolidation. Unlike other states, it has never granted such a right upon the sale of assets or charter amendments.[53] A series of revisions to the statute from 1967 onwards has rather curtailed the right to dissent. It has been noted that in Delaware the appraisal right is of decreasing

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184 would not override the terms of a valid contract, freely entered upon, which dealt with the very situation covered by the section. For a discussion on the exclusion of appraisal rights via the articles of incorporation, see Magnet, J., supra note 34 at pages 159 - 160. However, the question is not dealt with in the context of an unanimous shareholders' agreement, which is, in all likelihood, where any such derogation of rights would occur.

[53] Folk, *The Delaware General Corporate Law*, 1972, Little Brown & Co., Boston, p. 372.

importance and might possibly be eliminated except in the situation where there is no market for the class of stock concerned.[54]

Although the only type of transaction which will trigger the appraisal right is a merger or consolidation, section 262 of the Delaware Corporate Code[55] which deals with appraisal rights provides that the right may arise pursuant to a merger effected under one of several sections of the Code. These sections cover all the various permutations of constituent corporations in a merger. Section 251 deals with the merger or consolidation of two domestic (Delaware) corporations. Section 252 authorizes the merger of a domestic and out-of-state corporation. This section also permits the merger of a Delaware corporation with a corporation from a jurisdiction other than one of the United States, providing that the resulting corporation will be a Delaware corporation. A merger or consolidation of a domestic corporation and a joint stock or other association may take place under the aegis of section 254. This section provides for the agreement to be approved, certified, and acknowledged by each of the stock and non-stock corporations in the same manner as is provided in sections 251 and 255. Section 257 allows the merger or consolidation of domestic stock and non-stock corporations. Section 258 governs the merger of domestic and foreign stock and non-stock corporations.

In the above situations appraisal rights are available to the shares of any class or series of stock of a constituent corporation. One further kind of merger is allowed by statute. Under section 253 a parent corporation which owns at least 90 percent of *each class* of the stock of its subsidiary, may merge with that subsidiary. Appraisal rights in this case are available only to the minority shareholders of the subsidiary Delaware corporation which is party to the merger. Their appraisal rights are stated to be those set forth in section 262.[56] This latter section provides that in a merger or

[54] Ibid, 373.
[55] DEL. CODE ANN. tit. 8, General Corporation Law (1974).
[56] DEL. CODE. ANN. tit, 8, section 253(d) (1974).

consolidation shareholders who have neither voted in favour of the transaction nor consented thereto in writing, shall be entitled to an appraisal by the Court of Chancery of the fair value of their shares.[57] A major exception to those who would otherwise qualify for appraisal rights has been effected by section 262 (b)(1). No appraisal rights are available where the shares are either listed on a national securities exchange or held by more than 2,000 stockholders. A further restriction provides that no appraisal rights are available for any shareholders of the constituent corporation surviving a merger, if the merger did not require the vote of the stockholders for its approval. In effect, if a market exists for the shares then a shareholder who objects to the merger must either acquiesce in the transaction or sell his shares on the market. Supposedly, the current market price is a reflection of the "fair value" of the shares. In these circumstances, it is premised, an appraisal by the court would be redundant.

However, in an "exception to the exception", appraisal rights will be available if shareholders are by the terms of the merger agreement required to accept for their stock anything other than shares of the corporation surviving or resulting from the merger/consolidation, shares of stock of any other corporation which at the effective date of the merger or consolidation would be either listed on a national securities exchange or held by more than 2,000 stockholders; cash in lieu of fractional shares of the corporations, or any combination of shares and cash for fractional shares.[58]

While the right to an appraisal will only arise if the merger or consolidation and resulting modification of stock rights meets the above conditions, section 262(c) allows a corporation to provide in its certificate of incorporation that appraisal rights as provided by statute will be available upon such further occasions as an amendment to the certificate of incorporation, any merger in which

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[57] DEL. CODE ANN. tit. 8, section 262(a) (1974).
[58] DEL. CODE ANN. tit. 8 section 262(b)(2) (1974).

the corporation is a constituent corporation or the sale of all or substantially all of the assets of the corporation.

C. Triggering Provisions Under the New York Corporate Code

In New York a shareholder's right to an appraisal arises by virtue of section 910.[59] A shareholder has the right to receive payment for his shares upon a merger, consolidation or sale, lease, exchange or other disposition of the corporate assets. By recent amendment, a shareholder of a subject corporation has the right to appraisal upon his dissent from a share exchange authorized by new section 913, where the acquiring corporation is acquiring all of the outstanding shares of one or more classes of a subject corporation.[60] The structure of the section is noteworthy. A shareholder of a domestic corporation has the right to receive payment of the fair value of his shares, subject to and by complying with section 623, which contains the procedure for enforcing the right.[61] Thus the New York statute makes explicit what is implicit in the other statutes under consideration. The right to a valuation and payment for one's shares may be lost at a number of stages in the enforcement process.

A shareholder who is entitled to vote, who does not assent to a proposed merger or consolidation to which the corporation is a party or to a sale, lease, exchange or disposition of all or substantially all of the assets has the right to receive payment of the fair value of his shares.[62] However, this right is not available to a shareholder of the surviving corporation in a merger between a domestic corporation which owns at least 90 percent of the outstanding shares of another domestic (subsidiary) corporation, or a merger between domestic and foreign corporations.[63] The right accrues

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59 N.Y. BUS. CORP.LAW, section 910 (Consol. 1977).
60 N.Y. LAWS, 1986 ch. 117, section 1.
61 N.Y. BUS. CORP. LAW, section 910(a) (Consol. 1977).
62 N.Y. BUS. CORP. LAW, section 910(a)(1) (Consol. 1977).
63 N.Y. BUS. CORP. LAW, section 910(a)(1)(A)(i) (Consol, 1977).

solely to dissenting shareholders of the disappearing corporation. The right is also withheld from shareholders of the surviving corporation in a merger, other than a parent-subsidiary or domestic-foreign merger, unless the merger effects certain changes in the rights of the shares held by such shareholders.[64] No appraisal rights will arise as a result of a sale, lease, exchange or other disposition of assets if the disposition is wholly for cash, the corporation is dissolved and the cash distributed within one year after the transaction. This is one instance where all shareholders of a class are treated equally. Appraisal rights here would be unnecessary.

As in Delaware, appraisal rights are given to the minority of the subsidiary in a "short-form" merger, where the parent corporation owns at least 90 percent of the shares of a subsidiary. Also, in a merger authorized by section 907, between a domestic and foreign corporation, appraisal rights are given to the shareholders of the subsidiary, whether it be a domestic or foreign corporation. In these two situations the shareholder must file with the corporation a written notice of his election to dissent, in compliance with paragraph (c) of section 623.

D. Triggering Provisions Under the California Corporate Code

In California dissenters' rights are governed by section 1300 of the California General Corporation Law.[65] A shareholder may in certain circumstances require the corporation "to purchase for cash at their "fair market value", his shares. California grants a shareholder the chance to opt out of the corporation in the event of a reorganization or "short-form" merger. In the latter case, the right is restricted to shareholders of the disappearing corporation.[66] A reorganization is

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64 N.Y. BUS. CORP. LAW, section 910(a)(1)(A)(ii) (Consol. 1977). See also section 806.

65 CAL. CORP. CODE (West 1988).

66 CAL.CORP. CODE, section 1300(a) (West 1988).

defined in section 181 of the General Corporation Law. As employed in the statute, "reorganization" means:

- a merger (merger reorganization)
- the acquisition by one corporation in exchange in whole or in part for its equity securities (or those of another corporation in the control of the acquiring corporation) of shares of another corporation, if, immediately after the acquisition, the acquiring corporation has control of such other co.poration (exchange reorganization)
- the acquisition by one corporation in exchange in whole or in part for its equity securities (or the equity securities of a corporation which is in control of the acquiring corporation) or for its debt securities (or debt securities of a corporation which is in control of the acquiring corporation) which are not adequately secured and which have a maturity date in excess of five years after the consummation of the reorganization, or both, of all or substantially all of the assets of another organization.

The California statute attempts to treat all forms of corporate combinations in the same manner, with requirements for shareholder approval and the provision of dissenters' rights. In general, shareholder approval requires a majority of all the outstanding shares of each class.[67] "Approved by outstanding shares" is also a defined term, meaning approved by the affirmative vote of a majority of the outstanding shares entitled to vote. Such approval shall include the affirmative vote of a majority of the outstanding shares of each class or series entitled, by any provision of the articles or of this division, to vote as a class or series on the subject matter being voted upon.[68]

The emphasis is placed upon approval by affirmative vote of the outstanding shares. Section 1300(a) in conferring an appraisal right in reorganizations, confers the right, "if the approval of the

[67] CAL. CORP. CODE, section 1201(a) (West 1988).
[68] CAL. CORP. CODE, section 152 (West 1988).

outstanding shares of a corporation is requirrd", upon "each shareholder of such a corporation, *entitled to vote on the transaction*". Shareholders of a disappearing corporation in a short-form merger are also given the right to receive payment for their shares. By definition, their votes would have no effect upon the outcome of a vote. The appraisal remedy is restricted to "dissenting shares" as defined by the section. Section 1300 stipulates four requirements which the shares must meet before the right to receive payment arises. Firstly, the shares must not have been, immediately prior to the reorganization or short-form merger, either listed on a national securities exchange, or on an approved list of over-the- counter margin stocks.[69] This "stock market exception" will not apply however, if there are any restrictions upon the transfer of the shares, or if demands for payment are filed by 5 percent or more of the outstanding shares of a class, despite the fact that it is listed on a stock exchange or traded over the counter.[70]

Secondly, the shares must have been outstanding on the date for the determination of those entitled to vote on the reorganization and were either not voted in favour of the reorganization or, if the shares were listed on an exchange, or traded over the counter, they must have been *voted* against the reorganization. In the case of a short-form merger, the shares must have been held of record on the effective date of the merger.[71] Thirdly, the dissenting shareholder must demand that the corporation purchase the shares at their fair market value[72] and fourthly, the dissenting shareholder must submit his shares to the corporation's principal office, or the office of a transfer agent, for endorsement.[73]

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[69] Hereinafter referred to as "O.T.C.". The approved list is the O.T.C. margin stock list published by the Federal Reserve Board.

[70] CAL. CORP. CODE, section 1300(b)(1) (West 1988).

[71] CAL. CORP. CODE, section 1300(b)(2) (West 1988).

[72] CAL. CORP. CODE, section 1300(b)(3) West 1988).

[73] CAL. CORP. CODE, section 1300(b)(4) (West 1988).

As in Delaware, California eliminates dissenters' rights where the shares are listed on national securities exchanges or the O.T.C. margin stocks list published by the Federal Reserve Board, on the theory that a shareholder has the opportunity to sell his shares in a highly liquid market. In Delaware, the measure of value employed is "fair value" but market value is a very influential factor in judicial appraisal proceedings. In California, to allow appraisal where the shares were actively traded in great volume would not confer much advantage, since under section 1300, shareholders are entitled only to "fair market value".

The stipulation that a holder of shares listed on a securities exchange or the O.T.C. margin stocks list must *vote against* the reorganization ensures that the corporation is informed of the extent of objection to the transaction and the potential for demands upon the corporate treasury.[74] Because of the five percent objection level in section 1300, the fact that a company's shares are listed on a securities exchange does not protect the company from appraisal actions.

E. Triggering Provisions Under the Model Business Corporation Act of the American Bar Association

The Model Business Corporation Act first appeared in 1943 and has had considerable influence in the United States. It was promulgated by the American Bar Association as a model for states intending to revise their corporation statutes.

The various states were competing for the revenues that accrued from the incorporation of companies within their jurisdictions and thus were tending to enact very "liberal" (from the corporation's viewpoint) corporation statutes. Delaware was widely regarded as the winner in this "race for the bottom", with little protection for the investor. The Delaware statute was frequently drawn upon by

[74] Ibid.

other states. The Model Act was initially intended as an alternative source for states wishing to modernize their corporate law.[75]

However, as corporate law "tended more and more in the direction of a single set of workable ground rules for the corporate entity, leaving regulation either to the equitable jurisdiction of the courts, to regulation through statutes of a policing nature or through the informed judgment of administrative agencies", the Model Act, which was itself endorsed by leaders of the corporate bar and essentially a committee product, began to emulate the trend towards permissiveness. Nonetheless, the Model Act generally exhibits more concern for the rights of shareholders than is common in the majority of corporate statutes.

Section 80 of the Model Act[76] provides the right to dissent in the following situations:

- any plan of merger or consolidation to which the corporation is a party,[77]
- any sale or exchange of all or substantially all of the property and assets of the corporation not made in the usual and regular course of its business, including a sale in dissolution, [78]
- any plan of exchange to which the corporation is a party as the corporation the shares of which are to be acquired,[79] or
- any amendment of the articles of incorporation which materially and adversely affects the rights of the dissenting shareholder by diminished voting, pre-emptive or preferred dividend rights.[80]

A sale of assets pursuant to a court order, or a sale for cash on terms requiring that all or substantially all of the net proceeds of

[75] See Cary, W., *Federalism and Corporate Law: Reflections upon Delaware*, 83 Yale L.J. 663 (1974).
[76] MODEL BUS. CORP. ACT, (rev'd. 1978)
[77] MODEL BUS. CORP. ACT, section 80(a)(1), (rev'd. 1978).
[78] MODEL BUS. CORP. ACT, section 80(a)(2) (rev'd. 1978).
[79] MODEL BUS. CORP. ACT, section 80(a)(3) (rev'd. 1978).
[80] MODEL BUS. CORP. ACT, section 80(a)(4) (rev'd. 1978).

sale be distributed to the shareholders in accordance with their respective interests, within one year after the date of sale, will not give rise to appraisal rights.[81]

Typically, the section does not apply to shareholders of the surviving corporation in a merger if a vote of shareholders of that corporation is not necessary to authorize such merger. The Model Act at one time contained the "stock market exception" to appraisal rights. However, this was eliminated in the 1978 revision, in view of increasing skepticism of the ability of the market to provide a shareholder with the "value" of his shares.

F. De Facto Merger Doctrine

It will have been noted that, of the above jurisdictions, Delaware does not provide appraisal rights in the event of a sale of all of a company's assets. A continuing problem for the courts has been the characterization of certain types of corporate combinations. The issue is important for the effects such a characterization will have on the rights of a shareholder. Very often the result of a sale of corporate assets cannot be distinguished from a merger. However, this result has been obtained without furnishing appraisal rights to the shareholders of the selling corporation. The classic enunciation of the *de facto* merger theory occurred in *Farris v. Glen Alden.*[82] List was a Delaware corporation. Glen Alden was incorporated in Pennsylvania. Glen Alden was engaged chiefly in coal mining, whereas List was a holding company with interests in motion picture theatres, textiles, real estate and, to a lesser extent, the oil & gas industry. In terms of size Glen Alden was considerably smaller. Yet the reorganization agreement provided for the smaller company, Glen Alden, to acquire all of List's assets, by the issuance of Glen Alden stock to List. To accomplish this, Glen Alden had to increase its authorized share capital by 5,000,000 shares, without

[81] MODEL BUS. CORP. ACT, section 80(a)(2) (rev'd. 1978).
[82] 393 Pa. 427, 143 A.2d 25 (1958).

according any pre-emptive rights to its own shareholders. The Supreme Court of Pennsylvania noted that with the proliferation of hybrid forms of corporate combinations, it was no longer helpful to consider an individual transaction in the abstract and solely by reference to the various elements of the transaction to determine whether it is a sale or a merger. Instead, to determine properly the nature of a corporate transaction, one 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."[83] The court considered that the reorganization so fundamentally changed the character of Glen Alden, that to refuse its shareholders the right to dissent would in reality force them to give up their stock in one corporation and against their will accept shares in another corporation. The Pennsylvania statute allowed the purchase of assets without according appraisal rights. However the court held that in the present circumstances, with the elaborate provisions for the dissolution of List, the assumption of its liabilities by the "new" company List Alden, the directors and executives of List taking control of List Alden, and with List shareholders holding a majority of List Alden's stock - then the transaction was no longer a simple purchase of assets, but a merger. The attempt to structure the transaction so as to avoid conferring appraisal rights was unsuccessful.

The Delaware courts have taken a contrary view. In response to the de facto merger theory, they presented the "equal dignity" theory. In *Hariton v. Arco Electronics, Inc.*,[84] the court acknowledged the force of the plaintiff's contention that the sale of Arco's assets had achieved the same result as a merger. But the sale of assets provisions and merger provisions were independent of one another - of equal dignity. Framers of re-organizations could resort to either type of corporate mechanics to achieve the desired end. Furthermore,

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[83] Ibid., 143 A.2d. 25, at p. 28.
[84] 41 Del. Ch. 74, 188 A.2d 123 (1963).

the provisions of the statute regarding the sale of assets had been scrupulously observed. The court stressed the general theory of Delaware corporate law :

> "action taken pursuant to the authority of the various sections of that law constitute acts of independent legal significance and their validity is not dependent on other sections of the Act."[85]

Accordingly, the sale was legal.[86]

G. Triggering Provisions Under United Kingdom Corporate Legislation

Sections 425 - 427 of the 1985 Act[87] deal with arrangements and reconstructions sanctioned by the court. Under section 425, a "compromise or arrangement" may be proposed between a company and its creditors, or between the company and its members. The court directs that a meeting be held to vote on the agreement. If a majority in number, representing three-quarters of the value of the creditors or members, as the case may be, agrees, the arrangement shall be binding upon them and the company, subject to the matter being approved by the court. An arrangement under this section is expressly stated to include a reorganization of the share capital of the company. Section 426 stipulates the dissemination of information regarding the scheme to members and creditors. Section

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[85] *Ibid.*, 188 A.2d 123, at p. 125.

[86] In a recent decision, *Rideau Carleton Raceway Holdings Ltd.* (1984) 28 B.L.R. 89, the Ontario Divisional Court allowed a company's appeal from the Director's cancellation of its certificate of amendment. The company had complied with all of the statutory requirements for amending its articles of incorporation. The changes could also have been brought about by way of an arrangement under the Business Corporations Act R.S.O. 1980 c.54. Although there was nothing untoward in the conduct of the company, the Director believed that the public interest would be better served by proceeding by way of an arrangement. Galligan J. noted "... if the change was one that might lawfully have been obtained by resort to one or other of the statutory procedures, the right to set aside a certificate for "sufficient cause" could not give the Director the power to decide in a given case which route the corporation should have followed", at p. 91.

[87] Companies Act 1985 c. 6.

427 confers certain powers upon the court when an application is made to it under section 425. If the compromise or arrangement was proposed to enable the reconstruction of any company or companies or the amalgamation of two or more companies and will involve the transfer of all or part of "the undertaking or property" of a company party to the scheme, it is within the court's power to provide for any persons who dissent from the scheme.[88] The court has the discretion to lay down such time limits and other procedures regarding those who dissent, as it thinks fit.

It is possible to characterize an arrangement under the above sections as one requiring the sanction of the court. Furthermore, dissenters' rights do not automatically arise but are a matter for the discretion of the court. Under section 582 it is possible for a liquidator, where the company is in voluntary liquidation, to accept as consideration for the sale of property of the company, where the sale is to another company, shares of the purchasing company. The liquidator must have the sanction of a special resolution of the transferor company.[89] The section also permits the liquidator to enter into an arrangement where the transferor company may participate in the profits or receive any other benefit from the transferee company.[90] It is not necessary to apply to the court to affect an arrangement under this section. The special resolution is sufficient authority. However, the section does provide some relief for the minority. If a member of the transferor company, who did not vote in favour of the special resolution expresses his dissent in writing to the liquidator, within seven days of the passing of the resolution, the liquidator must either not proceed with the deal, or purchase the dissenter's interest. The price to be paid for the dissenter's shares will be determined by agreement or arbitration.[91]

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88 Companies Act 1985, Section 427(3)(e).
89 Companies Act 1985, Section 582(2).
90 Companies Act 1985, Section 582(3).
91 Companies Act 1985, Section 582(5).

While sections 425 and 582 may both cover the same type of reorganization, only section 582 automatically provides any protection for the minority. Section 425 will cover a wide range of reorganizations, from a simple composition with creditors, to an amalgamation involving radical alterations to share and loan capital.[92] To take advantage of the section it is no longer necessary that the company go into liquidation, although if the scheme involves the transfer of one company's undertaking to another company, the court has power under section 427 to provide for the dissolution of the transferor company, without winding up.[93] It is possible to use section 425 as a means of merging fully solvent concerns. By contrast, if a reconstruction is commenced under section 582 the company must resolve on a winding up. In these circumstances there is no procedure similar to section 427 for dispensing with formal assignments of property or of winding up. On the other hand, the scheme may be implemented without the need to apply to the court for approval. This factor will make a section 582 arrangement cheap, convenient and most useful in a straight forward situation, where a new company is being formed to take over the "undertakings" of the companies which are being merged.[94] Section 582 will trigger dissenters' rights, but it is to be noted that the minority shareholders do not have a special right to apply to the court. Their right is to be bought out of the company, the price being determined by arbitration.

Where the arrangement involves the transfer of a company's shares, usually pursuant to a take-over bid, section 428 provides for the compulsory purchase by the transferee company of the shares of the dissenting minority. This section is the British equivalent of section 199 of the Canada Business Corporations Act, and the American "short-form" mergers. The level of ownership, or acceptance of the take-over bid is generally the same in the three countries - ninety

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[92] See Gower, *Principles of Modern Company Law* (4th ed.) 1979, Stevens and Sons, London, 687.
[93] Ibid, 688.
[94] Ibid, 691.

percent of the shares involved. Section 428 refers to acceptance by holders of not less than nine-tenths in value of the shares whose transfer is involved. If the detailed provisions of the section are complied with, the transferee company may give notice to the dissenting shareholders of its intention to acquire their holdings upon the same terms and at the same price as accepted by the approving shareholders. Section 429 gives a minority shareholder the opportunity to require the transferee company to buy him out on the same terms, or on such other terms as may be agreed upon or as the court may order. The shareholder has the option of challenging the terms of the take-over, although due to the numbers involved - acceptance of the offer by ninety percent of the independent shares of the offeree company - such a challenge is rarely successful.

The remaining section which may require the purchase of a minority shareholder's interest is section 461 of the 1985 Act.[95] Any member of the company may apply to the court under section 459 for an order under section 461, if the affairs of the company are being conducted in a manner "unfairly prejudicial to the interests of some part of the members", including the applicant. An applicant may also use the section to obtain relief from some proposed action or omission of the company. The court has authority to provide for the purchase of the shares of any of the members, by other members or by the company itself.[96]

[95] Companies Act 1985, c. 6.
[96] Companies Act 1985, section 461(2)(d).

Chapter 3

Procedure to Enforce the Appraisal Remedy

It is anomalous that once the decision on principle has been made to allow a shareholder to withdraw from the company, the procedure devised to accomplish this objective is invariably unwieldy and characterized by numerous time periods for the lodging of objections, filing of demands for payment and delivery of share certificates. These time periods are ignored at the shareholder's peril. Yet the procedure for enforcing the right to payment is the very nub of the remedy.

A shareholder's right to a judicial valuation of his holding depends upon his complying with two kinds of pre-conditions. Initially, he must bring himself within the terms of the triggering provisions of the corporate statute and secondly, he must faithfully follow the various steps laid down by statute for the enforcement of the right to payment. The slightest delay may result in loss of the appraisal remedy. It is ironic that a process heralded for its conferral of flexibility upon a corporate re-structuring is itself rigidly structured.

A fundamental similarity will be discerned in the essential elements of the procedure laid down by the statutes. The basic approach taken is that of a ritual of notice-giving within definite time constraints. From the shareholder's standpoint, these constraints may operate to his disadvantage, permitting very little time in which to assess available information and make an important investment decision. Furthermore, the statutes remain silent on the type and extent of information that the shareholder is entitled to receive from the company in order to evaluate the company's offer of payment. Subsection 184(12)(a) of the C.B.C.A. simply states that the offer must be accompanied by a statement showing how the fair value was determined. This may take the form of a simple arithmetical calculation. However an explanation of the valuation method employed, together with a statement of the company's objectives and projections for the upcoming year would provide a more satisfactory basis for such decision-making. The variations in procedural requirements do not alter the thrust of the main provisions which require immediate notification to the company of objections to proposed changes, which could result in appraisal proceedings.

A. Under the Canada Business Corporations Act

a. Statutory Requirements

The procedure laid down by section 184 has been described as a "morass"[97]. Admittedly this stricture was delivered by a judge whose chief concern was the preservation of minority rights. Yet, while the statute provides a detailed procedure, there is some confusion that arises from the possibility of conflict between certain subsections of section 184 and the effect of those subsections on the rights of the parties. For example, failure to comply with time limits has serious consequences only for the shareholder, not the company. In addition, subsection 184(3) states that the shareholder's right to receive payment is in addition to any other right he may have, yet subsection 184(11) provides that upon sending the demand for payment, the shareholder ceases to have any rights as a shareholder other than the right to be paid the fair value of his shares.

Initially it is made quite clear that there can be no partial dissent. A dissenting shareholder may only claim payment for all of his shares of a particular class registered in his name.[98]

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[97]Per Laycraft J. in *Jepson et al v. Canadian Salt Company Ltd.* (1979) 4 W.W.R. 35, 7 B.L.R. 181, at p. 193:

> "I am left to wonder at the legislative policy which produced this procedural morass".

[98]C.B.C.A., subsection 184(4).

Normally the company will send out notice of the shareholders meeting at which the transaction will be considered and of the right to dissent, between twenty-one and fifty days before the meeting.[99] A shareholder must then send to the corporation at or before the meeting a written objection to the resolution, except where the corporation did not send him notice of the purpose of the meeting or notice of his right to dissent.[100] After the meeting, if the resolution is carried, the company must, within ten days, send to a shareholder who filed an objection, notice that the resolution has been adopted.[101] Upon receipt of this notice, the dissenting shareholder must within a further twenty days, send to the company a written notice containing his name and address, the number and class of shares in respect of which he dissents and a demand for payment of the fair value of those shares.[102] Thereafter, the shareholder has thirty days in which to send in his share certificates to the company or its transfer agent.[103] Upon receipt, the shares are then endorsed by the company to the effect that they are dissenting shares and returned to the shareholder.[104] While this is going forward, the corporation must, within seven days from the date the resolution becomes effective or the day on which it received the shareholder's notice of dissent, whichever is later, send to the dissenting shareholder a written offer to pay for the shares an amount considered by the directors to be their fair value, together with an explanation of how that value was determined.[105] Every offer made by the company to shareholders holding the same class or series of shares must be on the same terms.[106] The shareholder then has the option to accept the company's offer or proceed to a judicial determination of the value of his holding. If the shareholder accepts

[99] C.B.C.A., subsection 129
[100] C.B.C.A., subsection 184(5).
[101] C.B.C.A., subsection 184(6).
[102] C.B.C.A., subsection 184(7).
[103] C.B.C.A., subsection 184(8).
[104] C.B.C.A., subsection 184(10).
[105] C.B.C.A., subsection 184(12).
[106] C.B.C.A., subsection 184(13).

the offer, the company must make payment within ten days. If the shareholder does not accept within thirty days, the offer of payment by the company is deemed to lapse.[107]

If the company and the shareholder cannot agree on value, the statute then prescribes the manner in which the dispute is brought before the court. Where the corporation fails to make an offer of payment or the shareholder fails to accept the offer, the corporation may apply to the court to fix a fair value for the shares. The corporation has fifty days from the effective date of the resolution to apply to the court.[108] If the corporation makes no application, the shareholder is then entitled to apply to the court, within a further period of twenty days.[109] Fortunately, the court has power to extend the time period for the bringing of the application in both instances.[110]

During this elaborate process, the shareholder must object to the resolution, submit a demand for payment and send his share certificates to be endorsed. The shareholder is responsible for carrying the action forward. While the corporation has certain obligations of notification and furnishing information to its shareholders, failure to meet these obligations does not appear to alter its position in the proceedings. However, the position is different for a shareholder.

The term "dissenting shareholder" is not defined by the Act, simply the conditions giving rise to the right to dissent. Subsection 184 (3) provides that entitlement to payment for shares is based upon shareholder compliance with section 184. Subsection 184 (9) states that a shareholder who fails to submit his certificates for endorsement loses his right to make a claim. It is also arguable that the right will be lost if the shareholder fails to make a timely objection and demand for payment. The court is given discretion to

[107]C.B.C.A., subsection 184(14).
[108]C.B.C.A., subsection 184(15).
[109]C.B.C.A., subsection 184(16).
[110]C.B.C.A., subsections 184 (15), (16).

extend the time period within which the corporation or shareholder is permitted to bring an application for the court to fix the fair value of the shares, but there is no such relieving provision for the time periods relating to the objection and demand for payment - the qualifying provisions.

b. Judicial Interpretation of Statutory Requirements

i. Who is a "Dissenting Shareholder"

Much of the Canadian jurisprudence on the appraisal remedy has highlighted several inherent problems with the procedure. In *Manitoba Securities Commission v. Versatile Cornat Corporation*[111], the court considered the meaning of the term "shareholder" as used in the section. Hewak J. of the Manitoba Court of Queen's Bench discerned two approaches in Canadian jurisprudence. One line of Manitoba decisions maintained that it was not strictly necessary for the name of the holder of the shares to be registered on the books of the company, in order to be considered a shareholder.[112] It was sufficient if a person could show that he was the beneficial or real owner of the shares. The contrary approach was exemplified by an early Ontario decision to the effect that persons whose names are contained in the share register of a company are deemed to be the holders of the shares.[113] American authority favoured this latter view. Hewak J. concurred. When statutes refer to stockholders, they refer to stockholders of record as they appear on the register of the company books.[114]

> "To me that is only reasonable. It would cause utter chaos in the world of commerce to hold otherwise and to expect corporations to deal with past shareholders,

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111 (1979) 7 B.L.R. 38.

112 *Re. Kootenay Valley Fruit Lands Co.* (1911) 18 W.L.R. 145; *Re. Great West Permanent Loan Co. and Winding-up Act* (1927) 2 W.W.R. 15

113 *Tough Oakes Gold Mines Ltd. v. Foster* (1917) 39 O.L.R. 144, 34 D.L.R. 748.

114 *Supra*, note 111, at p. 52.

> prospective shareholders or simply share "holders" in their attempt to run the business of the companies." [115]

This interpretation resulted in a shareholder losing his right to dissent under the Manitoba Corporations Act.[116] After sending in his notice of objection, the shareholder transferred his shares to another company. After the defendant company notified the shareholder that the resolution had been passed, the transfer of his shares was registered. Consequently, he was no longer a registered shareholder when he sent in his demand for payment. The fact of his re-acquisition of the shares sometime later could not correct the defect. There can be no quarrel with the result of this decision. A practical approach was taken to what is by nature a pragmatic remedy. The company is undoubtedly entitled to a cut-off date to enable it to determine and deal with dissenting shareholders.

The decision of *Re National Auto Radiator Manufacturing Co. Ltd. and Warner* [117] was also concerned with the question of whether a shareholder was a "dissenting shareholder" within the terms of Section 184. The shareholder had brought an action to determine the fair value of her shares. The company applied to have the action quashed on the grounds that a Motions Court judge lacked jurisdiction to determine the issues and that the shareholder did not come within the meaning of "dissenting shareholder". Craig J. held, on the question of jurisdiction, that the Act contemplated application to the court in a summary manner. To give "sense and substance" to the statutory provisions, the court to whom the application to fix fair value was made, would also have jurisdiction to determine a preliminary question such as the status of the applicant. The company disputed the shareholder's status as a dissenting shareholder, since the resolution giving rise to the right to dissent had not been and would not be implemented. The decision on the substantive matter was left to the decision of the Motions

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[115] *Ibid.*

[116] Section 184 of the Corporations Act, 1976 (Man.) c. 10, as amended, is similar to its federal counterpart.

[117] (1981) 20 C.P.C. 196.

Court judge dealing with the application to fix the fair value of the shares.

ii. Implications of Procedural Time Limits

The confusion which can result due to the effects of the various time periods was apparent in *Re Skye Resources Ltd. et al.*[118] Here, Crown Life was the beneficial owner of shares which were registered in the name of Roytor. Roytor, on instructions from Crown Life, objected to a proposed amalgamation and directed Skye Resources to send further notices to an address other than the one listed on the share register. The objection was dated 22 December 1981. The company delivered notice of approval of the amalgamation to Roytor on 31 December, 1981 at its registered address and also sent a copy by mail to Crown Life which was received on 5 January 1982. Roytor sent a demand for payment on 22 January 1982 and when the shares were forwarded for endorsement the company refused to do so on the basis that the demand for payment had been filed out of time. The company maintained that the 20 day period began to run on 31 December 1981, with the delivery of the notice to Royter. However, Holland J. held that the demand was made timeously. According to subsection 246 (1) of the C.B.C.A., notice must be sent to a shareholder at his latest address as shown on the records of the corporation. But "records" are not limited to the security register. Subsection 236 (1) refers to "registers or other records of a corporation". Thus the address for notification in Roytor's letter of objection constituted a "record" of the company. Furthermore, since the company had employed two methods for communicating the notice of the resolution's passing, Crown Life was entitled to rely upon the date of receipt of the letter mailed directly to its headquarters as the time from which the twenty day period for the submission of its demand for payment would be calculated. The court commented that Crown Life's application to fix a fair value of its shares, submitted in conjunction with the

[118](1982) 18 B.L.R. 131. Appeal dismissed, (1983) 141 D.L.R. (3d) 767.

application to have its shares endorsed, was premature since there were further procedural requirements of section 184 which had not yet been fulfilled.

Another recent decision, although concerned with the time limits imposed on a shareholder by section 199, the compulsory purchase section, indicates that, wherever possible, the court will try to salvage a right of action for the minority shareholder. In *Manning v. Harris Steel Group Inc., Willox et. al. v. Harris Steel Group Inc.*[119] the British Columbia Court of Appeal insisted that the various provisions, including time limitations, of section 199 had to be read as a whole. Manning had failed to bring his action within the time prescribed by subsection 199(10), that is, twenty days from the date the company failed to bring the action. Initially, when the application was heard in Chambers, it was dismissed on the basis of the shareholder's failure to meet the requisite time limit. However, as another minority shareholder had filed a similar application within the time period in Ontario, the Court of Appeal reasoned that "the issue of whether the time limits provided in the statute had been met is determined by looking at the date upon which the *first* application by a dissenting shareholder is brought". Such a view was necessary in order to give any effect to the terms of subsection 199(13), which provides that if an application is made by a dissenting shareholder in time, then all other dissenting shareholders shall be made parties to the proceeding and bound by the fair value found by the court. Thus Manning, who had not made his application to the court in time, must be treated as if he had done so, if he were to be entitled to the same price as all the other dissenting shareholders.

iii. Problems Caused by the Adversarial Nature of the Procedure

Once an application is before the court the issue of fair value is determined by the normal adversarial process. The traditional rule

[119] (1984) 28 B.L.R. 240.

that the plaintiff carries the burden of proof in the action has caused some misgivings. It is apparent that if a minority shareholder brings the action and finds himself in the position of plaintiff, it may be difficult for him to establish his estimate of the fair value of his holding without access to the detailed information concerning the enterprise in the corporate records.

The initial problems raised by the adversarial process have drawn different responses from the courts. *Robertson et al v. Canadian Canners Ltd.*[120] involved an application to fix fair value by a shareholder. The company raised a preliminary objection on the grounds that the material filed did not disclose a real dispute as to the fair value of the shares and that the shareholder had failed to meet the onus of proof allegedly upon him. Steel J. decided that the appropriate way to deal with the matter was to direct a trial of the issues. He evinced some concern with the effect of subsection 184 (20) which, in his opinion, provided that any determination made by the court would be binding on all dissenting shareholders, whether they were before the court or not. There was some dispute over who were dissenting shareholders and whether notice of the present application had been served on those shareholders. A trial of that issue and also of the fair values of the shares was directed. Steel J. noted that the material before him contained neither the company's balance sheet nor the financial statements, which were some of the basic items that must be considered in determining a fair value for the shares.[121] Subsection 184 (12) of the Act imposes an obligation on the directors to fix a fair value and to show by accompanying statements how it was reached. The shareholders in the present case refused the offer. However, because of this initial obligation upon to the company to justify its fair value figure, Steele J. considered it appropriate for the company to be the plaintiff in the trial of the action. Because of the nature of the action, with the duty placed

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[120](1978) 4 B.L.R. 290.
[121]*Ibid*, 291.

upon the court to fix a fair value, there was no real onus of proof upon either party.

The question of the burden of proof was dealt with differently in *Neonex International Ltd. v. Kolasa.*[122] An amalgamation was proposed between Neonex, a public corporation, and a private corporation which was wholly owned by a shareholder who controlled 46.5 percent of the common shares of Neonex. In due course Neonex applied to the court to fix a fair value for the dissenters' shares. By the amalgamation agreement, public shareholders were to receive $3.00 in cash or a non-voting preference share of the amalgamated company, with a stated capital of $3.00. There were "seriously contested issues of fact to be resolved". Accordingly, Bouck J. ordered the petition to be converted into an action, with the company as plaintiff. The company would then, according to the traditional adversarial process, bear the burden of proof in establishing the fair value of shares as alleged by it. The shareholder respondents had requested the appointment of an appraiser. The request was not well received by the court. Numerous problems sprang to mind.

> "Where an amalgamated company has only one easily appraised piece of property, the appointment of an independent appraiser might be appropriate. It is not suitable for this kind of complaint, due to the complex nature of the operations of Neonex....Who would pay the cost of the appraiser during the course of the inquiry?...From whom would the appraiser take his instructions?...If the court did not appoint an appraiser, where does the onus of proof lie?...What happens if his (appraiser) evidence is shown to be erroneous? What other evidence would the court then have to reach a decision?" [123]

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[122](1978) 2 W.W.R. 593, 3 B.L.R. 1, 84 D.L.R. (3d) 446.
[123]*Ibid*, 3 B.L.R. 1, at p. 14.

Bouck J. clearly felt that the rules of civil procedure, of evidence and the adversary system could not accommodate the appointment of an appraiser.

However, the Act itself stipulates that an appraiser may be appointed and it could be argued that the complex nature of the company's operations, emphasized by Bouck J., is precisely the kind which requires the efforts of qualified appraisers in coming to a fair value of the company as a whole.

iv. Procedural Hardships for Minority Shareholders

While Bouck J. perceived inadequacies in the litigation process when applied to the appraisal remedy, the implications of such inadequacies for the rights of the minority were underlined in *Jepson et al. v. The Canadian Salt Company Ltd.*[124] Here, the rigours imposed on a dissenting shareholder by the procedural requirements of section 184 were questioned by Laycraft J. The corporate transaction involved was an "amalgamation squeeze-out". The defendant company was continued by an amalgamation under the Canada Business Corporations Act between a predecessor Canadian Salt Co and Morton Industries of Canada Ltd. (hereinafter MIC), which owned 80 percent of the outstanding shares of Canadian Salt. MIC announced a take-over bid for the outstanding minority interest, after which it intended to amalgamate with Canadian Salt. The plaintiffs gave written notice of their objection to the amalgamation on 17 October 1977. The shareholders' meeting was held on 28 October 1977. On 11 November 1977 the company sent a notice to the plaintiffs that the amalgamation had been made fully effective by the issue of a certificate and articles of amalgamation. The plaintiffs responded by letter on 17 November 1977 asking for a "written offer in an amount considered by the directors of the corporation to be a fair value". The company then maintained that the time for dissenting under the section had expired.

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[124](1979) 4 W.W.R. 35, 7 B.L.R. 181.

Laycraft J. remarked:

> "Section 184 of the Canadian Business Corporations Act prescribes a remarkably rigid procedure, which, moreover, seems to be slanted in favour of the amalgamated corporation and against a dissenting shareholder. In several places in section 184 there is a requirement that specified notices, containing specified information, be sent within specifically limited times. On the face of the section, failure by the corporation to meet the requirements of the section has no particular penalty. On the other hand, failure by the shareholder to observe some provision of the section can result in the draconian penalty of complete loss of his investment in the corporation." [125]

Laycraft J. held that the initial letters from the plaintiffs made it plain that they opposed the amalgamation. Further, although the company did not meet the time limit of ten days for the notice of adoption of the resolution, the plaintiffs replied within six days of receipt of the notice. Their letter of 17 November 1977 was also considered by the court to be a valid objection. The plaintiffs did not specify the number of shares held by them in respect of which they dissented. However, the court noted that this information was "clearly possessed by the corporation". Fortunately, the court was able to point to a letter which did specify the shares. The most serious hurdle for the court and the minority shareholders was the company's contention that the plaintiffs' failure to tender their shares within 30 days from their 17 November 1977 letter, resulted in the loss of their right to receive payment. To overcome this, Laycraft J. singled out a sentence in the company's notice of 11 November 1977:

> "No continuing value attaches to the certificate or certificates you hold for shares of Old Salt. You need not return any such certificates but should now treat them as worthless paper".[126]

[125] *Ibid*, 7 B.L.R. 181, at p. 191.
[126] *Ibid*, 194.

Accordingly, he held that the company had waived its right to insist upon tender of the share certificates.

This was certainly an instance where the company's rather smug elaboration backfired. However it was a fortunate circumstance for the dissenting shareholders. Without that sentence, Laycraft J., who was obviously attempting to salvage some remedy for the minority, would have been powerless in the face of the blunt provision of subsection 184 (9).

The analysis of Laycraft J. of the procedural requirements of C.B.C.A., section 184 was substantially endorsed in a report produced by the Institute of Law Research and Reform in Alberta. It was noted that the procedure was designed to give the corporation the greatest practicable opportunity to determine who the "serious" dissenters were; to give the shareholders the opportunity to consider an offer for their shares without incurring legal or professional costs and, ultimately, to encourage settlement of the valuation dispute. Nonetheless, the complexity, rigidity and length of time involved caused some concern. The report conclued that "uniformity in the procedure for giving effect to the appraisal right, unlike uniformity in the principle of the appraisal right" was not a pressing concern. The report proposed a considerably simplified procedure which would speed application to the court.[127]

B. Under the Delaware Corporate Code

a. Statutory Requirements

Just as Laycraft J. described the Canadian procedural requirements as a morass, the process of perfecting the appraisal remedy in Delaware has been described as "tortuous".[128] However, Delaware recently simplified its appraisal section with respect to the actions

127 Institute of Law Research and Reform, *Proposals for a New Alberta Business Corporations Act*, 1980, Vol. 1, pages 134 - 135.

128 Folk, *The Delaware General Corporate Law* 1972, Little, Brown and Co., Boston, p. 375.

required of the shareholder. In short, the dissenting shareholder need only file a demand for appraisal before the vote is taken and commence a petition in the Court of Chancery within 120 days after the merger's effective date. If a corporation proposes a merger or consolidation which will trigger appraisal rights, it must notify, not less than 20 days prior to the meeting, each of the stockholders entitled to appraisal rights, that such rights are available. The corporation must include in its notice to shareholders, a copy of section 262.[129] A stockholder wishing to demand appraisal for his shares must "deliver to the corporation, before the taking of the vote on the merger or consolidation, a written demand for appraisal".[130] The stockholder must then be notified by the corporation, within 10 days after the effective date of the merger or consolidation, that the reorganization has been consummated.[131] The corporation (the surviving or resulting corporation) need only inform stockholders who have complied with the requirements of the section regarding notice of dissent and who have refrained from voting in favour of the merger or consenting thereto.

If the merger or consolidation was carried out pursuant to section 228 or 253, that is the "short form" merger, the corporation must, either before or within 10 days after the effective date, inform the stockholders entitled to appraisal rights of the existence of those rights and the effective date of the merger.[132] The stockholder then has 20 days after the date of the mailing of the corporation's notice, to submit a written demand for the appraisal of his shares.

Thereafter, application may be made within 120 days of the effective date of the merger to the Court of Chancery by either the surviving or resulting corporation or any stockholder who has complied with the provisions of the section, for a determination of

[129] DEL. CODE ANN. tit. 8, section 262(d)(1) (1974).
[130] *Ibid.*
[131] *Ibid.*
[132] DEL. CODE ANN. tit. 8, section 262(d)(2) (1974).

the value of the stock "of all such stockholders".[133] The stockholder is given the right to resile from his initial decision to seek an appraisal. He may withdraw his demand within 60 days of the effective date of the merger and accept the terms offered upon the merger or consolidation.[134] The stockholder is entitled, within 120 days after the effective date, upon written request, to receive from the corporation a statement containing the number of shares which were not voted in favour of the merger or consolidation, with respect to which the corporation has received demands for appraisal, and the number of stockholders who hold these shares. The corporation is obliged to furnish the information within 10 days of the stockholder's request or within 10 days from the expiration of the period allowed for delivery of demands for appraisal, whichever is later.[135] These provisions give the shareholder some flexibility in deciding how best to protect his investment in the company.

The legislation is concerned that all dissenting stockholders be aware of any appraisal proceedings, participate fully in them and be bound by the court's decision as to entitlement and value. If petition is made to the court by a stockholder, service of a copy is made on the corporation. The corporation must then file with the court office a list of the names and addresses of all stockholders who have demanded payment for their shares and with whom no agreement as to the value of the shares has been reached. If the corporation initiates court proceedings, such a list must be filed with the petition. Notice of the time and place of the hearing is then given in such publications as the court thinks fit and is sent to the corporation and the stockholders on the list. At the hearing, the court is empowered to determine which stockholders have complied with the statutory provisions and are thus entitled to appraisal rights.[136]

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[133] DEL. CODE ANN. tit. 8, section 262(e) (1974).
[134] *Ibid.*
[135] *Ibid.*
[136] DEL. CODE ANN. tit. 8, section 262(f),(g) (1974).

b. Judicial Interpretation of Statutory Requirements

i. Definition of "Stockholder"

There are many decisions on the technicalities of section 262 which support the claim that "the appraisal right is more complex than its intrinsic significance merits".[137] The section defines "stockholder" as a holder of record. Although the statute was not always as explicit, the courts limited the remedy to registered shareholders.[138] Thus in *Loeb Rhodes & Co. et al v Hilton Hotels Corporation,*[139] the court ruled that there had been no timely dissent within the requirements of the section, where the only letter received by the corporation prior to the shareholder meeting was that sent by the beneficial owners of a certain number of shares. Although a written objection was sent by the registered owner, it was not received by the company until some days after the meeting. When the beneficial owners attempted to obtain the appointment of an appraiser to determine the value of their stock, the corporation objected on the ground that valid written objections to the merger were not filed before the taking of the vote. The court noted that it was settled law that only a registered owner is a "stockholder" within the meaning of the merger-appraisal provisions of the corporate code, the rationale being that in estimating the number of dissenters, a corporation is entitled to rely exclusively on its records and need not become involved in disputes between registered and non-registered stockholders. Because of the various dates involved, the stockholders attempted to set up a presumption that a letter reaches its destination in due course of post, when it is proved that it was mailed properly, relying on various cases dealing with acceptance of offers by mail. The court emphasized the requirement of the section that the objection be "filed".

> "The word "filed", in this context means delivery to the corporation. The very purpose of the written objection,

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[137] Folk, supra note 128, at p. 373.
[138] *Ibid.*
[139] 222 A. 2d 789 (1966).

> as notice to the corporation of possible dissentients...requires actual receipt by the corporation before the vote is taken...the claimants...must prove actual delivery to the corporation before the vote is taken."[140]

The stockholder's appeal was dismissed. In their initial action, *In the Matter of Hilton Hotels Corporation,* the Vice Chancellor observed that the burden of proof of compliance with the statutory requirements is on the stockholder claiming the right to appraisal.[141]

ii. Liberal Construction of the Statute

Although this may seem an undue hardship for the stockholders, the court's attitude towards dissenters in general is that if the statutory form of procedure has been complied with, then the statute shall be liberally construed. Thus, in *Schenley Industries Inc. v Curtis,*[142] where the short form merger provision provided that a dissenting shareholder, within 20 days after mailing by the corporation of the notice of filing and recording of the merger agreement, may demand in writing, payment for his stock, the court held that the twenty day period began on the date of the posting of the notice by the corporation. The time of the written demand by the shareholder was the date of posting of the demand. The corporation had argued that the date of the demand should be the date of its receipt. The court disagreed. To adopt the corporation's contention "would inevitably result in many cases in considerably shortening the period of time within which the stockholder must make his written demand". The matter did not rest there, for the court pointed out that the shareholder has not perfected his right solely by depositing his demand in the mail.

> "The corporation must receive the demand, otherwise the statutory scheme of permitting the corporation, after a

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140 *Ibid.*, at p. 793.
141 210 A. 2d 185 at p. 187.
142 152 A. 2d 300.

> certain time, to bring into court all dissenting stockholders would be thwarted. This would cause no hardship to stockholders since registered mail could be used." [143]

When considering the objection itself, there is a broad latitude given to the court in determining whether a particular writing constitutes a valid objection. As Vice Chancellor Seltz put it:

> "In view of the type of proceeding here involved, I believe stockholder draftsmanship should not be tested by professional standards."[144]

C. Under the New York Corporate Code

a. Statutory Requirements

In New York, the shareholder's right to dissent from certain corporate actions is regarded as a basic right of share ownership.[145] A detailed procedure is laid down in section 623 with the express purpose of ensuring that the right is effective. If a shareholder intends to enforce his right, he must file with the corporation written objection to the proposed action, before the meeting at which the vote is to be taken. The objection must include a demand for payment of the fair value of his shares if the action goes ahead.[146] The corporation has 10 days from the "shareholder's authorization date" to give written notice of the authorization to each shareholder who filed written objection. However, if a shareholder voted for or consented in writing to the proposed action, he is not entitled to such notice and he is deemed to have "elected not to enforce his right to receive payment for his shares".[147] When the shareholder files his notice of election to dissent, or within one month from that time, he must send his share certificates to the corporation or its transfer agent, for endorsement. Failure to do so

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[143] *Ibid.*, at p. 302.
[144] *Wiswell v. General Waterworks Corporation*, 66 A. 2d 424.
[145] Legislative declaration, Laws 1982, Ch. 202, Section 1.
[146] N.Y. BUS. CORP LAW, section 623(a) (Consol. 1977).
[147] N.Y. BUS. CORP LAW, section 623 (b) (Consol. 1977).

can result in the shareholder losing his dissenter's rights, at the option of the corporation.[148] Within 15 days after the expiry of the period for filing notices of election to dissent, or 15 days after the proposed action is consummated, the corporation is required to make a written offer to all shareholders who filed a notice of election to dissent, to pay for their shares a price considered by the corporation to be their fair value. The offer must be accompanied by a statement of the number of shares with respect to which notices of election have been filed and the number of shareholders involved. In addition if the corporate action has been consummated, the offer must be accompanied by advance payment equivalent to 80 percent of the amount offered, if the shareholder has already submitted his certificates to the corporation. If the shareholder has not yet submitted his certificates, the company must advise him that upon their surrender, he shall receive an advance payment of 80 percent of the offered price. The statute specifically provides that the acceptance of the advance payment does not constitute a waiver of any dissenter's rights.[149]

It is a function of the provision to encourage resolution of disagreements regarding fair value without resort to judicial proceedings. The procedure outlining application to the court is conditioned upon the corporation failing to make an offer to purchase within the fifteen day period, or if the offer is made, failure by the shareholders to agree with it, within 30 days.[150] Initially, the statute provides that the application is to be made by the corporation within 20 days of the expiration of whatever time limit is operable as above mentioned.[151] If the corporation fails to institute proceedings within the 20 day period any dissenting shareholder may make the application not later than 30 days after the expiration of the 20 day period. However, "if such proceeding is not instituted within such 30 day period, all dissenters' rights shall

[148]N.Y. BUS. CORP LAW, section 623 (f) (Consol. 1977).
[149]N.Y. BUS. CORP LAW, section 623 (g) (Consol. 1977)
[150]N.Y. BUS. CORP LAW, section 623 (h) (Consol. 1977).
[151]N.Y. BUS. CORP LAW, section 623 (h)(1) (Consol. 1977).

be lost unless the supreme court, for good cause shown, shall order otherwise".[152]

As in Delaware, all dissenting shareholders are to be made parties to the action. The corporation is required to serve notice of the petition upon each dissenter.[153] The court must initially determine the entitlement of the shareholders and then may proceed to a determination of fair value of the shares, as of the close of business on the day prior to the shareholders authorization date.[154] .There is a major restriction on the availability of appraisal rights, in that the remedy has been confined, both under the former Stock Corporation Law, and under the present statute, to voting stock. The statutory language refers to "any shareholder entitled to vote".[155] This phrase has been interpreted as limiting the right to voting stock.

b. Judicial Interpretation of Statutory Requirements

i. Who is a "Dissenting Shareholder"

In *Application of Harwitz,*[156] the preferred, non-voting stockholders argued that appraisal was not limited to those who voted against the proposal to sell the company's assets, but extended to *all* shareholders *except* those who voted in favour of the proposal. The Supreme Court considered that proposition untenable:

> "...if it was the legislative intent that section 20 should be applicable to non-voting stock and that non-voting stock should have the right to apply for appointment of appraisers as well as voting stock, then there was no need to include in section 20 the phrase "entitled to vote thereon".[157]

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[152] N.Y. BUS. CORP LAW, section 623 (h)(2) (Consol. 1977).
[153] N.Y. BUS. CORP LAW, section 623 (h)(3) (Consol. 1977).
[154] N.Y. BUS. CORP LAW, section 623 (h)(4) (Consol. 1977).
[155] N.Y. BUS. CORP LAW, section 910 (a)(1) (Consol. 1977).
[156] 80 N.Y.S. 2d 570.
[157] *Ibid.*, at p. 573.

ii. Implications of Procedural Time Limits

Because of the numerous time limits imposed by the section the court is frequently called upon to rule on the timeliness of various actions. The court is given discretion to dispense with exact compliance upon good cause shown. In *Sasseen et al, v. Danco Industries Inc.*[158], the minority shareholders in a close corporation were allowed to exercise their appraisal rights. While they had made their objection to the sale of the company's principal assets and their demand for payment as required by the statute, they had failed to make timely submission of their stock certificates to the corporation for notation to the effect that a demand for appraisal had been made. The court found in favour of the stockholders, noting that there had been a series of communications between them and the corporation from the time of the approval of the sale, up to the commencement of appraisal proceedings. During this period "the corporation had no reason to believe that the petitioners would relinquish their rights to appraisal". Furthermore, the court clearly felt that to refuse appraisal relief would result in substantial prejudice to the minority.

> "They would be deprived of their right to payment and would be relegated to their status as minority stockholders. It is undisputed that the respondent is a close corporation and there is no market for its shares. On the other hand, the corporation has not been prejudiced whatsoever."[159]

This attitude was reinforced by the Appellate Division of the Supreme Court in *Davis v. Adirondack Industries Inc.*[160] The corporation had moved to dismiss the application for determination of value on the grounds of a 25 day delay in the filing of the petition. The court "was not unmindful" that the procedure to enforce the appraisal remedy was conditioned upon the observance of the time requirements laid down by statute. Nevertheless, the Legislature had

[158] 246 N.Y.S. 2d 440.
[159] *Ibid.*, at p. 442.
[160] 308 N.Y.S. 2d 107.

given the court discretion to waive absolute compliance in the interests of equity. The court upheld the lower court's ruling of good and sufficient cause shown for the delay particularly because of the absence of prejudice to the corporation and the substantial prejudice to the stockholder if the petition were dismissed[161].

Yet the time limits were imposed for a purpose and the Supreme Court, Appellate Division, has recently indicated that these limits are ignored at the shareholder's peril. In *McGowan v. Grand Island Transit Corporation,*[162] the Appeal Court found that the shareholder's application to determine his right to payment and the fair value of his shares stated no cause of action, since the merger did not affect his status and rights in the surviving corporation. The court went on to note that the shareholder had failed to file his notice of election to dissent, in accordance with section 623(c), which gives the shareholder a period of 10 days from the date the corporation gave notice of the proposal. Thus his petition would have had to be dismissed, even if he had established a right to payment. The unlucky shareholder had also failed to file his petition within the required time-frame. It was noted:

> "Although the court might quite properly have exercised the discretion provided in subparagraph (2) of paragraph (h) of Section 623 "for good cause shown" in order to extend the statutory period, that discretion was unavailing where petitioner has failed to qualify as a dissenting shareholder".[163]

iii. Consecutive Nature of Procedural Requirements

The procedure laid down in section 623(h) for bringing the matter to court was considered in *Re. Gruntal & Co.*[164] There was some dispute between Gruntal & Co., the nominee holder, and the corporation, Endicott Johnson, over whether Gruntal had made a timely filing of

161 *Ibid.*, at p. 109.
162 App. Div., 437 N.Y.S. 2d 158.
163 *Ibid.*, at p. 160
164 328 N.Y.S. 2d 141.

its notice of dissent. The expiry date was October 21, 1971. On October 19, 1971, an employee of Gruntal telephoned the corporate secretary of Endicott Johnson and was allegedly told to send in the share certificates for notation. The certificates were mailed on October 22 and received by Endicott on October 26. The corporation refused to accept the certificates for notation from Gruntal claiming that there had been no compliance with the statute, since notice of election to dissent had not been made prior to the cut-off date. Gruntal then brought a petition for the determination of its status as dissenting shareholder. Gruntal's petition was dismissed. Gruntal had argued that the term "dissenting shareholder" as used in the statute comprised only those stockholders who were acknowledged by the corporation to have properly dissented or to whom the corporation had made an offer. Since Gruntal had not strictly complied with section 623(3), it maintained it was not a "dissenting shareholder" within the meaning of section 623(h) and therefore its remedies should not be limited to those set forth in that section.

The court agreed that the statute did not make clear whether "dissenting shareholder" included those who claimed the right of appraisal but had failed to strictly comply with each step giving rise to the appraisal, as well as those who had complied with all the steps. But to limit the relief provided by section 623(h) solely to those who had properly dissented and to whom the company had failed to make an offer would be to construe the language of the section too narrowly. The phrase "if the corporation fails to make an offer" would include Gruntal & Co. The language did not limit relief to those who had properly dissented and were entitled to an offer. This brought Gruntal & Co. within the terms of the section. According to the court, the statutory scheme envisages the corporation, in its action under section 623(h)(1), asking the court to determine a questioned dissenter's right to payment. If the corporation fails to do so, the shareholder can have his right to payment determined in a special proceeding brought under section 623(h)(2), but only after the 20 day period given exclusively to the corporation in which to raise an action, expires. The general intent of the provision is to place upon the corporation the obligation of initiating the appraisal procedure and to prevent a multiplicity of actions. Gruntal & Co's petition was dismissed, since it had been filed within the period reserved exclusively to the corporation.

D. Under the California Corporate Code

a. Statutory Requirements

The California statute makes a distinction between public and private companies, quite apart from the familiar "stock market exception" to appraisal rights, although that, too, is adopted. Shareholders of a public company must *vote against* the proposed reorganization in order to preserve their appraisal rights. In private companies, it is sufficient if the shareholders do not vote in favour of the reorganization.[165] In addition to the voting requirements, the California Code provides that the shareholder must submit a written demand for payment of the fair market value of the shares to the corporation[166]. To be effective, this demand must be received by the corporation or its transfer agent no later than the date of the shareholders' meeting to vote upon the reorganization or within 30 days after the date on which the notice of approval was mailed to the shareholder, if approval was sought by written consent.[167] The shareholder's demand must state the number and class of shares which the shareholder wishes the corporation to purchase and a statement of what the shareholder considers to be their fair market value, as of the day before the announcement of the proposed reorganization. The shareholder's statement is deemed to be an offer by the shareholder to sell the shares at that price[168]. The corporation must mail to each shareholder a notice of the approval of the reorganization within 10 days from the date of such approval, together with a copy of the pertinent sections of the appraisal

165 CAL. CORP. CODE, section 1300(b)(2) (West 1988).
166 CAL. CORP. CODE, section 1300(b)(3) (West 1988).
167 CAL. CORP. CODE, section 1301(b) (West 1988).
168 CAL. CORP. CODE, section 1301(c) (West 1988).

statute, a statement of the price which the corporation believes is the fair market value of the dissenting shares and a "brief description of the procedure to be followed if the shareholder desires to exercise the right under such sections". It is expressly provided that the statement of price constitutes an offer by the corporation to purchase the shares at that price.[169]

Within 30 days after the date on which the notice of approval was mailed by the corporation, the shareholder is required to submit his certificates with respect to the shares which he demands be purchased, for endorsement to the effect that they are dissenting shares.[170]

If the corporation and the shareholder can agree upon the price of the shares, the statute provides for the shareholder to receive payment within 30 days of the agreement, together with interest at the legal rate on judgments, from the date of the agreement[171]. On the other hand, if no agreement can be obtained on price or if the corporation denies that the shares in question are dissenting shares, then the shareholder may file a complaint requesting the court to determine whether the shares are dissenting shares and the fair market value of those shares. Such an action may be commenced by the shareholder within six months from the date on which the notice of approval of the reorganization was mailed, but not thereafter.[172]

b. Judicial Interpretation of Statutory Requirements

Provision is made for the court to appoint one or more appraisers and thereafter to approve the report, if it is found to be reasonable.[173] If there is any delay upon the part of the appraisers in

[169]CAL. CORP. CODE, section 1301(a) (West 1988).
[170]CAL. CORP. CODE, section 1302 (West 1988)
[171]CAL. CORP. CODE, section 1303 (West 1988).
[172]CAL. CORP. CODE, section 1304 (West 1988).
[173]CAL. CORP. CODE, section 1305(a) (West 1988).

filing their report, the court shall determine the fair market value of the dissenting shares.[174]

In *Gallois v. West End Chemical Company*[175], the plaintiff attempted to show that his callable participating preferred stock was *de facto* non callable as a result of an informal decision of the directors. In the course of its judgment, the court commented upon the provision for the appointment of appraisers.

> "The court was given the option to appoint appraisers, which it would presumably do in a case where there was no market for the stock...but it could save the parties the unnecessary burden and expense of an appraisal where there was an established market..."[176]

The Court noted that the legislative purpose was to eliminate the necessity of appraisal where an actively traded stock for which there was a market, was involved. At the same time, the dissenting shareholder was not to be paid a price that reflected a distortion of the value of his stock by reason of the proposed merger.

The same plaintiff brought a separate action against *Stauffer Chemical Company*[177], the surviving company in the merger, seeking a declaration that he was entitled to stock dividends declared by the surviving corporation during the litigation to determine the value of his shares in West End Company. The plaintiff had based his argument upon section 4314 (now section 1307):

> Cash dividends paid by the corporation upon the dissenting shares after the day on which the vote was taken and prior to payment for the shares by the corporation shall be credited upon the total amount to be paid by the corporation therefor,

buttressed by section 4315 (now section 1308):

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[174]CAL. CORP. CODE, section 1305(b) (West 1988)
[175]8 Cal. Rptr. 596.
[176]*Ibid.*, at p. 600.
[177]*Gallois v Stauffer Chemical Company*, 34 Cal. Rptr. 411.

> Except as expressly limited in this article, holders of dissenting shares continue to have all the rights and privileges incident to their shares, until the fair market value of their shares is agreed upon cr determined...

The appellant maintained that the dividends referred to must be those of the surviving corporation, since the separate existence of the constituent corporation ceases upon the merger. However, the court disagreed. For the most part, in the appraisal sections, where the term "the corporation" is used it refers to the company in which the interested shareholder holds stock. Furthermore, the fact that the constituent corporation goes out of separate existence upon the merger does not render the section meaningless. The function of the section (4314/1307) is to protect dissenters during the interval between shareholders' approval and completion of the merger, however long or short that period may be.

The court explained that the purpose of the merger statute in general was "to strike the fair market value as of the date before the stockholders vote, excluding appreciation or depreciation in consequence of the proposed action" and, if the vote favoured a merger, "to bring about as speedy a conclusion as possible."[178] The court's interpretation of section 4314 is designed to further the statutory objectives.

> "Cash dividends of the constituent or disappearing corporation are credited upon the valuation, thus implementing the method of determining value as of the day before the voting; but share dividends, which would simply diminish the value of each share (there being no prospect of future earnings) are allotted to the holder. He is protected against diminution of value by dividend action. On the other hand there is no incentive, through possible increment, to his delaying the winding up of his relations with the company of which he was part owner."[179]

[178] *Ibid.*, at p. 413.
[179] *Ibid.*, at p. 412.

Finally, the court commented that "it would be incongruous" to permit a dissenter during the period when the court stands ready to adjust the value of his shares, "to participate in the earnings of a company, the fortunes and risks of which he chose not to participate in".[180]

E. Under the Model Business Corporation Act

The Model Act does not differ markedly from the American jurisdictions under discussion in so far as the procedural requirements are concerned. Initially, the company must notify shareholders of the existence of the right to dissent and obtain payment for their shares, if the proposed corporate action is one of the triggering events.[181] In turn, the shareholder must file with the company before the vote is taken, a written notice of his intention to demand payment if the proposed action is effectuated. The shareholder must also refrain from voting his shares in favour of the proposal.[182] If the proposal is adopted, the company must again notify those shareholders who gave notice of their intention to demand payment. This second notice must state where and when a demand for payment should be sent and certificates be deposited in order to obtain payment. The time set by the company for the demand and the deposit of certificates can not be less than 30 days from the mailing of the notice.[183] If the company fails to carry out the proposed action within 60 days from the date set for demanding payment it must return any certificates that have been deposited. The corporation has the option of going ahead with the re-organization at a later date, if it sends out a new notice to the shareholders.[184]

The Model Act places the emphasis on negotiation between the company and its shareholders on the question of valuation, in the

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180 *Ibid.*, at p. 413.
181 MODEL BUS. CORP. ACT, Section 81 (b) (1978).
182 MODEL BUS. CORP. ACT,Section 81 (c)(1978).
183 MODEL BUS. CORP. ACT,Section 81 (d)(1978).
184 MODEL BUS. CORP. ACT,Section 81 (f)(1978).

hope of avoiding a judicial appraisal. Immediately upon the completion of the "triggering" corporate action, the company must pay the shareholders who have made the demand and deposited their shares, the amount which it estimates is the fair market value of the shares with interest, if any has accrued. The remittance must be accompanied by the company's balance sheet, statement of income and the latest interim financial statements.[185] At this point the onus shifts to the shareholder. If the corporation fails to remit in accordance with the requirements, or the shareholder believes that the amount remitted is less than the fair value, he may send the company his estimate of the value and a demand for payment of the deficiency. If the dissenter does not file such an estimate within 30 days after the date of the mailing of the company's remittance, the shareholder is entitled to no more than the amount sent by the company.[186] Thereafter, if within 60 days from receiving a demand for supplemental payment, if any such demands remain unsettled, the corporation must petition the court to determine the fair value of the shares.[187] All dissenters whose demands are outstanding are made parties to the proceeding.[188] If the company fails to file the petition, each dissenter who has made a demand and who has not settled his claim has the right to be paid by the corporation the amount demanded by him and can sue therefor.[189]

The Model Act, while it follows the general notice giving procedure is unique in imposing a financial sanction upon the company for failure to commence the appraisal action. The shareholder, too, must accept the responsibilities attached to his decision to dissent. He must state in writing the amount which he will accept. If he does nothing, he is deemed to accept the amount remitted by the company. However, the Model Act promotes informed decisions on the part of the shareholder by compelling the company on each notification to

[185]MODEL BUS. CORP. ACT,Section 81 (f)(3)(1978).
[186]MODEL BUS. CORP. ACT,Section 81 (g)(2)(1978).
[187]MODEL BUS. CORP. ACT,Section 81 (h)(1)(1978).
[188]MODEL BUS. CORP. ACT,Section 81 (h)(3)(1978).
[189]MODEL BUS. CORP. ACT,Section 81 (h)(6)(1978).

the shareholder to provide a copy of the sections dealing with appraisal rights and to provide recent financial information with its remittance of the fair value.

F. Under United Kingdom Legislation

a. Statutory Requirements and Judicial Interpretation Thereof

Under sections 425 to 427 of the Companies Act[190], which authorize the court to give its approval to an arrangement among the members of a company, the procedure is generally *ex parte* by originating summons.[191] Application may be made by a shareholder, creditor or, if the company is being wound up, by the liquidator. The court then directs the holding of a shareholders' meeting to vote upon the proposal. If the arrangement receives the approval of a majority in number and three quarters in value of the votes cast, the arrangement becomes binding on all concerned including the company, if the court gives its sanction. Application is made to the court by petition upon the requisite majority being attained at the meeting. Provision is made for the circulation of information prior to the shareholders' meeting. With the notice of the meeting, the company must furnish a statement explaining the effect of the arrangement. Any material interests of the directors must be disclosed by the statement and the effect upon those interests of the proposed arrangement.[192] If the shareholder dissents from a take-over bid, where the offeror company has successfully acquired nine-tenths in value of the target shares, he may apply to the court to determine the terms on which his shares are to be acquired by the transferee company.[193] If the take-over bid garners nine-tenths in value of the target shares, the transferee company is required, within one month of the date of the share transfer to give notice of that fact to the holders of the remaining shares who have not

[190]Companies Act 1985 c. 6.
[191]Gower, *Modern Company Law* (4th ed) at p. 686, note 33.
[192]Companies Act 1985, section 426(1)(a).
[193]Companies Act 1985, section 429.

assented to the take-over bid.[194] Thereafter, the dissenter has three months from the giving of such notice to notify the transferee company to acquire his shares.[195] The section permits the company to acquire the dissenters' shares if it so wishes. Generally, the bidding company is allowed four months from the making of the offer to acquire ninety percent of the shares. If successful, it then has two months in which to give notice to the dissenters of its intention to compulsorily acquire their shares.[196] The shareholder then has one month in which to apply to the court in an attempt to vary the terms of the offer.[197]

The court also has the power to provide for the purchase of shares of a complaining shareholder under section 459 of the 1980 Act.[198] The basis for the order is that the interests of the member are being unfairly prejudiced through a course of conduct of the corporate affairs, or by some act or omission. Application to the court may be made by the shareholder, by petition. [199] The court has a general power to make such order as it thinks fit to give relief from the subject matter of the complaint. In *Meyer v. Scottish Co-Operative Wholesale Society*[200], Lord President Cooper noted that in the argument before him, it had been "hinted that the section enabled the court to do practically anything which might seem equitable to redress any prejudice inflicted upon a minority of shareholders." Nonetheless the Lord President demurred:

> "We have not been constituted an earthly Providence in matters of this kind, and it is for the petitioners to state what they primarily want and to justify their request by relevant arguments showing that their

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[194]Companies Act 1985, section 429(2).
[195]Companies Act 1985, section 429(3).
[196]Companies Act 1985, section 428(2).
[197]Companies Act 1985, section 428(4).
[198]Companies Act 1985 c. 6.
[199]Companies Act 1985, section 459(1).
[200]1954 S.C. 381.

complaint and request are within the purview of the section."[201]

As previously mentioned, although a shareholder may require his interest in the company to be bought by the liquidator where a reconstruction is proceeding via section 582 of the 1948 Act, the value to be paid for the shares is to be determined by arbitration, failing agreement. The Companies Clauses Consolidation Act provides for two arbitrators and an umpire.[202]

G. Summary

The decision to claim payment for one's shares will not be made lightly. The exercise of the right to dissent requires constant vigilance upon the part of the shareholder. It would seem that from a procedural viewpoint, there is no advantage conferred upon the dissenting shareholder apart from the existence of the remedy. The predominant concern of the procedure for enforcing the right to receive payment is to ensure that any demands from the dissenting minority upon the corporate treasury are rigidly controlled.

The corporation sets off the process of notice-giving, but in general it does not suffer any grave consequences for its failure to observe the time limits imposed. At no time is the proposed reorganization called into question. On the contrary, it is the shareholder's position which may be prejudiced by his failure to meet the time limits imposed on him. There are several occasions where his right may be lost altogether. Prompt notification by the shareholder that he intends to dissent, followed up by another notice or demand for payment must be submitted to the company in order to qualify as a dissenting shareholder. These initial steps are of the utmost importance because the statutes do not confer on the courts, and the courts have not assumed, any discretion to relieve against non-compliance with these particular periods. The statutes allow and the

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201 *Ibid.*, at p. 388.
202 Gower, supra note 191, at p. 692, note 71.

courts have exercised a discretion in permitting late filing of the petition to the court. In short, the courts may be persuaded to help a shareholder who has slipped up in the midst of the process, but they will not assist a shareholder to qualify as a dissenter. This he must do by himself. Failure by the company to observe its obligations under the statute may be used by the shareholder to explain or justify delay on his part. The New York courts have been susceptible to this approach, particularly when it can be demonstrated that there is no prejudice to the company in relaxing the time period. However this argument will not avail a shareholder who fails to inform the company of his intention to dissent within the required time. The fundamental premise of the statutes allows the shareholder to assert his claim only upon suitable notice to the company, prior to the vote on the reorganization.

The Canadian courts have struggled to reconcile the harsh effects of the limitation periods with the idea of appraisal as a shareholder remedy. The concept has its origins in the assertion of notions of fairness over the ability of a majority to alter the nature of a company. Nonetheless, the tension between the interests of the shareholder and the interests of the company has resulted in the latter receiving paramount consideration in the procedure for enforcing appraisal. The company must be aware of the extent of the claims at all times in order to plan its business and financial strategy. Granted, the minority has the right to withdraw, but it must do so in accordance with the provisions. There must be no dilatoriness, vagueness or speculative actions which could harm the company and of course, the majority interest.

It is for this reason that the statutes also regulate the circumstances under which the shareholder can withdraw his demand for payment. In Canada, the demand for payment can be withdrawn only before the company has made its offer to purchase the shares.[203] In Delaware, a shareholder has 60 days from the effective date of the merger within which he may withdraw his

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[203] C.B.C.A. section 184(11((c).

dissent.[204] A similar period applies in New York with the proviso that if the company fails to make a timely offer to purchase, the shareholder has 60 days from the date the offer is made.[205] In California the shareholder must obtain the consent of the corporation to the withdrawal of the demand for payment.[206]

The procedure also attempts to a greater or lesser degree, depending upon the jurisdiction, to bring the parties to a negotiated settlement on the value of the shares. The procedure is such that all requirements must be fulfilled consecutively before the company or shareholder can apply to the court. The success of the process depends to a certain extent on the information available to the shareholder on how the company reached its valuation decision.[207] On a very basic level the procedure can only be termed a fair compromise between the opposing interests of shareholder and company if the shareholder is made aware not only of the existence of the right, but the steps which he must take to secure that right. The American jurisdictions provide for the company to send a copy of the pertinent sections to the shareholder with the notice of the proposed change. The Canadian statute provides only that the shareholder be informed of his right to dissent.

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204 DEL. CODE ANN. tit. 8. section 262(e)(1974).

205 N.Y. BUS. CORP. LAW, section 623(e) (Consol. 1977)

206 CAL. CORP CODE, section 1309(d) (West 1988).

207 See Kanda, H., Levmore, S., The Appraisal Remedy and the Goals of Corporate Law, (1985) 32 U.C.L.A. Law Rev. 429, where it is suggested that one of the credible goals of appraisal is that of the discovery by shareholders of wrongful behaviour on the part of management. This would be brought about by the disclosure of pertinent infomation in the appraisal process. However, it is also acknowledged (p. 444) that this goal is dependent upon the type of information deemed relevant to appraisal. With respect, while such "discovery" may be a factor in appraisal proceedings, on a practical level, the shareholder would not commence such an action simply as a discovery exercise.

Chapter 4

Scope of the Remedy

Given the complexity of the procedure laid down by statute, one might wonder at the nomenclature of minority shareholder's remedy for the appraisal right. Nonetheless, in the decisions on the scope of an appraisal action - the substantive issues - it is possible to discern in judicial attitudes to the remedy a concern for the fairness of the entire transaction regarding the minority. There are certain corporate manoeuvres which transgress judicial notions of fair play and are thus subject to careful scrutiny and analysis of their purpose: this in an action where ultimately the issue is reduced to one of monetary compensation.

A. The Canadian Position

a. Judicial Approach to the Nature of the Appraisal Remedy

In a painstakingly researched opinion, Greenberg J. has taken a stance on the role and power of the courts in a section 184 action, which will doubtless be embraced by the rest of his brethren. In the *Domglas*[208] appraisal, which arose out of an amalgamation "squeeze-out", Greenberg J. noted that the statute left the term "fair value" undefined. It would therefore be the task of the court to interpret and construe the term. In approaching this task,

> "...the appraisal remedy should be construed and applied in a fair, large and liberal manner, so as to achieve its primary purpose of protecting and benefiting the dissenting shareholders."[209]

A "fair value" would be one which was just and equitable. The terminology contained within itself the concept of adequate

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[208] *Domglas Inc., Domglas Inc. v Jarislowsky et al* (1980) Que. S.C. 925, 13 B.L.R. 135, aff'd 138 D.L.R. (3d) 521, (1982) Que. C.A. 377.
[209] *Ibid.*, at p. 162 B.L.R.

compensation consistent with the requirements of justice and equity. Of particular interest to Greenberg J. was the fact that while the expression "fair value" appears eight times in section 184, the first five times it is preceded by the definite article "the" and on the last three occasions, by the indefinite article "a". "The" fair value implies that there is one specific value. "A" fair value implies that there is not one, but rather various possible fair values. There existed a range within which the value could be fixed by the court. To Greenberg J.'s mind, this was no accident nor coincidence. "Parliament must be assumed to have intentionally and deliberately distinguished between those instances where "the" is used and those where "a" is employed."[210] Thus, Greenberg J. reasoned that the court was endowed with a latitude and discretion in the exercise of its equitable jurisdiction, since the sections which speak of the court's power to fix fair value are phrased as "a fair value".

The trend in the United States has been for the appraisal statutes, while leaving "fair value" undefined, to enumerate certain factors which the court should consider in its determination of fair value. The New York statute ordains the court to

> "...consider the nature of the transaction giving rise to the shareholder's right to receive payment for shares and its effects on the corporation and its shareholders, the concepts and methods then customary in the relevant securities and financial markets for determining fair value of shares of a corporation engaging in a similar transaction under comparable circumstances and all other relevant factors."[211]

The Delaware statute speaks simply of "all relevant factors" being considered.[212] While the Canadian statute gives no such direction it is clear from the Domglas decision that the courts' range of enquiry will be as extensive.

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210 *Ibid.* at p. 165 B.L.R.

211 N.Y. BUS. CORP LAW, section 623(h)(4) (Consol. 1977).

212 DEL. CODE ANN. tit. 8, section 262(h) (1974), exclusive of any element of value arising from the accomplishment or expectation of the merger or consolidation.

b. Developing Appraisal as a Minority Shareholder's Remedy

The development of appraisal as an effective shareholder remedy, and not simply as a mechanism for maximizing corporate flexibility, depends upon the court being able to consider the nature of the transaction. At times this may bring the remedy very close to the oppression remedy of section 234.[213] The most common situation in which an overlap of the two remedies may occur is the amalgamation squeeze-out. In the Domglas case, the minority shareholders of Domglas Ltee were "squeezed-out" upon the amalgamation of that company with its parent corporation which owned 96 percent of the shares. This was accomplished by the issuance to the minority of redeemable preference shares, which were redeemed by the new corporation upon the completion of the amalgamation. The minority had patiently held their shares for years during which the company had suspended payment of dividends and ploughed earnings back into the company. When the lengthy process of re-investment and modernization was about to come to fruition the minority were "cashed-out" of the company via section 177. Greenberg J. noted that in the instant case there was "not even a hint of oppression as such". But he then cautioned:

> "where the amalgamation provisions of the CBCA are used to force out or "squeeze-out" the minority shareholders...the application to such an amalgamation of the provisions of section 184 of that Act must, as in the case of the oppression remedy, be interpreted in a manner which advances the remedy."[214]

The court explained that in cases where dissenting shareholders are squeezed-out, a tactic equivalent to expropriation, "fair value" included something more than "fair market value". It must include a premium for forcible taking. This was the price which must be paid

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213 See Beck, Minority Shareholders Rights in the 1980's, *Corporate Law in the 1980's*, Law Society of Upper Canada 1982, 311 at p. 331. See also Bruun and Lansky , The Appraisal Remedy for Dissenting Shareholders in Canada: Is is Effective/ (1978) 8 Man. L. J. 683.

214 *Supra*, note 208, 13 B.L.R. at p. 163.

by the company (majority shareholder) for the privilege of ousting the minority.[215]

As an example of how the same situation is approached under a section 234 action, the oppression remedy, there is the decision of Montgomery J. in *Alexander et al. v. Westeel-Rosco Ltd et al.*[216] Jannock Ltd. had made a take-over bid for the shares of Westeel-Rosco. It did not obtain a sufficient number of acceptance to use the compulsory acquisition provisions. Instead, Jannock transferred its shares to a wholly-owned subsidiary and thereafter proposed an amalgamation between itself, Westeel-Rosco, the holding company and two other wholly owned subsidiaries. The minority shareholders of Westeel were to receive non-voting redeemable preference shares, which were to be redeemed by the amalgamated corporation. The plaintiffs were successful in restraining the company from holding a meeting to approve the amalgamation, pending trial. Although this was solely an interlocutory proceeding, Montgomery J. commented on a number of the varied issues which were raised.

It is interesting to note that the proposed amalgamation was considered a possibly *improper* expropriation of the minority's shares.[217] The provisions in the Canada Corporations Act and the CBCA, which allowed compulsory acquisition were examined. Jannock Ltd. had failed in its take-over bid to get the requisite 90 percent which would then allow it to use the compulsory purchase section to acquire the remaining 10 per cent of the shares. The amalgamation was seen by Montgomery J. as an attempt to do indirectly, what it had failed to do directly. The introduction of the holding company made possible a vertical amalgamation and provided a vehicle for a favorable tax ruling for the minority being ousted. However, it also "provided the only manner of doing an end run around section 199 of the CBCA". Montgomery J. continued:

215 *Ibid.*. at p. 223.
216 (1978) 4 B.L.R. 313.
217 *Ibid.* at p. 321.

"If the legislature intended this section to encompass expropriatory powers, they should have said so in clear unambiguous words. In my view the section should not be construed to import such powers".[218]

Furthermore, the conduct of the directors might be found to be in breach of their fiduciary duty to the company in proposing the amalgamation. The proponents of the scheme believed that profitable economies of scale would result from the re-organization, but the court wondered why the minority shareholders should be cut off from these future profits.

The decision in *Westeel-Rosco* echoes to a certain extent the sentiments expressed by Bouck J. in *Neonex International Ltd. v. Kolasa*.[219] Another amalgamation squeeze-out was the cause of the action. Neonex was indirectly controlled by one Pattison, with 46.5 percent of the common shares. At the meeting to vote on the amalgamation, Pattison's interest represented 62.3 percent of the votes cast in favour of the amalgamation. The minority shareholders again received redeemable preference shares. At the outset Bouck J. commented that with the introduction of section 177, authorizing an amalgamation which has the approval of two-thirds of the shareholders, the 90 percent forcing-out method was rendered redundant.

"A majority shareholder need not bother using that process when the same result can be achieved with only a vote of 66 2/3 percent of those present at a meeting. What is more, the instigator of the take-over bid can even count his own shares in arriving at the 66 2/3 percent."[220]

If Pattison had followed the section 199 procedure, the minority shareholder would have had access to "a variety of protective mechanisms" not available on amalgamation. In particular, under section 199, the court has greater freedom in determining fair value

218 *Ibid.* at p. 321.
219 (1978) 3 B.L.R. 1.
220 *Ibid.* at p. 13.

than under section 184, which stipulates that the calculation must be done as of the close of business on the day before the amalgamation resolution was adopted.[221] Under section 199, however, Bouck J. considered it at least arguable that a fair value should reflect any benefit the majority might receive by reason of the take-over.[222] The type of corporate procedure in question was regarded by the court as expropriation. In such circumstances, the law will be particularly concerned with the rights of the dissenters. The court referred to the policy of the common law of protecting the minority from the abuse of an unreasonable majority.

> "If Parliament had intended to deprive the minority of these common law rights, then the law demands the statute say so in the most clear and unequivocal language. Otherwise the common law will biossom through the cracks and crevices of the legislation and try to ensure that justice is done".[223]

The litigation in *Jepson v. The Canadian Salt Company Ltd.*[224] had an unusual feature in that although the action was raised under section 184, the Company had acquired 96 percent of the independently held shares. It could have brought an application under section 199. On the nature of the offer, Laycraft J. had this to say:

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221 C.B.C.A. section 184 (3).

222 But see Prof. Magnet's position in *Shareholders' Appraisal Rights in Canada*, 11 Ottawa L. Rev. 98, at p. 147, where he suggests that a shareholder has less protection in the determination of the fair value of his shares under C.B.C.A. section 199, than under section 184. However, it is submitted that Bouck J. has made the accurate analysis. Under section 184, "fair value" is to be determined as of the close of business on the day before the resolution was adopted. Prof. Magnet asserts that, in the case of an amalgamation (which would give rise to appraisal under section 184), the financial advantages which will accrue as a result of the amalgamation must be calculated in appraising the fair value of dissenting shares. The contrary is the case. See *Canadian Gas and Energy Fund Ltd. et al. v. Sceptre Resources* (1985) 29 B.L.R. 3, where, in adopting the market value approach to the determination of fair value under section 184, the court made an adjustment to market value in recognition of the fact that market prices at that time already reflected the value of the "merged" corporation. "Fair value ... must reflect that value to shareholders of the company in which they had invested *before (emphasis added)* the introduction of a reorganization which changed somewhat the nature of their investment." p. 193. By contrast, there is no such limitation placed on the assessment of fair value under section 199.

223 *Supra*, note 219, at p. 13.

224 (1979) 4 W.W.R. 35, 7 B.L.R. 181.

> "It may be however that the shareholders accepted the offer because they had little or no choice but to accept it. When a $20.00 offer is combined with the promise of an amalgamation resulting in a $20.00 share which it is intended immediately to redeem, only a shareholder willing to involve himself in litigation has any choice. Moreover many minority shareholders will not possess a sufficient degree of business sophistication or will not have available the expert advice needed to meet as an equal, persons able to devise such take-over mechanisms."[225]

Thus the court concurred with Bouck J.'s opinion that the common law would stand as the champion of the minority. The court must be astute to protect the rights of minority shareholders, so far as possible, while still giving effect to the terms of the statute.

The confusion between the relationship of sections 184 and 234 was dealt with in *Les Investissements Mont Soleil Inc. (IMS) v National Drug Inc.*[226], a decision of Quebec Superior Court Justice Hurtubise. The action arose out of an amalgamation squeeze-out. Under the proposed amalgamation agreement, the minority shareholders were to be given non-voting preference shares in the new company, which would then be redeemed for $16 per share. IMS objected to this price and commenced an action under section 184. Its action was successful, the court fixing a fair value of $27.55 per share. What is of interest is that the shareholder requested as a head of compensation an "oppression remedy" of 5 per cent. However, it was noted by the court that while abuse or oppression are referred to in section 234, they are not elements of a claim under section 184. On the other hand, the court would not simply accept as a fair value for section 184, a valuation acceptable to the Ontario Securities Commission for the purposes of that body's disclosure requirements. Nonetheless, the court observed the considerable benefit to the amalgamated company and the fact that the minority shareholders were forced to give up their shares. The court then

225 *Ibid.* at 190.
226 (1982) 22 B.L.R. 139

exercised its discretion in fixing fair value by imposing a premium of 20 per cent on the base value of each share to arrive at a fair value of $27.55 per share.

While the majority of these decisions were delivered in the preliminary stages of litigation under sections 184 and 234, it is clear that the courts are concerned with the use of amalgamation squeeze-outs. Some courts have accepted the legality of the freeze-out, others have castigated the technique as possibly improper, all have commented on the expropriatory nature of this type of amalgamation and compensated the minority by way of the "force-out" premium.

In an amalgamation freeze-out the minority is given no choice between continuing in the restructured enterprise or dissenting and seeking an appraisal. Instead the choice is between accepting the company's "cash out" offer or gambling that the court's determination of fair value will be in excess of that of the company. As has been illustrated, in most cases the minority shareholder is in no position to make a reasoned, informed decision on the fate of his investment in the corporation. Apart from the question of the investment sophistication of the dissenting shareholder, in many cases the decision to dissent must be made within a short time span, otherwise the right to dissent may be lost. The paucity of information made available to shareholders has been the subject of judicial comment. Quite often the minority is dependent for information on the very people in whose interest it lies to offer and pay as low a price as possible for the minority shares.

c. The Relationship between Access to Information and The Burden of Proof

While access to information is crucial for an informed decision on the part of the shareholder, it is equally significant during the conduct of the action. As previously mentioned there has been some consideration of where, if at all, the burden of proof should fall in an appraisal action. Two decisions which reflect differing attitudes are *Neonex*[227] and *Robertson*.[228] Bouck J. considered that a heavy burden rested on Neonex to show it had offered the dissenters a fair value for their shares. The court, in ordering a trial conducted upon an adversary basis with pleadings being exchanged, was influenced by the fact that Pattison was in control and would derive substantial benefits from the amalgamation.

> "It would be naive to think that he detailed all the facts in the information circular which illustrated the highest fair value for the shares. His interests were to offer as little as was reasonably possible. Three dollars may represent the fair value of the shares, but the dissenters should not be compelled to accept Pattison's assurances on blind faith and untested evidence."[229]

Bouck J. ordered that in the action, the company would be in the position of plaintiff and that it would be required to prove that the fair value of each share was in fact $3.00. The dissenting minority would be able to assess the company's evaluation by way of discovery of documents and examination for discovery.

In *Robertson*, on the other hand, Steele J. considered the *Neonex* decision, but took a different approach. He agreed that the Act casts upon the directors an obligation in the first instance to fix a fair value of the shares and show by an accompanying statement how it was determined. Thus it was appropriate for the company to be the plaintiff in the action. However, "where the duty is upon the court to determine what the fair value is", there was no real onus of proof on either party, "because the court must come to a conclusion itself".[230] The company had the duty of supplying all necessary information to assist the court.

The question of the burden of proof was formerly a considerable obstacle for shareholders dissenting from a take-over bid where the

227 *Supra* , note 219.
228 *Robertson v Canadian Canners Ltd.* (1978) 4 B.L.R. 290.
229 *Supra*, note 219 at p.13.
230 *Supra*, note 228 at p. 292.

company, under section 199 is entitled to acquire their shares at a fair value. Under the predecessor sections authorizing compulsory purchase of shares,[231] the dissenting shareholder had the heavy burden of establishing the "unfairness" of the take-over price. There was a presumption that the offer was *prima facie* fair, since it had been accepted by at least ninety percent of the target shares. The complaining shareholder had to affirmatively establish that, notwithstanding the views of a very large majority of shareholders, the scheme was unfair.[232] In practice, this was an insurmountable hurdle. In the first decision under section 199,[233] McEachern C.J., was of the opinion that the line of cases which placed the onus on the dissentients, should continue to apply to actions under section 199. Nevertheless, in assessing the weight to be given the majority opinion to accept the offer, the information upon which the decision was reached could be considered by the court. This was, in effect, interjecting a preliminary assessment by the court, the result of which *might* place the burden of proof squarely on the dissentients. In the event, the court concluded that the offer was *prima facie* fair as of the offering date, and that the onus was on the dissentients to adduce evidence of its unfairness.

However, the Chief Justice reversed his position on the onus of proof in *Cyprus Anvil Mining Corporation.*[234] Noting that "the matter does not appear to me now as it appears to have appeared to me then",[235] the court conceded that the new language of section 199 demanded a different construction:

> "Under that statute the court must fix a fair value for the shares. Whether this will be done by reference to market price or asset value or on a discounted cash flow is a matter for determination in accordance with the

231 E.g. Canada Corporations Act R.S.C. 1953 C. 53, Section 128, R.S.C. 1970 c.C-32, Section 136.

232 *Re Hoare and Co. Ltd.* (1933) 150 L.T. 374.

233 *Re Whitehorse Copper Mines Ltd.* (1980) 10 B.L.R. 13.

234 (1982) 20 B.L.R. 21.

235 Adopting the phrase of Bramwell B. in *Andrews v Styrap* (1872) 26 L.T. 704 at p. 706.

> circumstances in each case, but I am driven by the language of section 199 to conclude that the shareholders are entitled to judgment for the fair value without regard to the question of whether the offered price is shown to be fair or unfair in relation to the determined fair value...I do not think that the language of section 199 permits the court to impose an onus of establishing unfairness upon the dissenting shareholders".[236]

The Chief Justice then went on to adopt the view of Steele J. in *Robertson*, that there is no real onus of proof on either party since the court must come to a conclusion itself.

Put another way, it could be said that there was an onus on each party, to adduce evidence to establish by a balance of probabilities, the correctness of the contentions upon which each relied.[237]

Greenberg J. in *Domglas* noted that a petition pursuant to section 184 is not the usual adversary proceeding. He was of the opinion that the comments of both Bouck J. and Steele J. were obiter dicta since it would be the judge making the decision on the merits, who would be called upon to determine which party, if any, had the burden of proof. The approach of Steele J., however, was thought to be more consistent with the intent of the procedure outlined in section 184. In the circumstances of the *Domglas* petition, Greenberg J. said that if he were to impose the burden of proof on the corporation, solely because it was the petitioner, then,

> "all that a corporation in that position need do is to refrain from applying under subsection 15 thereof. This would impose upon the dissenting shareholders the obligation to apply pursuant to subsection 16 thereof, thus shifting the burden of proof to them."[238]

d. Is Appraisal the Exclusive Remedy of the Shareholder?

236 *Supra*, note 234 at p. 42.
237 *Ibid.*.
238 *Supra*, note 208, 13 B.L.R. at p. 154.

A further problem which the existence of the appraisal right gives rise to is that of the exclusiveness of the remedy. There has been some confusion in the United States over the effect of the existence of appraisal upon other courses of action open to a dissenting shareholder, such as seeking to enjoin the transaction or suing for damages. In some American jurisdictions the statute specifically states that appraisal is the exclusive right of the shareholder if the prescribed "triggering transactions" are implemented. In others the statute is silent.[239] In section 184, the appraisal right is stated to be "in addition to any other right" which the shareholder may have.[240] Thus, depending on the circumstances, a shareholder has a choice between bringing an action under section 184 or section 234. He may wish to sue the directors for breach of fiduciary duty to the company. However, once the choice has been made to proceed under section 184, then it is arguable that the decision is irrevocable on the part of the shareholder. Although subsection 184(3) provides that appraisal is "in addition to any other right" which a shareholder may have, subsection 184(11) provides that upon sending a demand for payment to the corporation, the dissenting shareholder ceases to have any rights as a shareholder, other than the right to be paid the fair value of his shares.[241] In *McConnell v. Newco Financial Corporation*,[242] minority shareholders brought a petition under section 234 challenging the passing of an extraordinary resolution consolidating the company's shares on a basis of 1,000 to one. The petition was challenged by the company because, long before the section 234 action was commenced, the minority had sent notice under section 184 requiring the company to purchase their shares at a fair value. The company argued that the shareholders had ceased to

239 E.g. CAL. CORP. CODE, section 1312 (West 1988), (exclusive remedy); N.Y. BUS. CORP LAW, section 623(e) and (k) (Consol.1977). The Delaware Corporate Code is silent on whether appraisal is the shareholder's sole remedy.
240 C.B.C.A. Section 184 (3).
241 Under C.B.C.A. section 184 (11), the shareholder may revoke his demand before the corporation makes an offer, or where the corporation fails to make an offer. If the directors revoke the resolution, the rights of the shareholder are reinstated as of the date of the notice of the demand for payment.
242 (1979) 8 B.L.R. 180.

have any rights other than the right to receive a fair value for their shares. The shareholders were allowed to continue with the section 234 action on a technicality. The notices sent under section 184 were held invalid, and did not therefore bar the availability of the oppression remedy. Appraisal rights are available by way of section 170 and section 184 upon the consolidation of shares, but only where section 170 comes into play in authorizing a separate class vote on the measure. Esson J. held that where there was only one class of shares, section 170 did not apply and thus there could be no recourse to appraisal under section 184. The court noted that all shareholders had the right to vote under the provisions of the articles.

> "The purpose of [section 170] is to give a right to vote in an appropriate manner where the articles either give no right at all or give one which, because of the subject-matter of the amendment, would not protect holders of shares of a particular class or series."[243]

While this decision thus avoided the question of the apparent conflict between subsections 184(3) and (11), the matter was dealt with in *Re Brant Investments Ltd. and Keeprite Inc.*,[244] a decision of Justice Callaghan. A meeting was called to vote upon Keeprite's proposal to purchase substantially all of the assets and business of I.C.G. Manufacturing Ltd., who coincidentally was the owner of 65 percent of the outstanding shares of Keeprite. Brant Investments, owner of a mere 28 percent of Keeprite's shares, voted against the resolution and then exercised its right to dissent under section 184. Keeprite made an offer to Brant of $9 per share. Brant refused, on the basis of valuations which it had indicating a fair value of $20-$22 per share. Keeprite then decided to issue a rights offering. Common shareholders would have the right to purchase three additional common shares at $8 per share for each share held. At this stage Brant brought a motion for interim and permanent relief under section 234, alleging that the proposed acquisition of I.C.G.

243 *Ibid.* at p. 185.
244 44 O.R.(2d) 661

was for an amount in excess of fair market value and without full disclosure. Furthermore, the proposed acquisition would adversely affect the value of the minority's investment. Brant wished to have Keeprite enjoined from proceeding with the rights offering, which of course would severely dilute Brant's interest. Keeprite urged subsection 184(11) upon the court. While acknowledging the force of that subsection, the court stressed that subsection 184(11) must be interpreted in the light of the object and purpose of all the provisions of section 184. The appraisal remedy was a contingent remedy, since the corporation would only be permitted to pay the dissenters if it met the liquidity and solvency requirements of the section. If it could not meet those requirements the dissenting shareholders had the right to withdraw their dissent and retain their full rights as shareholders. Furthermore, subsection 184(3) clearly states that appraisal is in addition to any other right the shareholder may have. A remedy with such characteristics, it was reasoned, was not intended to preclude the broad rights referred to in section 234. A distinction was drawn between the usual rights of a shareholder such as the right to vote or receive dividends and the status to challenge oppressive actions under section 234. The court saw nothing inconsistent in allowing a shareholder to exercise his appraisal right and at the same time permitting him to proceed as a complainant under section 234. The court emphasized the very short period of time within which the shareholder was required to send in his demand for payment of fair value. He could not reasonably be expected to make an intelligent choice between the section 184 and section 234 remedies in such a short time. This was particularly so if the shareholder was neither a director nor officer of the company. Such an interpretation was reinforced by reference to section 231 which defines a claimant for the purposes of section 234 as including a registered holder, director, or officer and a former registered holder, director or officer. This decision would appear to allow a shareholder to resort to both remedies where appropriate.

Of particular interest is the court's insistence upon a broad and liberal interpretation of sections 184 and 234 from the minority's perspective.[245] While section 184 is ultimately directed to the resolution of a valuation dispute, section 234 provides the means for the courts to test qualifying transactions for substantive fairness. The latter section may prove the vehicle for a successful challenge by a minority shareholder to an amalgamation squeeze-out. As previously mentioned, the courts have been divided on whether or not this type of amalgamation is permissible. The purported authorization for such a transaction is found in paragraph 176(1)(d). The amalgamation agreement is required by the legislation to set out certain things, among which is

> "...if any shares of an amalgamating corporation are not to be converted into securities of the amalgamated corporation, the amount of money or securities of any body corporate that the holders of such shares are to receive in addition to or instead of securities of the amalgamated corporation."[246]

While this language is broad enough to encompass a squeeze-out, the fact that the subject is not dealt with in more explicit language opens the legitimacy of the transaction to question, especially since there does exist a section which deals with compulsory expropriation in a carefully prescribed manner. It is anomalous that shareholders of a mere 10 percent of the independently held shares in a take-over bid have greater protection than the one-third of the total number of shareholders who might vote against an amalgamation resolution.[247]

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[245] *In Re Bradley Resources Corp. and Kelvin Energy Ltd.* 18 D.L.R. (4th) 468, the Alberta Court of Appeal commented that the new right given shareholders by section 184 creates a special category for interlocutory relief, not unlike those where the assertion is of an acknowledged property right. Kelvin Energy had sold all of its assets. Bradley had objected and applied for an order fixing the value of its shares under section 184. The court enjoined Kelvin from dealing with the proceeds of the sale without prior approval from the court and from creating new debts pending the valuation and payment for Bradley shares.

> "It would be unthinkable if this new right could be effectively destroyed or put at substantial risk during the period before final judgment and payment precisely because the company proceeds down the new road." at p. 472.

[246] C.B.C.A section 176(1)(d)

[247] An examination of the following cases lends force to this argument: *Esso Standard (Inter America) Inc. v J and W Enterprises et al. and M.A. Morrisroe* 1963 S.C.R. 144;

B. Delaware

a. Judicial Approach to the Nature of the Remedy

When examining the Delaware cases for the limits and ramifications of the appraisal remedy, the philosophy of the statutory merger provisions must be borne in mind, for it is with reference to this attitude that the court's evaluation of the circumstances surrounding the merger will be carried out:

> "...under the law of merger each minority stockholder...has had at least constructive notice that he may be lawfully eliminated as such a stockholder unless the plan of corporate reorganization designed to absorb his stock interest is so grossly unfair as to be invalid."[248]

The courts will not impede the consummation of an orderly merger which complies with the statute. Appraisal is seen as "an efficient and fair method... which permits a judicially protected withdrawal from a merger by a disgruntled shareholder".[249]

The Delaware statute is silent on whether appraisal is the minority's exclusive remedy. As a general rule, the courts have long held that the stockholders are put to an election by the statute between acquiescing in the merger or demanding an appraisal of their stock.[250] However, there are circumstances where the court will say "that the duty to make an election does not arise".[251] If the merger is not authorized by law, or is induced by fraud, the shareholder is not required to make his election and may attempt to

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Triad Oil Holdings Ltd. et al. v Provincial Secretary for Manitoba (1967) 59 W.W.R. 1; *Stevens v Home Oil Co. Ltd.* 123 D.L.R.(3d) 297. Consideration should also be given to legislating the "majority of the minority" test as some protection for the minority in a squeeze-out.

248 *David J. Greene & Co. v Schenley Industries*, (Del. Ch. 1971) 281 A.2d 30 at p. 35.

249 *Ibid.* at p. 36.

250 Folk, The Delaware General Corporation Law, p. 395.

251 *Cole v National Cash Credit Ass'n.* 156 A. 183 at p. 187.

enjoin the merger. "The exercise of the statutory right of merger is always subject to nullification for fraud".[252]

b. The "Business Judgment" Rule

While the courts are prepared to examine the circumstances of a merger, there is a presumption that the judgment of the governing body of a corporation, whether it be the board of directors or a majority stockholder "is formed in good faith and inspired by a *bona fides* of purpose". Directors are allowed a great deal of leeway in the exercise of their discretion. Their actions may be ill-advised or unprofitable, but they will not be called into question by the court. This "business judgment" rule, as it is called, is normally applicable to stockholder challenges to the fairness of merger terms.[253] It places a heavy burden on the plaintiff to establish a lack of business purpose which could amount to actual or constructive fraud. Furthermore, it has been long established that mere inadequacy of the price offered to the minority will not reveal fraud.[254] If a complainant's case is based on the alleged unfairness of the terms of the merger as between the majority and minority, "the unfairness must be of such a character and must be so clearly demonstrated as to impel the conclusion that it emanates from acts of bad faith, or a reckless indifference to the rights of others interested rather than from an honest error of judgment".[255] Thus in *Porges v. Vadsco Sales Corporation*, an attempt was made to enjoin the merger of Vadsco with its wholly owned subsidiary. The dissenter, who held preferred stock in the defendant objected to terms which provided for the conversion of the preferred stock into preferred and common stock of the surviving corporation while the common stock of the defendant was also converted, though on a lesser ratio, into common stock of the surviving corporation. The plaintiff maintained that the

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252 *Ibid.*

253 See Nathan and Shapiro, *Legal Standard of Fairness of Merger Terms Under Delaware Law*, 2 Del. J. Corp. L. 44 (1977) at p. 45.

254 *Allied Chemical & Dye Corp. V Steel & Tube Co.* 14 Del. Ch. 1, 120 A. 486.

255 *Porges v Vadsco Sales Corp.* 32 A.2d 148 at p. 151.

common stock had no book value whatsoever. The balance sheet showed that the net worth of the company was exceeded by the fixed liquidation value plus accumulated dividends of the preferred shares. However, the court pointed out that the company was not in liquidation and that there was no semblance of a right in the preferred stockholders to require that it be liquidated. In arriving at a judgment of the fairness of the merger, the court would consider all of its terms. The court noted that after the merger, voting control would pass from the old common stockholders, to the old preferred stockholders, who would receive preferred and common stock in the new company. Furthermore, the merger had the approval of the defendant's directors, a two thirds majority of all its capital stock, and a majority of the preferred stock.

> "The evaluation of the benefits and detriments of a plan of this character, by the persons whose rights and interests will be affected and who hold a majority of the stock, is properly entitled to great weight."[256]

c. "Intrinsic Fairness" Doctrine

The court's reluctance to interfere with the decisions of the directors and the "required statutory majorities" stems from the notion that the fairness of the merger terms to the stockholders of a constituent corporation is a matter of prime concern to the directors of that corporation. Presumably the terms have been reached in the normal arms-length negotiation which is most likely to produce a fair price.[257] However, these conditions will not prevail where one of the constituent corporations controls or dominates the other. Accordingly, Delaware corporate law has evolved the "intrinsic fairness" doctrine which, in the situation where one corporation controls the other and there is some element of self-dealing, will override the "business judgment" rule. Judicial scrutiny is considered appropriate because of the probability of conflict of interest and breach of fiduciary duties owed by the directors of the

256 *Ibid.*
257 *Supra* note 248, at p. 44.

subsidiary, who are usually appointed by the parent, controlling corporation. In these circumstances the court examines the terms of the merger to assess their "intrinsic fairness".[258]

In *Sterling v. Mayflower Hotel Corp.*[259] the minority shareholders of Mayflower attempted to enjoin the consummation of a merger with Hilton Hotels Corporation. The principal issue before the Delaware Supreme Court was the fairness of the terms of the proposed merger to the minority stockholders of Mayflower. Hilton acquired a majority interest in Mayflower in 1946. It continued to purchase stock until 1952 at which time it owned approximately 83 percent of Mayflower's outstanding stock. All of the Mayflower directors were nominees of Hilton. The agreement provided for each share of Mayflower to be converted into one share of Hilton. Hilton would, after the consummation of the merger, pay, for a limited period, $19.10 a share for any Mayflower stock tendered to it by any minority stockholder. The plaintiffs were unsuccessful. There was no fraud or unfairness. The court compared the stock of both corporations on a number of bases - average earnings per share, dividends, book value and market value per share. It was noted that all of the comparisons rated the Hilton stock higher than Mayflower on all counts save market value. At the time the merger was proposed, Mayflower was selling at approximately $16.25. However, it was admitted by the plaintiffs that the current market value was fictitious - "higher than would be justified in a free and normal market uninfluenced by Hilton's desire to acquire it and its policy of continued buying". The plaintiffs argued for a liquidating value of $27.00 on the basis that in substance, the transaction was a sale of assets, not a merger. This proposition received short shrift, since to take it to its logical conclusion,

> "it would follow that upon every merger of a subsidiary into its parent corporation that involves a conversion of the subsidiary's shares into shares of the parent, the

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258 *Ibid.*, at p. 45.
259 92 A.2d 107.

> *market* value of the parent stock issued to stockholders of the subsidiary must equal the *liquidating* value of the subsidiary's stock...to apply the proposition would be to bestow upon the stockholder of the subsidiary something which he did not have before the merger and could not obtain - the liquidating value of his stock."[260]

The court noted that a merger contemplates the continuance of the enterprise, albeit in a different form, while a sale of all assets ordinarily involves the liquidation of the enterprise. Here there was no liquidation: Mayflower was being integrated with the Hilton enterprise. Although the plaintiffs were unsuccessful, they had the advantage of the rule that as majority stockholder, Hilton occupied a fiduciary position in dealing with Mayflower property.

With respect to Hilton's nominee directors on Mayflower's board, the court said:

> "Since they stand on both sides of the transaction, they bear the burden of establishing its entire fairness, and it must pass the test of careful scrutiny by the courts."[261]

In the event, the court found that the facts sustained the merger's conversion ratio.

The concept of fairness to the minority was further expounded in *David J. Greene and Co. v. Dunhill International Inc.*[262] This is a rare occasion in recent years[263] where the minority public shareholders were successful in obtaining a preliminary injunction against a proposed merger. Dunhill owned 80 percent of Spalding's stock. At the meeting, a majority of the minority interest (53 percent) approved the merger. The plaintiffs alleged that since the majority of Spalding's directors were appointed by Dunhill, through them, Dunhill controlled Spalding. A breach of fiduciary duty was alleged

260 *Ibid.*, at p. 111.
261 *Ibid.*, at p. 110.
262 249 A.2d 427.
263 See Folk, The Delaware General Corporation Law, p. 396. This is prior to *Singer v Magnavox*, below.

by the minority. Chancellor Duffy found that a business opportunity in the line of Spalding's business was acquired by Dunhill, the controlling stockholder. As for the merger terms, there was uncertainty regarding the appropriate multiplier. Substantial dilution in the earnings and book value of Spalding would occur from the proposed ratio for exchange.

The Chancellor noted that when a Delaware court is called upon to determine whether a proposed merger between a parent and a subsidiary corporation which it controls, should be enjoined, "fairness is the established criterion for judgment". The normal deference to sound business judgment is no longer the case when persons either stockholders or directors, who control the transaction and fix its terms, are on both sides. In such a situation, "intrinsic fairness, tested by all relevant standards, is then the criterion".[264] Because Dunhill stood on both sides of the proposed merger, the court ruled that it had the burden of proof to show that the transaction was fair after a careful scrutiny by the court.[265] Furthermore, the fact that the merger had been approved by a majority of the "disinterested" minority could not shift the burden of proof from Dunhill to the complainants. The Chancellor found that Dunhill had not met its burden of proof. This was not a finding that the merger was unfair. However, the plaintiffs had established their right to go to trial, and preliminary injunction was granted.

The granting of a preliminary injunction in Dunhill was a singular decision. The presence of a "pirated" corporate opportunity together with the outright dilution of the Spalding holdings by a deal engineered by Spalding's majority stockholder indicates that the actions complained of must be flagrant indeed to support an injunction. *David J. Green & Co. v. Schenley Industries Inc.*[266] confirmed the traditional approach that where there is no fraud or blatant overreaching in a parent-subsidiary merger, the dissatisfied

264 *Supra*, note 262 at p. 431.
265 *Ibid.*
266 *Supra*, note 248.

minority should not be permitted to enjoin the merger. Their recourse would be to an appraisal action. The proposed plan called for the merger of Schenley with a subsidiary of Glen Alden. Glen Alden controlled approximately 84 percent of the voting power in Schenley. The minority shareholders claimed that the merger was so grossly unfair that it should be enjoined as an attempt by self-dealing officers and directors to improperly eliminate the equity of the minority, to the advantage of Glen Alden. It was conceded by Glen Alden that its control of the affairs of Schenley was such as to call into play "the rule applicable to all instances of corporate self-dealing, namely that when officers and directors stand on both sides of a transaction complained of, they bear the burden of establishing its entire fairness".[267] The court noted that cash and a debenture of Glen Alden, rather than its common stock were being tendered for each share of Schenley proposed to be eliminated by the merger.

> "Thus the matter to be decided is the fair value of the offer being made to the plaintiffs and other minority stockholders of Schenley and whether or not this amount approximates the fair value of the shares of Schenley which the plan proposes to eliminate."[268]

Vice-Chancellor Marvel examined the past history of Schenley, noting the problems it had encountered due to loss of a profitable franchise. After examining all relevant data and reports, the court concluded that the market value of Schenley stock, "a public judgment as to the value of Schenley" closely approximated the price offered by Glen Alden.

> "Thus, unless the fair value of Schenley stock is so much greater than the total amount offered, or that the plaintiffs and other minority stockholders are being otherwise deprived of clear rights, or otherwise so taken advantage of by those charged with a fiduciary duty towards them as to constitute a form of constructive fraud, or the like, then it would appear that the parties

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267 *Ibid.*, at p. 32.
268 *Ibid.*, at p. 33.

are merely in dispute as to value for which an appraisal should be adequate."[269]

In view of Glen Alden's 84 percent holding, the rights of the minority in a section 251 merger were no greater than those in a section 253 short-form merger.[270]

d. The "Business Purpose" Rule

Although the onus had been placed on the corporate defendant/majority shareholder, to establish the fairness of the merger, it seemed that there was rarely any problem in satisfying the court. This changed abruptly with the landmark ruling of the Supreme Court in *Singer v. Magnavox*.[271] A tender offer was made which resulted in North American Development Corporation acquiring 84 percent of Magnavox's outstanding common stock. Thereafter a merger was proposed between Magnavox and T.M.C. Development Corp, a wholly owned subsidiary of North American Development Corp. The plaintiffs alleged that the merger was fraudulent because it served no business purpose other than the forced removal of the public minority shareholders of Magnavox, at a grossly inadequate price. Initially, the Court of Chancery ruled there was no fraud and that in any event, the plaintiff's remedy was to seek an appraisal. It was uncontroverted that the defendants had complied with the statutory requirements. However, on appeal, the Supreme Court ruled that this did not make the merger legally unassailable, particularly since the plaintiffs had invoked the fiduciary duty rule. The court analyzed "the encounter between the exercise of a statutory right and the performance of the alleged fiduciary duty". The court's decision was based not on fraud, but on the application of the law governing corporate fiduciaries. The defendants acknowledged their fiduciary duty but maintained that it had been met by offering the minority

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269 *Ibid.*

270 Vice-Chancellor Marvel commented at p. 35 "The opponents of the merger here in issue fail, in my opinion, to give proper consideration to the basic reality of Glen Alden's control of Schenley."

271 (Del. Supr.) 380 A.2d 969.

fair value for their shares. Further, the defendants maintained that the minority's exclusive remedy for dissatisfaction with the merger was to seek an appraisal under section 262.

The court noted that the crux of the defendants argument was that a shareholder's right lies exclusively in the *value* of his investment, not in its *form*.[272] The court did not agree. Because the power to merge is conferred by statute, every stockholder accepts his shares with notice thereof. Gone is the common law right of a single stockholder to simply veto a merger. However, it did not follow that those in control of a corporation could "invoke the power of merger" to get rid of a minority.

> "On the contrary...just as a minority shareholder may not thwart a merger without cause, neither may a majority cause a merger to be made for the sole purpose of eliminating a minority on a cash-out basis."[273]

The court concluded that in dealing with a freeze-out of minority shareholders as the alleged sole purpose of the merger, it is duty bound to closely examine the charge that the fiduciary obligation owed to the minority has been breached, even when all of the statutory formalities have been satisfied. Those in control of a corporation owe a fiduciary duty to the minority in the exercise of that control over corporate powers and property. The use of such power to perpetuate control is a violation of that duty.[274] A merger made for the sole purpose of freezing out minority stockholders was termed an abuse of the corporate process. It gave rise to cause of action for violation of fiduciary duty, for which the court would grant such relief as it deemed appropriate. Furthermore, even if the

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272 The Delaware court cited a California decision, *Jutkowitz v Bourns*, wherein the court summarized some of the values besides money which may be at stake in a "going-private" merger: "Money may well satisfy some or most minority shareholders, but others may have differing investment goals, tax problems, a belief in the ability of... management to make them rich, or even a sentimental attachment to the stock which leads them to have a differing judgment as to the desirability of selling out". The decision in *Jutkowitz* was subsequently withdrawn from the law reports.

273 *Supra*, note 271 at p. 978.

274 *Ibid.*, at p. 980.

freeze-out was not the *sole* purpose of the merger, minority shareholders would not be denied relief.

> "On the contrary, the fiduciary obligation of the majority to the minority remains and proof of a purpose other than a freeze-out, without more will not necessarily discharge it. In such case the court will scrutinize the circumstances for compliance with the *Sterling* rule of "entire fairness" and, if it finds a violation thereof, will grant such relief as equity may require."[275]

Thus was born the "business purpose" rule which has given such trouble to both academics and corporate legal advisors. The *Singer* case did not answer the question of *whose* business purpose was relevant. The plaintiffs maintained a "business purpose" was proper only when it served the interests of the subsidiary corporation. The defendants of course maintained that only a business purpose of the parent corporation was relevant. Perhaps feeling that enough had been accomplished the court left that question to another day.

Shortly thereafter, in *Tanzer v. International General Industries*,[276] it was held that a business purpose of the parent corporation would suffice. However, the minority was still entitled to a judicial review for "entire fairness" as to all aspects of the merger. The fiduciary duty still existed despite a *bona fide* purpose for eliminating the minority. In such a case, the duty of the majority was to treat the minority fairly.

A further refinement was added by *Roland International Corporation v. Najjar*[277] which involved a merger under section 253, the short-form merger. The defendants argued that section 253 presumed a proper purpose and thus the courts were precluded from any further inquiry. The Supreme Court, Duffy J. for the majority, pointed out that this argument missed the entire thrust of *Singer*. The law of fiduciary duty, on which *Singer* was based arose not from the

275 *Ibid.*

276 (Del. Supr.) 379 A.2d 1121.

277 (Del. Supr.) 407 A.2d 1032 (1977).

operation of section 251, but independent of it. "*Singer* presupposes full compliance with section 251 and its impact begins at that point".[278] The differences in terminology and procedure between section 251 and section 253 did not alter the duty which existed apart from the procedures permitted by statute. The court saw nothing magical about a 90 percent ownership of outstanding shares.

> "The short-cut to merger afforded by section 253 may not be used to short-circuit the law of fiduciary duty."[279]

Quillen J. lodged a dissent. He was concerned that the court was fleshing out broad equitable principles into rules and formats. He did not minimize the fiduciary problem:

> "But to say there is a fiduciary duty 'only begins analysis' and 'gives direction to further inquiry'. It should not be the trigger to a series of mechanics more akin to legislative detail and administrative regulation than equitable review."[280]

Here, the plaintiff filed the action over five months after the expiry of the twenty days given by the statute to demand an appraisal. Yet he did not seek to continue his equitable participation in Roland Corp. He wanted to be cashed out. "The whole thrust of the complaint is directed to an alleged gross and fraudulently inadequate price." In short the only issue raised was one of value and there was nothing in the pleadings to show why statutory appraisal would be inadequate.

e. Retreat from the "Business Purpose" Rule

The latest opinion on the thorny problem of cash-out mergers has retrenched considerably from the *Singer* decision. In fact, *Weinberger v. U.O.P. Inc.*[281] specifically overrules the business purpose requirement, labelling it a departure from prior case law, which did not have the virtue of any compensatory protection to

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278 *Ibid.*, at p. 1036.
279 *Ibid.*
280 *Ibid.* , at p. 1039.
281 (Del. Supr.) 457 A.2d 701 (1983).

minority shareholders. The rights of the minority were adequately protected by the fairness test which had long been applied to parent-subsidiary mergers, and the expanded appraisal remedy which the court proceeded to enunciate. In a cash-out merger, the shareholder's remedy is solely an appraisal under section 262. However the court adopted a less rigid and stylized approach to the valuation process. The concept of fairness had two basic aspects: fair dealing and fair price. The merger met neither standard. Again, directors on the board of U.O.P. were nominated by the parent corporation, Signal. Of the six directors (on a board of thirteen) selected by Signal, five were either directors or employees of Signal. A feasibility study had been prepared by two of U.O.P.'s directors who were also on the board of Signal. This study showed that a price in excess of that ultimately offered by Signal would be a good investment for Signal. This report was not shown to U.O.P.'s outside directors. There was no attempt to structure the transaction on an arm's length basis. Accordingly the court noted that Signal could not escape the effects of such conflicts of interest, especially where its nominees voted in favour of the transaction. Individuals who are directors of two corporations owe the same duty of good management to both. In the absence of independent negotiation, or a total abstention from voting, the duty must be exercised in the light of what is best for *both* companies. The court could not conclude that U.O.P.'s nominee directors had so acted.

On the burden of proof, the court held that, as required by the fairness test, the ultimate burden rests on the majority shareholder to establish by a preponderance of evidence that the transaction is fair. However, it is first the task of the plaintiff attacking the merger to demonstrate some basis for invoking the fairness obligation. If the merger has been approved by an *informed* vote of a majority of the minority shareholders, then the burden shifts entirely to the plaintiff to show that the transaction was unfair to the minority. This, too, is qualified by the stipulation of an "informed" vote, for "the burden clearly remains on those relying on the vote to show that they completely disclosed all material facts relevant to the transaction".[282]

Another qualification was indicated in the nature of the remedy. Ordinarily, a plaintiff's monetary remedy will be confined to "the more liberalized appraisal", but this in no way limits the Chancellor's historic powers to grant such other relief as the case may require. In particular, appraisal may not be appropriate where there are elements of fraud, misrepresentation, self-dealing, deliberate waste of corporate assets or gross and palpable overreaching.[283] This preserves the court's traditional equitable powers in such situations. The *Weinberger* decision draws upon the fairness doctrine enunciated in the *Sterling* case. Its influence can be seen in two recent cases.

In *Joseph v. Shell Oil Company*,[284] the importance of the fiduciary duty owed by the majority to the minority shareholders, where the majority stood on both sides of the transaction, was emphasized. The court granted a preliminary injunction preventing the completion of the tender offer because the majority shareholder had withheld relevant information on the value and extent of Shell's "probable" reserves from the investment bankers who were giving a fairness opinion on the amount of the tender offer. The court found that the minority had met the burden of showing a reasonable probability that the majority had not met its obligation of offering a fair price and giving full disclosure. If the minority shareholders were permitted to tender their shares without the majority making full disclosure, the minority would be forever denied the right to be treated fairly. This would constitute irreparable harm.

However, an action to enjoin a proposed merger was unsuccessful where the gravamen of all the complaints appeared to be that the cash-out price was unfair. In addition, appraisal was an appropriate

282 *Ibid.*, at p. 703.
283 *Ibid.*, at p. 714.
284 482 A.2d 335 (Del. Ch. 1984)

remedy for the allegations of unfair dealing. (The majority shareholder had waited until the end of a one year commitment as to the share price before proposing the merger, at a reduced price). Significantly, there were no allegations of non-disclosure or misrepresentation in connection with the transaction. The court reasoned that, since presumably the minority were fully informed, if they decided the offered price was less than fair value, they would be free to pursue their appraisal remedy. Moreover, because of the expanded appraisal proceedings described in *Weinberger*, damages for the alleged unfair dealing could be included in the appraisal award, if the plaintiffs were able to establish that they were damaged by unfair dealing.[285]

C. New York

The present New York statute provides that the enforcement by a shareholder of his right to receive fair value for his shares shall exclude the enforcement of any other right which he may have, resulting from his share ownership. However, the section expressly exempts from such limitation the right to bring an action on the grounds that the proposed corporate transaction is unlawful or fraudulent with respect to the shareholder bringing the action.[286]

a. Judicial Approach to the Nature of the Remedy

The Supreme Court Appellate Division reiterated in *Beard v. Ames*,[287] that section 623 is intended only to proscribe a shareholder's right to an action at law. It does not affect a shareholder's remedies in an action in equity. The statute was never intended to limit a shareholder's right of discovery. The plaintiff had commenced an action to rescind a merger on the basis that it was illegal, fraudulent and a violation of the defendant corporate management's fiduciary duty. Management had refused to disclose

285 *Rabkin v Phillip A. Hunt Chemical Corporation* 480 A.2d 655 (Del. Ch. 1984)
286 N.Y. BUS. CORP. LAW, section 623(k) (Consol. 1977).
287 468 N.Y.S.2d 253 (A.D. 4 Dept. 1983)

certain communications between the corporation and its attorneys concerning the merger. The lower court had found the communications to be privileged. This ruling was reversed on the ground that the lower court failed to balance the competing interests before ruling that the material sought was privileged.

Under the former Stock Corporation Law it was well settled that "the Legislature has the right at any time it sees fit to alter, suspend and repeal the charters of corporations".[288] The Legislature may make appropriate provisions for statutory mergers and if these provisions are duly complied with, the remedy of dissent and appraisal is the only one available. On appraisal, the shareholder is entitled to receive fair and full compensation.

In *Beloff v. Consolidated Edison Co. of New York*[289] the merger of a subsidiary with the parent corporation was challenged. The merger was effected under a provision which authorized such a merger if the parent corporation owned 95 percent or more of the stock of the merged corporation. The proper procedure was followed. No meeting of the subsidiary was necessary and statutory notice of the merger was sent to shareholders of the subsidiary after the event. In such a situation the court noted that a shareholder of the merged corporation has only one real right: to have the *value* of his holding protected, and that protection is given by the right to an appraisal. Such a shareholder "has no right to stay in the picture, to go along into the merger, or to share in its future benefits".[290]

> "He has no constitutional right to deliberate, consult or vote on the merger, to have prior notice thereof or prior opportunity to object thereto. His disabilities in those respects are the result of his status as a member of a minority, and any cure therefor is to be prescribed by the Legislature if it sees fit."[291]

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288 *beloff v Consolidated Edison Co. of New York*, 300 N.Y. 11, 87 N.E. 2d 561.
289 *Ibid.*
290 *Ibid.*, at p. 564.
291 *Ibid.*, at p. 565.

The plaintiffs had argued that an appraisal would not have brought them a fair return on their shares, since an appraiser would not have included as an element of value their proportionate interest in the subsidiary corporation's choses in action. The court declined to enumerate all of the items that appraisers should consider and remarked that,

> "when the Legislature has provided for such an appraisal and for appropriate judicial control and review thereof, plaintiffs may not refuse such an appraisal and upset the merger itself, merely on the assertion that the appraisal, if had, would not have done them justice."[292]

As an example of the type of situation where a shareholder will not be restricted to an appraisal, there is the sale of Arabol Manufacturing Co.'s assets to Borden Co. in return for Borden common stock.[293] Arabol had common and preferred stock outstanding. After the sale of all of its assets, Arabol proceeded to buy back its preferred stock, offering three shares of Borden for each Arabol preferred. Thereafter, it intended to distribute the remaining Borden shares to the owners of Arabol common stock, at 10 shares of Borden for one Arabol common. A holder of Arabol preferred shares who had not opposed the sale of assets, challenged this distribution on the basis that both common and preferred shareholders should participate equally. The court held that the distribution was improper, since there was nothing in the stock certificates or the charter authorizing such a differentiation. The difference on distribution was not a dividend, since the corporation had stated it would not declare a dividend. Thus, the preferred and common stock should participate equally in the assets upon liquidation. The plaintiff was not restricted to the options of acquiescing to the plan or seeking an appraisal. He could contest the planned distribution in equity.[294]

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292 *Ibid.*

293 *Newman v Arabol Mfg. Co.*, 245 N.Y.S. 2d 442.

294 *Ibid.*, at p. 444.

Breed v. Barton[295] outlines the limitations imposed on the shareholder by section 623. Mere allegations of fraud will not necessarily remove the shareholder from the ambit of the section. Here the merger was consummated in 1971. The minority shareholders filed their notice of election to dissent and brought appraisal proceedings. In 1977, the same shareholders commenced the present action as individuals and derivatively on behalf of the old company, alleging that they were damaged by the inadequate price offered for their stock by the controlling shareholder. It was also alleged that the directors of the former company knew or ought to have known of the failure to state material facts and untrue statements in the merger agreement. However the action was dismissed as failing to state a cause of action. The shareholders were excluded "from any other right to which they might be entitled by virtue of share ownership". Section 623(e) provided that upon filing of the notice of election to dissent, the shareholder ceased to have any right except the right to be paid the fair value of his shares.[296] Furthermore, the exception in section 623(k) on the grounds of fraud or illegality could not be relied upon. It would not sustain a derivative action, since the transaction must be unlawful or fraudulent as to the shareholder personally. The individual right of action could not be upheld either. The Legislature intended to limit the type of action which a shareholder would be entitled to prosecute, in the face of an appraisal election. Such action was curtailed to one seeking some form of equitable relief. Here the plaintiff was seeking damages. To allow the prosecution of such an action, in the court's opinion, would be unnecessarily duplicative, in that full and proper monetary recovery of the fair value of the dissenters' shares could be obtained in the appraisal proceeding. Shareholders would not be allowed "to re-open prior appraisal proceedings and again seek the identical relief merely by alleging

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295 (Ct. App.), 444 N.Y.S. 2d 609, 429 N.E. 2d 128, 54 N.Y. 2d 82.

296 N.Y. BUS. CORP. LAW, section 623(e) (Consol. 1977) now reads "*Upon consummation of the corporate action,* the shareholder shall cease to have any of the rights of a shareholder except the right to be paid the fair value of his shares...".

fraudulent or unlawful corporate conduct in relation to the merger".[297]

Nonetheless, in circumstances where breach of fiduciary duty on the part of the majority shareholder is alleged, based on his knowingly offering an inadequate price for the shares of the minority and his extensive self-dealing with the controlled corporation, a dissenting shareholder can elect to forego his appraisal remedy and pursue an equitable action for an accounting and damages.[298] *Breed v. Barton* was distinguished on the basis that, on that occasion, the shareholder had elected to pursue his appraisal rights. Thus, there was no danger in the present case of the type of duplicative proceeding which the *Breed* decision intended to prevent.

b. The "Business Purpose" Rule

Where minority shareholders are being cashed-out, the courts have developed a "business purpose" rule. In *Kurfield v. Equity Enterprises*,[299] the court had an opportunity to consider the same type of transaction as in Weinberger; namely a cash-out merger, the sole purpose of which was alleged by the plaintiff to be the elimination of the public shareholders. During the course of litigation a settlement had been reached. However some of the minority objected to the settlement figure, urging that it was unfair. In effect, the minority were being eliminated at a price far below book value. In its analysis, the court followed the route which

297 *Supra*, note 295, p. 612.
298 *Walter J Schloss Associates v Arkwin Industries Inc.*, (App.Div.) 455 N.Y.S. 2d 844
299 App. Div., 436 N.Y.S. 2d 303.

was later taken by the Delaware Supreme Court. The purpose of the merger statutes is to strike a balance between "the tyranny of majority shareholders and the recalcitrance of minority shareholders". Nonetheless, the fiduciary relationship of the majority to the minority persists, and the power of the majority must be exercised within the parameters of that relationship. In the present circumstances of a minority freeze-out, "the strict scrutiny test of the discharge of a fiduciary duty" would apply. The allegation of lack of a proper business purpose forms only part of a larger inquiry as to whether the conditions of the merger as a whole, compelling a liquidation of the minority interest, are fair to all concerned. As far as the settlement figure was concerned, the issue was whether the price offered approached the fair value of the stock, measured in relation to the probable success of the action.

> "In fairness to minority interests, we must judge the fairness of the settlement in part, at least, by the merits of the action. The merger here is not justified by any material advantage to Equity... The effect of the merger appears to affect only the minority shareholders by erasing their further participation in the affairs of Equity... the fact is that the record of Equity is that it has operated profitably and that by the merger Equity is intended to continue to operate."[300]

The question then narrowed to whether the proof presented by Equity established the fairness of the offer. The court held that it did not, noting that the analysis that would normally be employed in the appraisal process was not employed by the expert who valued the

300 *Ibid.*, at p. 310.

stock.[301] The case was remitted for a new hearing on the fairness of the settlement.

In *Clark v. Pattern Analysis Corporation*,[302] the defendant attempted a share consolidation of 4,000 to 1, to oust the minority who were former employees of the company. A preliminary injunction was granted. The court found that the shareholders would suffer irreparable harm as they would loose their status as shareholders. The majority shareholders, when they constitute management, owe much the same duty towards the minority as directors owe to all stockholders. There was evidence which indicated that the sole reason for the consolidation was to eliminate the minority shareholders. The court noted that "where there is an allegation of fraud, illegality or bad faith, coupled with a tenuous showing of legitimate corporate business purpose, fairness requires that a minority shareholder be afforded an opportunity to fully contest the actions of the majority before he is deprived of his property."[303]

The *Clark* decision was handed down in 1976. *Alpert v. 28 St. Corporation et al.*,[304] a 1983 decision, also stressed business purpose. While the statute clearly permitted cash-out mergers, the judiciary had imposed a limitation in that the merger must be for a legitimate corporate business purpose and not solely in the self-interest of the majority shareholders. In view of the possible influence of the *Weinberger* decision, there may be a withdrawal from the emphasis on business purpose in this jurisdiction.

D. California

a. Statutory Philosophy

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301 The valuation "expert" had given a weighting of seventy percent to market value, saying "in my experience, courts and security analysts are paying more attention to the market test than they are to the book value test". However, he admitted on cross-examination that Equity's stock was thinly traded and no market in a true sense existed!

302 384 N.Y.S.2d 660

303 *Ibid.*, at p. 664

304 478 N.Y.S.2d 443 (Sup. 1983)

The California appraisal provisions go further than those of Delaware and New York in closely circumscribing alternative remedies of shareholders who dissent from a corporate re-organization. Section 1312 of the code specifies that no shareholder who has a right to demand payment of cash for his shares has any other right, in law or *in equity* to attack the validity of the re-organization or have it set aside, except in an action to test whether the number of shares required to authorize the transaction have been legally voted. However, the problems which have been noted in the Delaware and New York cases, where one of the constituent corporations in the re-organization is controlled, directly or indirectly by another party to the transaction, are dealt with by the statute. Where a "control" situation exists, the general exclusion of remedies does not apply to a shareholder who has not demanded payment for his shares.[305] But, if the shareholder *institutes* any action to challenge the re-organization he loses his right to demand payment for his shares.[306] In addition the court is instructed that in an action attacking the re-organization, the consummation of the transaction shall not be enjoined except upon 10 day's notice to the corporation and upon a determination that clearly no other remedy will adequately protect the complaining shareholder. Where an action challenging a re-organization is brought, the burden of proof that the transaction is just and reasonable is on the controlling corporation.[307]

The California provisions have been drafted in furtherance of "a strong policy to facilitate business transactions and allow the majority to make full and effective use of their statutory powers".

[305] See *Sturgeon Petroleums Ltd. v Merchants Petroleum Ltd.* 195 Cal. Rept. 29 (Cal. App. 2 Dist. 1983). Shareholders who had voted against the merger and submitted their shares for endorsement as dissenting shares could not choose to have their status as dissenters lapse by simply not filing suit within the six month period. The company was entitled to hold them to their dissenting status and had authority to affirm such status.

[306] CAL. CORP. CODE, section 1312(b) (West 1988).

[307] CAL. CORP. CODE, section 1312(c) (West 1988).

[308] The concern is to guard against "strike tactics" by individual investors. As one commentator put it:

> "There are individuals in plenty who will seize upon any slight irregularity as the basis for a charge of fraud, capture any wisp of smoke and attempt to fan it into flame, begin a stockholders' action and set off the accompanying fireworks - and indicate, tactfully or otherwise, that their stock may be purchased at a price, and the suit withdrawn."[309]

Priority was given to devising a measure which would satisfy dissenting minorities and at the same time permit legitimate consolidations and mergers without unlimited litigation at the instance of "piratical obstructionists". It has been argued that the limitation on equitable rights is not as burdensome to the minority as would initially appear, for the dissenting shareholder would otherwise be obliged to indulge in much more burdensome litigation, at a high cost to himself and others.[310]

b. Judicial Implementation of Statutory Philosophy

The courts have been sympathetic to the aims of the statute. In an early decision dealing with an attempt to upset a completed merger on the ground of the inadequacy of the ratios of exchange of stock, the court remarked:

> "When you buy stock in a California corporation you are advised that your associate shareholders holding two-thirds of the shares may consolidate your corporation with another into a third corporation, offer you what

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308 See Ballantine and Sterling, *Upsetting Mergers and Consolidations: Alternative Remedies of Dissenting Shareholders in California*, 27 Calif. L. Rev. 644 (1939) at 645.
309 Berlack, *(1937) 35 Mich. L. Rev. 597*, 604, quoted in Ballantine, *supra* note 87, at 649. In a similar vein, the Report of the Institute of Law Research and Reform, Alberta, *Proposals for a New Business Corporations Act* (1980) Vol. 1, commented that, while the appraisal remedy is intended to give a *bona fide* minority a weapon against an unfair or unprincipled majority, "it may instead give an unfair or unprincipled minority an opportunity to extort benefits from the majority", at p. 129.
310 *supra*, note 308 at 650.

> they please of its shares in exchange for those you hold, and, if you do not like the offer may buy out your shares at their fair market value at the time they vote the consolidation." [311]

Thus there is no underlying "natural right" of a shareholder to follow his investment into a consolidated corporation.

It should also be noted that where the terms of the merger call for shareholders to receive consideration other than cash, then the arrangement will be subject to the approval of the Commissioner of Corporations, who will certify that the terms are fair as to the parties involved. Without the certification of the Commissioner, a re-organization cannot proceed.

E. United Kingdom

The British courts are concerned with the fairness of the various types of corporate re-organization and upon examination of the case law, the development of a "doctrine of fairness" is integrally related to the strict interpretation of the various procedural requirements laid down by the statute. While section 459 relating to oppressive and prejudicial acts, is in a class by itself, the courts have shown a willingness to consider the remaining sections dealing with the structuring of re-organizations, particularly as to how they may interact on a single transaction.

a. "Fairness" Through Adherence to Statutory Requirements

As previously mentioned, the attractiveness of section 582 lies in the fact that a sale of assets, provided it is accompanied by a winding-up, may proceed without the sanction of the court. Yet the courts have long held that the rights made available to dissenting shareholders under that section cannot be excluded by any alterations to a company's memorandum of association. In the

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311 *Beechwood Securities Corp. Inc. v Associated Oil Co.* 104 F. (2d) 537, at p. 539.

leading case of *Bisgood v Henderson's Transvaal Estates Ltd.*,[312] the Court of Appeal held the scheme under consideration to be *ultra vires*. The company's undertaking was to be sold to a new company, formed for the purpose, in exchange for the same number of L1 shares in the new company as were outstanding in the old. The new shares were to be distributed among the shareholders of the old company on a one-for-one basis. The snag was that the shares of the old company were fully paid, whereas the new shares would only be credited with 17s. 6d. per share.

The court noted that the purpose of the scheme was to avoid the provisions of section 161 of the Companies Act 1862, which protects the dissenting member from such a scheme by securing to him the value of his investment in the company, determined by arbitration or agreement. The present scheme sought to impose an assessment upon the members: liability to make further contributions to the capital of the company. Statute had imposed limitations on the memorandum, and articles.

> "There are matters in respect of which the constitution of the company cannot provide that the corporator shall not enjoy rights and immunities which the Statute gives him."[313]

The company owed its existence to statute and would therefore be bound by statute with regard to shareholders as well as creditors, in matters coming within the conditions of the memorandum. Indeed as was remarked, "Shareholders in these companies require protection just as much as creditors - perhaps even more." Thus the articles could not exclude a shareholder's right to dissent under the statute.

Under section 428, the compulsory acquisition section, it has proved very difficult for a minority shareholder to convince the court that his shares ought not to be purchased by the offeror company. The courts have always placed a heavy burden of proof on

312 (1908) 1 Ch. 743.
313 *Ibid.*, at p. 758.

the dissenter, stemming from the decision of Maugham J. in *Re Hoare*.[314] After noting that the legislature had not indicated any grounds on which the court was to intervene to prevent the transferee company from acquiring the shares of the dissenters, he stated:

> "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... it is manifest that the reasons for inducing the court to 'order otherwise' are reasons which must be supplied by the dissentients... and that the onus is on them of giving a reason why their shares should not be acquired by the transferee company."[315]

However, there are situations where the court will intervene. In *Re Bugle Press*[316] the majority shareholders attempted to use the provisions of section 428 to oust the minority shareholder. The majority shareholders, with a holding of ninety percent, incorporated a company of which they were the sole subscribers. This company then made a take-over offer for the shares of Bugle Press. The majority holders accepted the offer. The minority shareholder objected and sought relief under section 428. At first instance, Buckley J. saw great force in the argument put forward by the minority holder that the transferee company was merely a screen for the ninety percent shareholders and that there was no independent majority exercising any sort of disinterested choice in the matter of whether or not the offer should be accepted.[317] In these circumstances the onus would be on the other side; it would be incumbent upon the majority to satisfy the court that "the scheme is one with which the minority holder ought reasonably to be compelled to fall in". Buckley J.'s decision was affirmed by the Court of Appeal. Lord Evershed M.R. again took up the point that in previous cases, the 90 percent of shareholders who accepted the offer were wholly

314 (1933) 150 L.T. 374
315 *Ibid.*, at p. 375.
316 (1961) 1 Ch. 270.
317 *Ibid.*, at p. 276.

independent of the offeror. Thus although the present case fell strictly within the terms of section 428, the fact that the transferee company was for practical purposes the equivalent of the majority shareholders, was sufficient for the court to exercise its discretion "to order otherwise". To allow the compulsory acquisition under such conditions would be to allow the majority to evict the minority. Buckley J. had based himself on the proposition that the onus rested upon the transferee company to satisfy the court that the price offered was a fair price. The Court of Appeal however, based itself upon the broader ground that the 90 percent majority shareholders were themselves the transferee company.

The problem with voting requirements and "interested" parties arose again in *Re Hellenic & General Trust Ltd.*[318] In this arrangement, proposed under section 425, the court admitted that the terms were certainly fair, yet upheld a minority shareholder's objection to the scheme. The arrangement called for the ordinary shares of Hellenic to be cancelled, and new shares issued to Hambros, which happened to own 53 percent of Hellenic already. The other minority shareholders were to receive cash for their shares in an amount representing net asset value, an amount which was between 20 to 25 percent more than the market value. But, if the scheme went ahead, National Bank of Greece, a 14 percent shareholder of Hellenic would be subject to severe capital gains tax. Their 14 percent shareholding rendered them safe from compulsory purchase under section 428, but could the same effect be achieved by Hambros under section 425? Apparently not. The resolution approving the scheme certainly had the required majority: 86 percent in number and 84 percent in value. However, the votes of M.I.T. (the holding company for Hambros' shares in Hellenic) were vital to the attainment of that majority. In the event, the court considered that the agreement of the shareholders had been improperly obtained. Section 425 provides for the vote of the classes of members. The question was whether M.I.T., a wholly

[318] (1975) 2 All E.R. 382.

owned subsidiary of Hambros, should form part of the same class as the ordinary shareholders. Templeman J. summarized the problem:

> "Hambros are purchasers making an offer. When the vendors meet to discuss and vote whether or not to accept the offer, it is incongruous that the loudest voice in theory and the most significant vote in practice should come from the wholly owned subsidiary of the purchaser. No one can be both a vendor and a purchaser, and in my judgment for the purpose of the class meetings in the present case, M.I.T. were in the camp of the purchaser."[319]

The parent and subsidiary had a "community of interest" which differed from the interest of the other shareholders.

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319 *Ibid.*, at p. 386

Chapter 5

Valuation of Dissenters' Shares

The previous chapters have been concerned with the statutory requirements that must be met and the problems that will be encountered by a minority shareholder who decides to seek the "fair value" of his shares. Initially the decision to dissent will have been taken in an attempt to force the corporation, or majority shareholder to increase the terms offered. Failing such a resolution, the minority may anticipate that the court will come down on its side in fixing a value for the shares. This opinion of the outcome may be based to a large extent on the shareholder's misgivings as to the fairness of the corporation's suggested price. While the court may partake of the dissenter's sentiments, very often there will be difficulties in tailoring the results achieved by the valuation process to meet the legitimate expectations of the minority shareholder. The chief limitation, particularly in the amalgamation squeeze-out situation, stems from statute. Most of the appraisal statutes provide that fair value is to be fixed as at the close of business on the day prior to the date of the resolution regarding the change. Generally, an amalgamation will be proposed and effected in anticipation of increased profits from the merged enterprise. The dissenting minority is precluded both practically and legally from participating in these increased profits.

Thus, in a squeeze-out situation, the minority would fare better in an action to enjoin the proposed arrangement. Here, the philosophy behind the appraisal remedy has no application, since the shareholder is not given a chance to continue in the new enterprise. In a public company, the minority may still be at a disadvantage due to the date imposed by statute for the valuation. Market price is one component which the court will consider. It is inevitable that the market value of listed shares will fluctuate in accordance with the market's evaluation of the outcome of the arrangement.

However, a certain degree of flexibility remains in that the statutes do not define "fair value". The concept has been developed by the courts as they attempt to distinguish the various valuation concepts and endorse appropriate valuation techniques.

It is necessary to turn to their decisions to discover what principles of valuation are involved when a dissenting shareholder calls for a valuation of his holding. The court will normally have the benefit of testimony from a number of experts. However, the statutes give the court a great latitude and it is the judge's decision as to value which will prevail.[320] The judges have also illuminated certain techniques of valuation.

A. Principles of Share Valuation

In any approach to valuation there are certain fundamental principles which are observed. The cardinal principle of valuation theory maintains that there is no such thing as absolute value. Every valuation will be for a specific purpose, in order to have any relevance. In addition, the value determined relates to a specific time. A corporation will encounter favourable and adverse conditions during its life which will alter the value to be placed on its shares at any given time. Value is forward-looking. The past results of any corporation are useful only in so far as they point out a level of performance which may reasonably be expected in the future.[321]

Many valuations are perforce calculated "after the fact". This particularly true in appraisal litigation. However, because share valuation involves pricing the corporation's future at a particular time, hindsight evidence should not be used to support predictions of

320 It is common for American statutes to provide for the appointment by the court of appraisers, with the court having the power to confirm, modify or reject their report.
321 See generally, Adamson, Valuation of Company Shares and Businesses, 3d ed. (Law Book Company of Australasia Pty. Ltd.), Baynes, Share Valuations, Heinmann Ltd,

share values. The "wisdom which might be provided by the knowledge of subsequent events" must be rejected.

How a valuation is achieved is of extreme importance. Generally there are three basic techniques available for use in valuations - net asset value, market value or hypothetical market value, and investment value.[322] Each method will produce a different result for the same shareholding.

These elements of valuation are referable to the value of the corporation as it existed prior to the change on which the appraisal right is based. The net asset value may be calculated on a liquidation basis, or on the basis of a going concern. The particular approach will depend on the situation of the company and the nature of the assets. Sometimes this figure is obtained by determining the present cost of reproducing the same assets, then discounting to reflect the age and obsolescence of the assets. Alternatively, the cost of "present-day" facilities capable of performing the same function may be calculated and then reduced by a percentage to reflect the remaining life of the assets. However, asset values tend not to be used as the sole factor in any valuation because this approach "runs counter to another fundamental concept of business valuation, namely, that an on-going enterprise is something more than the aggregate of its assets". A share is not simply a pro rata interest in the assets of a company, but an interest in a going concern.

Market value is based on the price at which the stock is selling, or could be sold to a willing buyer. The current market price will not always be accepted by the court without enquiry into market conditions. Market price will be regarded as less than reliable, however, where trading is irregular or thin, or where the price may be subject to manipulation. When considering market value the courts will frequently take an average of the market price over

[322] See: Note, *Valuation of Dissenters' Stock under Appraisal Statutes,* 79 Harv. L. Rev. 1453 (1966).

several months to achieve a "dependable" figure. A particular problem with market value, in the context of appraisal proceedings, is that market values generally reflect the financial impact of the corporate action from which the shareholder dissents.

Investment value attempts to assess the earning capacity of the corporation. Future income is predicted upon the basis of the company's past performance. The final result is intended to approximate the price that a willing buyer would pay for the company. Here too, the earnings of several past years are averaged to obtain a figure which minimizes the effect of a spectacularly good or bad year. Once the average earnings have been decided, a multiplier must be chosen, to reflect the relative certainty and stability of future earnings; lower multipliers are applied to vulnerable businesses, while higher multipliers are suitable for established profitable companies.

The courts are also engaged in developing the rationale behind the remedy. In most jurisdictions the right to receive a fair value for one's shares is accorded in several varying circumstances. The question then to be determined is whether the "fair value" of a particular holding will always be the same, or whether the circumstances giving rise to the dissent will in some fashion affect the value of the shares. Should the "fair value" of a dissenter's claim include a premium if he is being ousted under a compulsory acquisition provision or amalgamation; if a victim of oppressive conduct, should the value of his shares include some measure of compensation?

Another factor which creates valuation difficulties is that of the type of company involved. For a shareholder in a large public company the stock exchange provides one means of expressing his displeasure with corporate policy or performance. His stake in the company is readily convertible to cash at prevailing market prices.[323] A minority shareholder in a private company, on the other hand will encounter considerable difficulty in attempting to liquidate his position.

The judicial valuation represents the culmination of a lengthy process for the dissenting minority. The three general methods of valuation discussed above will normally be considered by the court. Nonetheless, the courts have frequently stated that no single factor will be conclusive in all valuations. All of the circumstances will be considered before the appropriate method of valuation is decided upon. In many instances, the final result will be based upon a combination or modification of the three classic approaches.

B. Judicial Interpretation of Fair Value

a. Canadian Jurisprudence

Two decisions where the court has conducted a valuation of dissenters' shares under section 184 illustrate the effect on fair value caused by the selection of a particular method. The approaches taken differ, as do the type of company and transaction involved. It is also useful to compare the results obtained under section 184 with the valuations under section 199 and section 234. These latter sections do not specify the date at which the valuation is to be calculated, which increases the court's flexibility in fixing fair value.

i. Factors Influencing the Selection of Valuation Method

In *Re Montgomery et al. and Shell Company Ltd.*,[324] market value was of overwhelming influence. The company had created a new class of preferred shares which ranked in priority to the Class A common shares of the plaintiff who applied to the court, under section

323 Most American states have accordingly disallowed appraisal where the stock is listed on a national exchange.
324 (1980) 5 W.W.R. 543, 10B.L.R. 261, 111 D.L.R. (3d) 116, 3 Sask. R. 19 (Sask Q.B.).

184(16) of the C.B.C.A., to fix a fair value for his shares. The court noted that it was not concerned with the reasons for the creation of the shares nor whether the shareholders were right or wrong in deciding to become dissenters.[325] The plaintiff maintained that "fair value" was the asset value of $27.50. An expert for the plaintiff testified that the market value of approximately $16.50/share was underpriced and did not reflect the company's oil and gas reserves. The company's expert challenged this figure on the basis that it did not take into account the vast taxes which would have to be paid if Shell went into liquidation. The sole question before the court was whether market value or net asset value was a "fair value". In the court's view, asset value was linked to a hypothetical liquidation. American authority was considered by the court. In assessing fair value, net asset value, investment value and market value should be taken into account. They do not have to influence the result in every valuation proceeding. It suffices if they are considered.[326] The American authority had disregarded asset value since the company in that case was not being wound up, but would continue as a going concern.[327] This weighed heavily with Estey J. Furthermore, he disagreed with the reports which supported the net asset value of $27.50 per share because that estimate included "an eventual return of profits in refining and a restoration of natural gas markets".[328] This element of an "eventual return of profits" could not be taken as a figure on which to base a "fair value" on the date in question. With respect to another report, which arrived at a figure of $26.44 as the net worth per share, Estey J. remarked that "...the calculations are based on such things as future royalties and taxes. I do not think this report can form the basis of a fair value per share as of December 12, 1978."[329] He adopted market value as the best evidence of fair value in the circumstances of the case, although almost two-thirds of the shares were held by a holding company.

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325 *Ibid.*, 3 Sask R. at p. 21.
326 *Ibid.* at 26.
327 *Endicott Johnson Corp v. Bade et al,* 376 N.Y.S. (2D) 103.
328 *Supra*, note 325 at p.30.
329 *Ibid.* at 31.

> "The market value, where there is no indication of a majority shareholder trading, is certainly some evidence of the price at which small and comparatively large shareholders are prepared to sell and are prepared to buy the Class A common shares. It is not an estimate but an actual price."[330]

Fair market value was used as the main criteria for determining fair value in Canadian Gas and Energy Fund Ltd. et al. v. Sceptre Resources.[331] In this instance, the shares were of a public company - widely held and actively traded. The company was not owned or controlled by one shareholder or group of shareholders. Nonetheless, the market value as of the date prior to the adoption of the reorganization had to be adjusted since it already reflected in part the market's assessment of the proposed reorganized entity. Shareholders who dissented were entitled to the fair value of their shares in the company before the introduction of the reorganization. Accordingly, market prices prior to the announcement of the proposal were also taken into account.

The dissenting Shell shareholders had the option of remaining in the re-organized corporation. It was quite the opposite case in *Re Domglas Inc.*[332] Domglas Inc. was a public company which had been formed by the amalgamation of Domglas Ltee with its parent corporation, Consolidated Bathhurst (DG) Ltee. The latter company owned ninety-six percent of Domglas Ltee shares. The amalgamation agreement provided for shareholders of Consolidated Bathhurst to receive one common share of the new company (Domglas Inc.) and for each common shareholder of Domglass Ltee, other than Consolidated Bathhurst, to receive one redeemable preference share of Domglas Inc. These shareholders were then "squeezed-out" by the redemption of their shares at $20.00 per share. Section 199 which provides for compulsory acquisition could not be utilized, since the negative votes of the minority shareholders would prevent the necessary

330 *Ibid.* at 32.

331 (1985) 5 W.W.R. 43, 29 B.L.R. 3 (Alta. Q.B.)

332 13 B.L.R. 135 (Que S.C.), affd. (1982) 138 D.L.R. (3d) 521 (Que C.A.).

ninety percent of the shares not owned by Consolidated Bathhurst from being reached. The primary issue was the "fair value" of the dissenters' shares as of the valuation date. The court noted that a substantial majority of the minority shareholders had held their shares for several years, despite a lack of dividends. The company had used its earnings to embark upon a program of modernization and improvement. When these programs were about to come to fruition, the minority shareholders were eliminated. This tactic undoubtedly influenced the court to some effect.

One problem, from the dissenter's view point, with the valuation of minority shares is that in traditional valuation theory and commercial practice, they suffer a discount from the *pro rata* valuation of the company's shares by reason of their very nature. Their voting power is insufficient to influence any corporate decisions. However, Justice Greenberg ruled out a minority discount.

Since section 184 continuously referred to the valuation of the dissenter's shares rather than the valuation en bloc of the company, it would always by definition be a minority holding to which the appraisal remedy was granted. On this basis, Greenberg J. felt it would be inimical to the concept of "fair value" to apply a minority discount. He then considered the various valuation approaches. He recognized the inappropriateness of market price in the present circumstances. Although a listed company, there had been very little trading of Domglas Ltee's shares. During a two year period, less than one percent of the common shares were traded, or fifteen percent of minority shares. Thus the market for Domglas shares was "spasmodic", "irregular, intermittent and not sustained" and in view of the authorities, could be disregarded. The assets approach was touched on. Acknowledging that the general principle accepted by valuation theorists is that a business is worth only what it can earn, except where it is worth less on an earnings basis than the amount which would be realized if it were liquidated, Greenberg J. noted however, Bonbright's admonition that "the appraiser cannot intelligently make his forecast of earnings without reference to the costliness and the physical and functional condition of the separate assets."[333] Book value would not play any part in the court's determination of fair value, since Domglas carried its land at historical cost, and the land was obviously worth much more on the valuation date.

The earnings or investment value approach was the method of appraisal selected by the court. This would involve a "two stage exercise:

> (a) to arrive at the most probable and reasonable prospective net earnings; i.e. a stream of maintainable earnings projected into the near future,
>
> (b) to capitalize those projected net earnings at an appropriate rate; i.e. to fix an appropriate multiple, or price/earnings ratio."[334]

This method was regarded by the court as "the benchmark approach in valuing a business as a going concern, where no liquidation is postulated".[335] The net tangible asset backing of the shares would assist the court in establishing the price/earnings multiplier.

The court then addressed the relationship between the terms "fair value" and "fair market value". " Fair market value" was equated with "intrinsic value". "Fair value" imported something other than "fair market value". If Parliament had wished to invoke the concept of "intrinsic" value, it would have used the term "fair market value" as it had done in various other statutes.[336] In the present circumstances of a "squeeze-out", "equivalent to expropriation", fair value would include a premium for forcible taking, and no minority discount. This was consonant with the equitable jurisdiction

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333 *Ibid.* 13 B.L.R. at p. 197.
334 *Ibid.* at p. 200-201.
335 *Ibid.* at p. 221.
336 *Ibid.* at p. 222. For a criticism of Greenberg's analysis of the "value" terminology, see Krishna, V., Determining the Fair Value of Corporate Shares, (1987 - 88) 13 C.B.L.J. 132, at pp. 141 - 142.

conferred by Parliament upon the court, by the use of the expression "a fair value".

The court arrived at a fair value of $36.00 per share. The net maintainable earnings of $2.964 per share were calculated by the "weighting" of three overlapping periods where earnings per share ranged from $2.64 to $3.70. The earnings multiplier of 10.1 was chosen as being the mid point between 9.1 and 11.1 - a reasonable expected rate of return to investors in Domglas shares on the valuation date. This multiplier reflected the high net tangible asset backing and resulting low degree of risk and high quality of anticipated future earnings. This gave the court a figure of $29.94 per share as the fair market value of *each* common share. This calculation avoids a minority discount. To this value, the court added a premium of twenty per cent as compensation for the "forcible and compulsory dispossession" which brought the figure to $36.00 per share. Throughout its calculations, the court was guided by "criteria of fairness and equity to the dissenting shareholders, without doing an injustice to the company petitioner."[337]

Yet another approach to the determination of fair value was taken by the Manitoba Court of Appeal in *Re LoCicero et al. and BACM Industries Ltd.*,[338] a split decision overturning the trial judge's valuation. Again, the transaction in question was an amalgamation squeeze-out. The Court of Appeal stressed that what was to be valued was the overall fair value of the corporation. An *aliquot* part of the overall value would then be attributed to the dissenter's shares. The fair value of the shares was a proportionate part of the value of the corporation's property to the corporation and this value was to be determined by asking what the corporation would pay rather than lose the property.

ii. Comparison of Valuation under Section 184 with other Statutory Provisions

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337 13 B.L.R. at p. 223.
338 31 Man.R. (2d) 208 reversed in 25 D.L.R. (4d) 269.

1. Section 228 - British Columbia Companies Act

Section 228 of the Companies Act of British Columbia[339] is similar to section 184, in that it provides for a dissenting member to receive the fair value of his shares. It differs, however, from section 184 in the way the price is to be calculated. Under the British Columbia statute, the fair value is to be determined as of the day before the date on which the resolution giving rise to the dissent, was passed *including* any appreciation or depreciation in anticipation of the vote upon the resolution.[340]

The approach adopted by the judiciary in the interpretation of section 228 has been consistent. "Fair value" will not necessarily be ascertained by reference to stock market quotations. The court recognizes that there exists more than one method to determine the fair value of shares in a corporation

> "That value may be determined by reference to the market value of the shares on the stock exchange, by calculating the net value or the amount to be obtained upon a hypothetical liquidation or the investment value of the shares based on a capitalization of the earnings of the company."[341]

A "fair value" is represented by a proportionate value of the company as a going concern. Proportionate interest is interpreted on a pro rata basis, which effectively excludes any minority discount.[342]

2. Section 199 - C.B.C.A.

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339 Companies Act, 1973 c.18.

340 Companies Act, 1973, section 228 (4).

341 *Re Wall and Redekop Corp. et al* (1974) 50 D.L.R. (3d) 733, at 737, per MacFarlane J.

342 See *VCS Holdings Ltd. and Helliwell et al.* (1978) 5 B.L.R. 265; *Diligenti v. RWMD Operations Kelowna Ltd. (No. 2)* ,(1977) 4 B.C.L.R. 134.

The inherent injustice to the minority shareholders who patiently endured years without dividends while the company modernized, acquired property and re-invested earnings, only to be ousted from the company when these programs were about to increase earnings, was an important factor in the *Domglas Ltee* valuation. When the jurisprudence on section 199 of the C.B.C.A., which provides for compulsory acquisition of minority shares, is considered, there is a mixed response on the element of "expropriation"

As previously mentioned, section 199 gives a right of compulsory acquisition to an offeror in a take-over bid who acquires at least ninety percent of the target shares, excluding the shares owned or controlled by the offeror. In this situation the Canadian jurisprudence has followed a line of English decisions which held that an offer accepted by not less than nine-tenths of the shareholders must *prima facie* be taken to be fair and the court will not interfere unless it is affirmatively established by the complaining shareholder, that, notwithstanding the views of a very large majority of shareholders, the scheme is unfair.[343] In practice, this presumption has proved an insurmountable hurdle.

In *Re Shopper's City Ltd. and M. Loeb Ltd.*,[344] which concerned section 128 of the Canada Corporations Act,[345] (the forerunner of section 199 C.B.C.A.), Stark J. commented that there was a heavy burden on the shareholder to establish grounds for an order that he is not required to deliver up his shares at the offered price in accordance with the compulsory purchase provision. The court was not swayed by the shareholder's evidence that the price offered per share was $2.00 less than market value and even thirty-eight cents less than shareholder's equity on book values. The financial analysis demonstrated the company' spectacular growth, with sales tripling in dollar value in five years, and an annual increase in earnings. Yet

343 The locus classicus of this proposition is *Re: Hoare and Co. Ltd.* (1933) 150 L.T. 374.

344 (1969) 1 O.R. 449.

345 R.S.C. 1953 c. 53.

this evidence did not convince the court that the price offered was unfair. It merely suggested "that possibly a higher price could have been obtained."[346]

> "The mere fact that Mr. King (the shareholder) regards the offer as unfair is not sufficient. The question is whether the offer was unfair to the body of shareholders as a whole and no adequate evidence was presented before me that it was."[347]

Basing himself upon English authority, Stark J. noted that it was impossible to adopt an individual or subjective test of fairness.

In *Re Sayvette Ltd.,* [348] Loblaws had made an offer to purchase the minority shares in Sayvette. Loblaws owned or controlled approximately seventy percent of the issued shares. The price offered was $2.50 per share, which resulted in Loblaws acquiring ninety-three percent of the shares not owned by itself or its subsidiary. Loblaws then sought to purchase the few outstanding shares pursuant to section 136 of the Canada Corporations Act.[349] The dissenting shareholders were employees of Sayvette. Grange J. summarized their complaint as follows:

> "...under the proposed scheme they would suffer a loss and... they were assured as employees of the company that they would be able to retain these shares come what may. While I have great sympathy for these shareholders I cannot justify an order to the contrary upon their claims. The shares issued to them are not subject to any conditions and the decline in value of the shares is a risk taken by all investors. Essentially what they are complaining about is the state of the law and not the Loblaws scheme."[350]

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346 *Supra*, note 344, at p. 453.
347 *Ibid.* at p. 453.
348 (1975) 11 O.R. (2d) 268.
349 R.S.C. 1970 c. C-32.
350 Supra, note 348 at p. 270.

Furthermore, there was no expropriation of minority shares, since over ninety percent of the shareholders, excluding Loblaws and its subsidiary, had voluntarily accepted the proposal. This brought the applicants squarely within the terms of Section 136 and the heavy onus of establishing the "unfairness" of the scheme.

It is essential to note, however, that the statutory language upon which these decisions were made differs in an important respect from the present section 199 of the C.B.C.A. Under both section 128 and then section 136 of the Canada Corporations Act, the transferee company had the right to acquire the outstanding minority shares, upon the acceptance of its offer by not less than nine-tenths of the shares affected, upon the same terms as those accepted by the approving shareholders, unless upon an application by the dissenting shareholder, the court thought fit to order otherwise. Under section 199, the dissenting shareholder has the right to receive the "fair value" of his shares. The following cases were decided under section 199. As a matter of interest, they are both decisions of McEachern, the Chief Justice of the Supreme Court of British Columbia.

In *Re Whitehorse Copper Mines Ltd.*,[351] Hudson Bay Mining and Smelting Co. Ltd. made a take-over bid for all of the shares of Whitehorse, at $4.00 per share, at a time when the market price for the shares was $2.20. The offer was accepted by ninety-one percent of the shareholders, and accordingly, Hudson Bay applied for compulsory acquisition of the balance, under section 199. The company acquired a further seven percent of the shares, but the remaining shareholders elected to receive the "fair value" of their shares under the C.B.C.A. rather than accept the take-over bid price. The court fixed the fair value of the minority shares, at the date when the election was made, at $6.50 per share. Hudson Bay had prepared an in-house analysis which gave figures of $3.28 - $3.53 per share based on predicted metal prices. It also commissioned an opinion from investment advisors, who recommended $4.00 per share as a fair and reasonable offer. The independent directors of

351 (1980) 10 B.L.R. 113.

Whitehorse also obtained independent advice that $4.00 was fair and reasonable. The evidence indicated that of the two independent valuations, one contained an error in its calculations by omitting $11,000,000 from the sale of the opening inventory in its cash flow projection and both had used unduly pessimistic forecasts of metal prices, while ignoring completely the value of certain properties owned by Whitehorse. These errors were sufficient to cast doubt upon the report's recommendation of $4.00. Furthermore, in assessing the weight to be given the majority opinion to accept the offer, the information upon which that decision was reached, must be considered, despite the "reluctance of the court" to substitute its judgment for that of an overwhelming majority of shareholders. However, the court concluded that Hudson Bay's offer of $4.00 per share was *prima facie* fair as of the offering date and that the onus was on the dissentients to adduce evidence of its unfairness.[352] The market value of the shares was considered, but the court's position was that "while market value is often very persuasive on the question of value generally, it is necessary to examine the circumstances carefully in order to satisfy one's self that the market is a reliable guide to value before it is accepted as conclusive evidence of value".[353] The court was skeptical of market value, for the shares were thinly traded, with two groups owning approximately sixty-eight percent of the shares, who abstained from trading. Moreover, the Whitehorse annual and quarterly reports were unnecessarily gloomy and failed to give the market a chance to evaluate the potential of several of the company's properties. It was the potential of the various mining properties which influenced the court to fix a fair value of $6.50 per share. The difficult part of the evaluation was to determine what may properly be considered "without being overwhelmed by subsequent events".[354] The court accepted a study of the projected operation of the company's chief mine which placed a fair value of $5.78 per share to which was

352 *Ibid.* at p. 142.
353 *Ibid.* at p. 142.
354 *Ibid.* at p. 168.

added a figure for the potential of other operations which would be developed in the future. *Re Sayvette* was approved by McEachern C.J.S.C. Compulsory acquisition in these circumstances would not be equated with expropriation.[355]

In *Cyprus Anvil Mining Corp. v. Dickson*,[356] McEachern C.J.S.C. again went into great detail, considering various factors relevant to the valuation of shares in Vangorda Mines Ltd.

Of the various methods of valuation, the appropriate one under the circumstances was the "discounted income value" approach. The shares were not listed on any stock exchange. Net asset value of $1.50 per share was rejected as evidence of fair value. The two major shareholders were anxious to sell to the only buyer for whatever price they could get. Thus there was no question of a "negotiated" price representing the highest price available in an open and unrestricted market. This was not how the fair value should be determined. Furthermore valuations which were submitted to the court were based on the assumption that the Vangorda property would be developed as a free-standing mine, with all the necessary adjuncts in the way of plant and machinery. This was an unrealistic approach since the evidence showed that the company had originally bought the property with the intention of integrating its exploitation with the company's other properties nearby. A fundamental principle of valuation insists that the property will be valued at its highest and best use. The court noted that this was not an expropriation case:

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355 *Ibid.* at p. 137.

356 (1982) 20 B.L.R. 21. and (1984) 54 B.C.L.R. 225; reversed by the British Columbia Court of Appeal, as yet unreported. See also *Lough v Canadian Natural Resources Ltd.*, (1983) 45 B.C.L.R. 335, where the shares were valued using the market value method. The method to be used would depend on the circumstances of each case. One important factor was the nature and extent of the company's business which would make any other form of valuation very expensive. The fact that the shares were minority shares was irrelevant to the valuation.

> "My task is to fix fair value and in the discharge of that responsibility ! think I have a freer hand to do what is fair than some expropriation statutes would permit."[357]

A price equivalent to "fair value" was not fixed by the court in this decision. Instead, the various factors to be considered in the discounted cash flow value were set out by the court, leaving the parties to come to an agreement on value. Regard would be had to the ore reserves, metallurgy, method of financing the mining operation, the mining plan, running costs, exchange rate and, of course, taxes. The court was clearly unhappy with the price of $1.50 per share agreed upon between Cyprus An:.:l and the majority shareholder of Vangorda. It could not be the basis of a fair value determination in the first instance. However, if the discounted cash flow technique did not produce a value as high as $1.50, then $1.50 would be fixed as the fair value.

> "...I think it is fair to fix the only other positive value that can be extracted from the evidence."[358]

McEachern C.J.S..C's subsequent valuation using the discounted net cash flow method was reversed by the Court of Appeal which held that the evidence revealed that this particular method was less than reliable, since the company had no net cash flow record!

3 Section 234 - C.B.C.A.

Under section 234 the court may direct that a corporation or any other person, purchase the securities of a security holder, where there has been conduct, or the lack of it, which may be characterized as "unfairly prejudicial" to the interests of the security holder.[359] This power is but one of a variety of measures open to the court in resolving disputes over oppressive conduct. Unlike section 199 or

357 *Ibid.* at p. 47.
358 *Ibid.* at p.71.
359 C.B.C.A. section 234(3)(f).

section 184, there is no stipulation that the shareholder must receive fair value.

The reported decisions on section 234 have, not surprisingly, been concerned primarily with whether the facts alleged in the petition met the judicial standards of unfairly prejudicial conduct.[360] In *Meltzer v. Western Paper Box Company Ltd. et al.*[361] the applicants were minority shareholders in two family controlled private corporations who sought the dissolution of the companies on the grounds of "oppressive conduct". It was admitted that there had been certain irregularities in the observance of corporate formalities - failure to hold annual meetings and improper transfer of shares. The complainant had been removed from his position in the company where he had been employed for 25 years. However, the evidence established that the company had suffered from the conduct of the applicant. On the other hand, the majority shareholder had, through his efforts in the daily business of the companies, brought them to financial soundness. The court found that the respondent had behaved in an honest, astute and responsible manner. Dissolution was refused. Instead, the court ordered the purchase of the applicant's shares by the company or the shareholders. This was considered to be an appropriate solution and the court was empowered by the Manitoba Corporations Act [362] to make such order as it thought fit. The respondents were ordered to provide financial statements and all necessary explanations. There would then be an independent evaluation of the shares of the companies with the costs of the appraisal to be apportioned equally between the parties. The valuation would be conducted on the basis of the companies operating as "going concerns".

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360 E.g. *Redekop v. Robco Construction Ltd.* (1978) 89 D.L.R. (3d) 507, 5 B.L.R. 113.
361 (1977) 3 B.L.R. 113. See also *Abraham v Interwide Investments Ltd. et al*, (1985) 30 B.L.R. 177, where the directors had acted unfairly and prejudicially towards the plaintiff. No minority discount was applied to plaintiff's shares and certain substantial illegal payments of illegal directors' fees were deemed to be an asset of the company for purposes of calculating the fair value of plaintiff's shares.
362 The Corporations Act 1976 c. 40, ss. 207(1), 261(4).

A rather unusual solution was proposed in *Ferguson v. Imax Systems Corp.*[363] An application had been brought under section 234 for an injunction to restrain the holding of a shareholders' meeting, which was being called to approve a reorganization of share capital. Hollingworth J. did not consider that the shareholder had been oppressed. An appraiser was appointed under subsection 184 (21) with a view to fixing the fair value of the redeemable preference shares which the applicant was to receive under the reorganization she had sought to enjoin. There was no explanation given for the conversion of a section 234 action into a section 184 action. In certain conditions appraisal is an appropriate remedy, as in *Meltzer*, where negotiations for the purchase of the minority shares had commenced, and then broken down. In Imax, on the contrary, the shareholder wished to maintain her position in the company. As was to be expected this decision was reversed on appeal and an injunction against the share reorganization was granted. [364]

b. United States Jurisprudence

Valuation of shares under the appraisal remedy is one area where Canadian courts have shown no hesitation in consulting American jurisprudence, for method ot approach as well as the interpretation of particular valuation terms. However, not all states employ the same value term for the appraisal remedy. In Delaware and New York, the shareholder is entitled to the "fair value" of his shares, while in California, the measure specified is "fair market value".

An examination of the decisions of these three jurisdictions illustrates the variety of results brought about through lack of a uniform basis of judicial valuation of shares.[365] The fact that several states, including Delaware, have withdrawn appraisal rights from stocks listed on national stock exchanges has important

363 (1980) 12 B.L.R. 209, reversed on appeal.
364 43 O.R.(2d) 128
365 See Rams, *Judicial Valuation of Dissenting Shareholder Interests* (1973) 8 Lincoln L. Rev. 74, 74.

consequences for the rationale of the remedy as viewed by the legislatures.[366] At the same time, however, the courts approach market value with caution and in several decisions have used the existence of the appraisal remedy as a basis upon which to formulate greater measures for the protection of minority shareholders.[367]

c. Delaware

i. Judicial Elaboration on the Purpose of Evaluation

The Delaware decisions provide considerable details of the process and purpose of judicial valuation. In a 1950 decision which continues to be cited with approval, the court enunciated the following definition of value:

> "The basic concept under the appraisal statute is that the shareholder is entitled to be paid for that which has been taken from him, viz. his proportionate interest in a going concern. By value of the stockholder's proportionate interest in the corporate enterprise is meant the true or intrinsic value of his stock which has been taken by the merger."[368]

When fixing value, various factors must be considered. In the above decision the court listed market value, asset value, dividends, earning prospects and the nature of the enterprise. Very often these factors serve both as the basis for and evidence of "value".[369] This sometimes produces confusion over the definition of value, but this confusion would appear unavoidable due to the court's insistence upon examination of all pertinent variables before reaching a decision on value. In most cases, the court will consider at least the asset value, investment value and market value of the company and

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366 See Note, *Reconsideration of the Stock Market Exception to the Dissenting Shareholder's Right of Appraisal* , (1976) 74 Mich. L. Rev. 1023.
367 *Supra*, note 322 at 1463.
368 *Tri-Continental Corp. v. Battye,* 74 A.2d. 71 (1950) at 72.
369 *Ibid.*,at p. 77.

then find the rateable value of a single share, determined by these "types" of value. Then the court will assign "weights" to each of the value factors. The value per share obtained in this manner is then multiplied by the total outstanding shares to reach the "going concern" value of the enterprise. The relative weight or importance assigned to each value factor will be determined by the court after an examination of the facts of the particular case and circumstances of the company.[370]

ii. Varied Approaches to Fair Value

In *Re Delaware Racing Association*[371] appraisal proceedings resulted from a "short-form" merger. On appeal from the Court of Chancery, the Supreme Court held that the minority shareholders were entitled to be paid the "intrinsic" value of their shares determined on a "going concern" basis. The stockholders had argued that, under section 253,[372] the short-form merger provision, where they were forced out of the corporation by the holder of ninety percent of the shares and paid off in cash, they were entitled to reimbursement for what had been taken from them, namely an aliquot interest in the assets of the corporation, or a liquidating value. The proposition that a short form merger appraisal proceeding required different treatment from an ordinary section 251 merger, where it was appropriate to give the dissenting shareholder the going concern value of his shares, since he was free to elect to remain in or withdraw from the enterprise, was rejected by the court. In the "weighting" exercise, market value was given a rating of forty percent by the Vice Chancellor, since in the long run the most likely way in which an investor in the stock, if permitted to continue in the resulting enterprise, could have realized on his investment, was by way of a sale of his shares. In the event, the decision of the Vice Chancellor was affirmed.

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370 *Ibid.* at pp. 81-82.

371 213 A. 2d 203 (1965)

372 DEL. CODE ANN. tit. 8, section 253.

In *The Matter of General Realty and Utilities Corp.*,[373] the asset value of the corporation was weighted at fifty percent since the assets of the company comprised mainly securities and real estate, which could be easily liquidated. In his report, the appraiser noted that the intrinsic value of a stockholder's shares in a going concern should always be more than their liquidating value, and if not, the corporation would be a proper subject for liquidation. Also, in *Levin v. Midland-Ross*,[374] the company's highly liquid assets were an important value factor. However, in line with the view that the stockholder should be paid for his proportionate interest in a going concern, the appraiser, in determining asset value, was directed to calculate a figure which represented the present value of the assets.

The other common basis for valuation is that of the earnings value of the stock, which is derived from the earning capacity of the corporation as a whole. The Delaware courts have long held that the earnings value of stock must be determined from a survey of past earnings, not prospective earnings. In *Sporborg v. City Specialty Stores Inc.*,[375] the "weight" given to the earnings factor in the valuation was sixty percent. Here the appraiser had used only the earnings for the fiscal year immediately preceding the effective date of the merger. The court disapproved, stating that long range prospects should furnish the basis for sound valuation and that earnings should generally be capitalized over a period of three to five years, and sometimes even ten to fifteen years, where appropriate.

iii. Expansion of Scope of Valuation

The recent decision in *Weinberger v. U.O.P.*[376] indicates that the elaborate valuation techniques developed by the Court of Chancery, including the "weighting" procedure are no longer in vogue. The court

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373 52 A.2d 6 (1947).
374 194 A.2d 50 (1963).
375 123 A. 2d 121 (1956).
376 457 A. 2d 701 (1983) (Del. Supr).

noted at the outset that "... to give full effect to section 262 within the framework of the General Corporation Law we adopt a more liberal, less rigid and stylized approach to the valuation process than has heretofore been permitted by our courts".[377] Moore J. enunciated a test of fairness, against which the terms of the merger would be measured. The directors of the subsidiary, nominated by the majority shareholder had failed in their duty of loyalty to the subsidiary. They had failed to disclose to the independent directors the existence of a report which concluded that the acquisition of the outstanding minority shares would be a good investment at any price up to $24.00 each. There was no negotiation of the price, in the true sense of the word. The court noted, on the difference between a price of $21.00 and $24.00:

> "It shows that a return on the investment at $21.00 would be 15.7% versus 15.5% at $24.00. This was a difference of only two-tenths of one percent, while it meant over $17,000,000 to the minority."[378]

As set out by the court, the requirement of fairness against which the conduct of Signal, its designates on U.O.P.'s board and the bargain would be measured, has two basic aspects: fair dealing and fair price.

> "The former embraces the questions of when the transaction was timed, how it was structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained. The latter aspect of fairness relates to the economic and financial considerations of the merger, including all relevant factors: assets, market value, earnings, future prospects and any other elements that affect the intrinsic or inherent value of a company's stock".[379]

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377 *Ibid.* at p. 704.
378 *Ibid.* at p. 709.
379 *Ibid.* at p. 711.

The court then stated that it is not a bifurcated test. All aspects of the issue will be examined as a whole to determine if they meet the standard of "entire fairness". The plaintiff sought to establish that the price of $21.00 was unfair, and introduced testimony based upon a comparative analysis of the premium paid over market price in ten other tender offer/merger combinations and a discounted cash flow analysis, suggesting a price of at least $26.00 per share. In the lower court, the Chancellor had rejected this evidence. The approach to valuation in this situation, where a breach of fiduciary duty was alleged, was considered by the Chancellor to be the same as that in an appraisal proceeding. The "Delaware block" or weighted average method was employed, and the defendant's evidence of value accepted. The Supreme Court noted that this method had been in use for decades, but it was time for a change:

> "...to the extent it excludes other generally accepted techniques used in the financial community and the courts, it is now clearly outmoded. It is time we recognize this in appraisal and other stock valuation proceedings and bring our law current on the subject."[380]

It was not coincidental that, although the plaintiffs' discounted cash flow method of valuing U.O.P.'s stock was rejected by the Chancellor, it was precisely this method which was the focus of the report prepared for Signal recommending the purchase of U.O.P.'s outstanding stock. Accordingly, the Supreme Court held that the weighted average method of valuation would no longer exclusively control appraisal and valuation cases.

> "We believe a more liberal approach must include proof of value by any techniques or methods which are generally considered acceptable in the financial community and otherwise admissible in court..."[381]

This approach was mandated by recent legislative changes to the appraisal section, obliging the Court to determine "fair" value,

380 *Ibid.* at p. 712.
381 *Ibid.* at p. 713.

whereas previously the court had to determine "the value of the stock".[382] In determining such fair value, all relevant factors must be taken into account, excepting only any element of value arising from the accomplishment or expectation of the merger. Significant too, is the holding that "fair value" may include any damages, resulting from the taking, which the stockholders sustain as a class. In tracing the evolution of the section, the Court perceived "a legislative intent to fully compensate shareholders for whatever their loss may be, subject only to the narrow limitation that one can not take speculative effects of the merger into account".[383]

Thus, with the recent legislative emphasis on fair value, the Delaware court is shifting the focus of valuation to a consideration of "all relevant factors" and the fairness of the entire transaction. While the "block method" had its advantages and attempted to treat the minority shareholder fairly by determining what "weight" to assign particular value factors having regard to the situation of the company, the new approach will arguably do away with certain rules which had developed, notably the refusal to consider a projection of earnings.

d. New York

i. Judicial Progression from Market Value to Fair Value

New York State is another jurisdiction where the courts are wont to rely upon market value for the determination of value in appraisal actions.[384] Initially, the New York courts avoided making any pronouncements on the meaning of value, being content to accept the findings of the appraisers who were appointed by the court to "estimate and certify the value of such stock just prior to the taking of the objected to action."[385]

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382 *Ibid.* at pp. 713-714.
383 *Ibid.* at p. 714.
384 Note, *Dissenting Shareholder's Right of Appraisal - Determination of Value,* 28 N.Y.U. L. Rev. 1021 at 1026.
385 *Ibid*, at p. 1023.

In *The Matter of Fulton*,[386] appraisers had valued preferred stock for which there was no market, by adding together the book surplus and amount of capital stock and dividing this figure by the total number of common and preferred shares. The Court of Appeals rejected this valuation as being analogous to dissolution, whereas the purpose of the appraisal was entirely different. The purpose was to "save the dissenting stockholder from loss by reason of the change in the nature of the business."[387] Furthermore, "the payment of such actual value, even if more than the market quotation, is the price that must be paid by the corporation for the privilege of requiring a sale over the protest of the dissenting stockholders who are in effect being ousted from the corporation."[388] However, the "actual value" was being paid in this case only because there was no market for the stock. If there were a market, then market quotations that would probably have continued but for the corporate change, would be the controlling factor. In the event, the court decided that the actual value was the par value of the stock. The stock had been issued at par and had never sold above par.

In *Re Clark's Will*,[389] the court stated that market quotations should be considered only to the extent that they reflect a reasonable basis for estimating quotations which would have continued, but for the sale. The stockholder is not entitled to any enhancement of value present in market prices as a result of the sale from which he dissents. Other factors which should be considered as tending to affect market quotations are the rate and regularity of dividends, the management and reputation of the company and all other circumstances which would aid the court in estimating the future course of the market.

Nonetheless, while there is a strong presumption in favour of the reliability of the market process, the market itself has to conform

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386 257 N.Y. 47, 178 N.E. 766 (1931).
387 *Ibid.*
388 *Ibid*.
389 257 N.Y. 487, 178 N.E. 766 (1931).

to certain conditions. The market should be "an active, deep and fair exchange reflecting the judgment of voluntary buyers and sellers". In *Application of Behrens,*[390] the court noted that the weight to be given market value is related to the nature and extent of the market in the stock. In *Application of Marcus,*[391] the dissenting stockholder owned 50 out of 1,656,000 shares of common stock. When the shareholders voted to give preferred stock equal voting rights, Mrs. Marcus was the only member to seek an appraisal. She asked $400 per share for her stock, which was selling on the New York Stock Exchange at $43.44. Mrs. Marcus obtained a subpoena *duces tecum* ordering the corporation to produce its records. She contended that the present value of the company's assets was not accurately set forth in the financial statements and thus not properly reflected in the market price of the stock. The appeal court vacated the subpoena on the ground that "market value is the controlling consideration where there is a free and open market and the volume of transactions and conditions makes the market a fair reflection of the judgment of the buying and selling public".[392] The court said that Mrs. Marcus had also failed to suggest any substantial inaccuracies in the published financial statements as would cause inaccurate market valuations. The court reviewed the case law and emphasized that the facts of a particular situation will determine the factors to be considered and the weight to be given them.

The appeal court also upheld an appraisal based on the market value of American Telephone and Telegraph Corp. stock. The company had announced a plan to issue 3,000,000 common shares to employees at $20 below market. The company offered to pay the dissenters $152 per share, 5/8 of a point above its market price. The appraiser noted that the dissenters were able to present a formidable body of documentary proof, as well as opinion evidence to support their claim that the investment value was in the vicinity of $225, the net

390 61 N.Y.S. 2d 179.
391 79 N.Y.S. 2d 76 (1948).
392 *Ibid.* at p. 78.

asset value. However, he followed New York case law and valued the stock at market price.[393]

The emphasis on market value in the older cases has been significantly eroded by *Endicott Johnson Corp. v. Bade.*[394] The action arose out of the merger between Endicott and the McDonough Corporation. Market value was "eliminated as a meaningful factor" in this appraisal. Prior to the merger, Endicott's stock had been de-listed from the New York exchange, and was traded over the counter at $26.25. The appraiser noted that earnings were not helpful due to a dramatic change in the company's management, and that the market for the stock had become very thin. Accordingly he disregarded market value and valued the stock at $46.75. Endicott appealed arguing that market value should be given substantial weight. The Court of Appeals disagreed.

> "...the right of dissenting stockholders to obtain fair value rather than market value for their stock protects them from being forced to sell at unfair values arbitrarily and unilaterally fixed by those who may dominate a corporation..."[395]

The court also noted the policy considerations behind the appraisal remedy. The function of market value is limited to that of a component of fair value. Corporations should thus be stimulated "to minimize dissent by seeking the best possible deals and the protection of investors whose expectations do not center on the market".

e. California

i. Emphasis on Market Value

The California formulation of the appraisal remedy may be described as at the opposite end of the spectrum from Delaware. The

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393 *Application of Deutschmann,* 116 N.Y.S. 2d 578.
394 37 N.Y. 2d 585, 376 N.Y.S. 2d 103, 338 N.E. 2d 614 (1975).
395 37 N.Y. 2d 585 at 590.

essential difference is in the measure or type of value. While Delaware shareholders are entitled to "fair value", their California counterparts receive "fair market value".[396] The fair market value is to be determined as of the day before the announcement of the terms of the proposed merger or re-organization. The California Corporate Code provides for appraisers to be appointed, if the fair market value of the dissenting shares is in issue, or the court may make the determination.[397] Compared with the Delaware jurisprudence, the California decisions on the definition of fair market value are remarkably few. As the court remarked in a 1960 decision,

> "Our statute seems to have worked well, as this is the first case to come before an appellate court since it was enacted nearly thirty years ago."[398]

This decision, *Gallois v. West End Chemical Co.*,[399] states succinctly the philosophy behind the choice of fair market value as the measure of compensation:

> "Many writers prefer some other definition such as our former "fair cash value" or "intrinsic value" or "real value" or "fair value" etc. We do not know what these terms or others like them mean and we suspect that the writers who advocate them do not know either. They use them because they distrust the market as a gauge of value. Yet realistically, under our economic system, the value of any item of property on any given date, in monetary terms, is what it can be sold for in a free and fair market. This has long been the rule in this state in cases of condemnation of real property, a process at least as involuntary as that now before the court. In such cases the owner has no choice but to sell; in our case he had a choice of participating in the merger or receiving the fair market value of his shares."[400]

396 CAL. CORP. CODE, section 1300(a) (West 1988).
397 CAL. CORP. CODE, section 1304(c)(West 1988).
398 *Gallois v. West End Chemical Company*, 8 Cal. Rptr. 596 (1960) at p. 602.
399 8 Cal. Rptr. 596 (1960).
400 *Ibid.* at p. 601.

The plaintiff had attempted to show that his callable participating preference stock was *de facto* non-callable and thus its price should move along with that of the common stock. Evidence offered by the plaintiff that there was an understanding among the directors never to call the stock, since this would result in unfavourable tax consequences for the control group, was excluded by the trial judge. As was pointed out by the court, traders in the market had in fact taken into account the long period of thirty years during which the stock had not been called, and were willing to pay a price which in effect was a gamble that the stock would not be called. The market price of $1.30 per share was almost 25% higher than the call price. Furthermore, it would be inconsistent with the terms of the statute to permit the plaintiff to attack the market value. Previously, the corporate code had provided for shareholders to receive "fair cash value", and appraisers to be appointed in every case. This was soon amended to the present fair market value, with the court having the option of appointing appraisers. Thus, the changes eliminated the necessity of appraisal for cases where stock is actively traded. The functioning of the market would, if there had been such an informal decision not to call the stock and such had been made known to the traders along with the decision to merge, have assimilated the information into the current price and consequently be influenced by the very factors which must be excluded by the court in determining fair market value. Also, there are many situations where information is known to directors which if publicly announced would affect the price of a company's stock, for example, the date of a declaration of dividend. The court felt that "no one could successfully argue that the market price of the stock, before the dividend action was not a fair market price."[401] However, the market must be an active and informed one, "not distorted by fraud, manipulation, rigging or unfair conduct on the part of management vis-a-vis the shareholders."[402]

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401 *Ibid.*
402 *Ibid.*

Although not strictly an appraisal decision, *Jones v. H.F. Ahmanson and Co.*[403] illustrates the tendency to employ the appraisal remedy in situations arising outwith the appraisal section. This was a minority stockholder's class action against certain holders of stock of a savings and loan association, who had transferred a control block of shares in the association to a holding company. The association had retained the major part of its earnings, with the result that the book value of its shares was substantial. Its shares were not actively traded. The defendants incorporated United Financial Corporation of California, and transferred to it their majority holding of association stock, receiving 250 United Financial Shares for each association share. The minority shareholders were not offered the opportunity to exchange their shares. Shortly thereafter a public offering of United Financial stock was made, with most of the funds so garnered being distributed, as a return of capital, to the original shareholders of United Financial - the former majority shareholders of the association. A further public offering of United Financial occurred, with the result that the public market created for United Financial's shares rendered the association stock unmarketable, except to United Financial. The majority shareholders of United Financial then proposed terms for the exchange of association stock of the minority, which were less favourable than the basis for exchange which the majority had previously received. The Supreme Court held that the defendant majority shareholders had used their control of the association to obtain an advantage not made available to all stockholders, in the absence of compelling business purpose. This conduct was inconsistent with the duty of good faith and inherent fairness owed to the minority.

The court reasoned that from the standpoint of the minority, the transfer of control constituted a fundamental corporate change. Their position was drastically changed.

403 81 Cal. Rptr. 592

> "In short, the enterprise into which the minority stockholders were now locked was not that in which they had invested."[404]

In this case, appraisal rights were the very minimum to which the plaintiff was entitled. She should have been accorded the opportunity to exchange her association shares for United Financial on the same terms as the majority. Accordingly, if the plaintiff were successful at trial, she would be entitled to receive, at her election, either the appraised value of her shares on the date of the original exchange, plus interest, or the fair market value of a block of United Financial stock on the date of the action. The sum to be paid, however, would be reduced by the amount by which dividends paid on Association shares exceeded dividends paid on a corresponding block of United shares.

f. United Kingdom Jurisprudence

i. Fairness in Compulsory Aquisition Proceedings

In the United Kingdom, the courts have tackled the valuation issue chiefly in relation to section 428 of the 1985 Act and its predecessor. Although section 459 of the 1985 Act gives the court the power to order the purchase of members' shares, such an order has seldom been made. While the statute authorizes the purchase, it provides no indication of what value is to be paid, fair or otherwise.

The majority of decisions based on section 428 are concerned with the burden of proof placed upon the dissenter by the wording of the section. Shares may be compulsorily acquired "unless...the court thinks fit to order otherwise". Bearing in mind the current judicial and statutory emphasis on fairness, it is interesting to note the various factors considered by the English bench which fell short of establishing "unfairness". The task facing a dissenting shareholder under section 428 is just as formidable as that facing an American shareholder attempting to enjoin a merger in Delaware.

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[404] *Ibid*, at p. 605.

A predecessor of section 428, section 155 of the 1929 Act, similar in most respects, was the subject of an interpretation by Maugham J. which has persisted to the present day. The 1933 decision of *Re Hoare and Company Limited,*[405] concerned an offer made by Charrington and Co. Ltd. to acquire the shares of Hoare and Co. The offer was to give for every five shares of Hoare, L7.10s in cash, three 4 percent cumulative preference shares and two ordinary shares in Charrington. This offer was ultimately accepted by 99.86 percent of the total issued share capital of Hoare. The applicants, holders of 2,800 shares, sought an order from the court that Charrington was not entitled to acquire their shares. They argued that the offer was not really a fair one, because the income of the shares would be reduced as a result of accepting the offer. At the outset, Maugham J. indicated the difficulty he was in, since

> "...the legislature has not thought fit to indicate in any way however remote, the grounds on which the court is to intervene and to make an order preventing the transferee company from acquiring the shares of the dissenting shareholders."[406]

He then went on to give his oft-quoted view of the legislative intent:

> "...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...it is manifest that the reasons for inducing the court to 'order otherwise' are reasons which must be supplied by the dissentients...and that the onus is on them of giving a reason why their shares should not be acquired by the transferee company."[407]

Furthermore, the mere fact that the sale is compulsory was not to influence the court. "It has been called an expropriation, but I do not

405 150 L.T. 374.
406 *Ibid.* at p. 375.
407 *Ibid.*

regard that phrase as being very apt, in the circumstances of the case."[408] The crucial conclusion however, with regard to the development of an effective shareholder remedy was that, again, *prima facie*, "the court ought to regard the scheme as a fair one in as much as it seems ...impossible to suppose that the court, in the absence of very strong grounds is to be entitled to set up its own view of the fairness of the scheme in opposition to so very large a majority of shareholders."[409]

The court looked at the balance sheets of both companies commenting that very little real information could be gleaned from them regarding the capital value of assets, treating the companies as going concerns and "on the footing of a liquidation, the balance sheet figures are almost useless." However, the court proceeded on the basis that both companies were sound and solvent, with excellent prospects and was not persuaded that the offer was unfair. The court remarked with respect to the argument that the offer resulted in reduced income:

> "It is to be observed that the offer is partly for cash and partly for preference shares in the transferee company; and greater security may have to be bought at the expense of a somewhat smaller income."[410]

In *Re Evertite Locknuts Limited*,[411] Vaisey J. followed Re Hoare[412] and refused to "order otherwise" in a situation where the minority shareholder was unable to say whether he regarded the offer as fair or unfair, since at the time the offer was made, when he was called upon to consider it, he was without sufficient information on which to come to a conclusion. He requested information from the directors of the transferor company, but was refused. The court noted that such a grievance could not be put forward in an action against the

408 *Ibid.*
409 *Ibid.*
410 *Ibid.* at p. 376.
411 (1945) 1 Ch. 220.
412 *Supra*, note 405.

transferee company. The court had no evidence to rule on the information question, and was clearly swayed by policy considerations:

> "...if once it is conceded that a scheme of this kind can be upset merely for the reason that a shareholder is not given all the information which he might require or might expect from the directors of the transferor company, there would be no limit to the inquiry which would have to be set on foot as to the extent to which his demands for disclosure ought to be conceded."[413]

It could not be right that one shareholder, with one-seven-hundredth part of the share capital should be entitled to hold out against the 699/700ths of the share capital "merely because he has, as he thinks, been left somewhat in the dark in regard to the material facts".[414]

The decision of *In Re Press Caps Ltd.*[415] revolved around an item in the balance sheet of the transferor company. An offer for all the ordinary shares of Press Caps had been made by Metal Box Co. Ltd., at a price substantially above market. The offer was accepted by 96.8 percent in value of the shares. The applicants sought to prevent the compulsory sale of their shares to Metal Box on the basis that an item of freehold, appearing in Press Cap's balance sheet at approximately L29,000. was grossly undervalued. The true value was admitted to be in the region of L90,000. The applicants were initially successful before Vaisey J. who held that the offer was unfair. He was influenced by the discrepancy in the balance sheet, which was the only information provided to the shareholders of Press Caps. In his opinion there was a great deal of doubt regarding the appropriateness of the balance sheet as an estimate of value, which would also taint the market prices of the stock. However, the Court of Appeal reversed his decision. Somervell L.J. did not agree with Vaisey J.'s view of the balance sheet. It was not a "valuation".

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413 *Supra*, note 411 at p. 224.
414 *Ibid.*
415 (1949) 1 Ch. 434.

The figure was presented in accordance with common practice, at cost less depreciation. Therefore, there was nothing misleading about it. In fact, it was common knowledge that the value of freehold property was presented in this form, despite the substantial increase in value.

It was also argued that the price was unfair because the offer was made to acquire the entire shareholding, i.e. control, and that the Stock Exchange valuations of the shares neglected this element. The court answered this contention by pointing out that the offer had been accepted by 1,114 shareholders out of a total of 1,116, and that the price offered gave a substantial addition to the price obtained on the Exchange. Wynn Parry L.J. noted that "a valuation is only an expression of opinion. It may be made on a number of bases, but the final test of what is the value of a thing is what it will fetch if sold."[416] Since a market existed on the Stock Exchange, the prices on the exchange could be taken as a satisfactory indication of the value of the shares.

Vaisey J. gave come consideration to what could be characterized as an unfair scheme, in *Re Sussex Brick Co. Ltd.*[417] The scheme "must be obviously unfair, patently unfair, unfair to the meanest intelligence." The fact that a better scheme could have been devised is not enough to invalidate a scheme. The mere finding of items in the scheme which are open to criticism is not sufficient to establish unfairness "consistent with the spirit" of Maugham J.'s judgment. As a result of the scheme, using stock exchange values, "[the] shares (given up) were less than half the value of the shares given in substitution for them." The court found it "a little hard to see such a bad bargain" had been driven.[418]

A situation where the minority shareholder was forced to sell at a loss arose in *Re Grierson, Oldham & Adams Ltd.*[419] The applicant

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416 *Ibid.* at p. 447.
417 (1961) 1 Ch. 289.
418 *Ibid.* at p. 292.
419 (1968) 1 Ch. 17.

shareholder put forth a number of valuation factors in argument: over a number of years the price had exceeded the offer of 6s, the assets and prospects of the company warranted a higher price and the offer was made at a time when the market was temporarily depressed, and before it had reacted to the promising results of the latest financial year. Also it was stressed that the price of 6s. did not recognize the advantages accruing to the respondents from the take-over. None of these arguments was successful. Plowman J. stated that the issue was whether 6s. was a fair price at the time the offer was made. The fact that 6s. did not reflect the advantages accruing to the transferee company by obtaining control might concededly be used to justify paying a shareholder with a controlling interest, a large price for his shares but "it is not unfair to offer a minority shareholder the value of what he possesses, i.e. a minority shareholding."[420] Also, since this was a purchase of shares, not of assets, the market price on the Exchange would be cogent evidence of the true value of the shares.

ii. Fairness in Oppression Remedy Proceedings

Although under section 459 of the 1985 Act and its predecessors, the court has the power to order the purchase of a minority shareholder's shares, where the affairs of the company were being managed in a manner oppressive to some of the members, the section has rarely been used to make this type of order. In *Scottish Co-Operative Wholesale Society Ltd. v. Meyer and Another* [421] the Society had set up the Scottish Textile and Manufacturing Company Ltd., with the help of Meyer and Lucas. The Society held 4,000 shares, Meyer and Lucas held 3,900. The shares had a par value of L1.00. The company was formed to carry on the manufacture of rayon, which at that time could only be done under licence, by persons with the necessary skill and experience. Meyer supplied the expertise in the industry and was successful in obtaining supplies

420 *Ibid.* at p. 35.

421 (1954) S.C. 381, proof before answer allowed; (1957) S.C. 111, (1958) 3 All E.R. 66 (H.L.).

and contacts. The company prospered. An agreement had been made in 1947 which called for a re-alignment of the shareholdings, so that the Society should hold 70 percent and Meyer & Lucas 30 percent of the issued capital. Nothing further was done until 1951, when the question was raised. The Society felt it was entitled to acquire Meyer's shares at par value. Meyer disputed this price, pointing to the company's success. The shares were then valued by the company's auditors at L6.10s.11d. The Society dropped the re-purchase scheme. In 1952, the Society was free to manufacture rayon without a licence, and thereafter adopted a policy of refusing to supply the company with cloth. The directors of the company nominated by the Society allowed the company's trade to decline. In 1953, Meyer and Lucas offered their shares to the Society at L3.15s. each. The offer was refused. Conditions further deteriorated and the minority shareholders sought an order compelling the Society to purchase their shares. Both the First Division of the Court of Session and the House of Lords found that the conduct of the Society amounted to oppression as required by the section. The Lord President, Lord Clyde, stated that the section "warrants the Court in looking at the business realities of a situation and does not confine them to a narrow legalistic view."[422] In the event, the Society was ordered to purchase the shares of the minority at L3.15s. each. Unfortunately, although "a considerable body of evidence was led as to the value of the shares", the Lord President felt that "no good purpose would be served by considering these in detail".[423] Taking into account the requirements and object of the section, L3.15s. was a "fair figure". Lord Carmont noted that at the time when the Society attempted the share re-alignment, the shares had acquired "an intrinsic value" and that the minority would not accept par value for their holdings. The minority were entitled to be relieved of their shares as from the time when the oppression became apparent. In assessing the value of the shares at L3.15s. each, Lord Carmont considered that the Company was dependent upon the Society for

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422 (1954) S.C. 381 at p. 391.
423 (1957) S.C. 111 at p. 129.

premises and the means of production of the rayon and also for funds to finance payment for the raw materials.[424] Lord Russell compared the values of the shares obtained at different dates. In 1952, they had been valued at L6.0s.11d., but this valuation was open to criticism owing to a difference in the treatment of stock on replacement value rather than cost, which inflated the profit figure. Further, goodwill was increased by a sum of L9,000 which was actually required in the running of the business. The Society placed a value of L3.0s.4d. on the shares as at the same date. In 1953, the same valuer was of the opinion that the shares stood at L1.10s. In arriving at a fair value, the court should:

> "Look to the date when the proceedings were begun and ask...what would have been a fair figure for the Society to have paid at that date. In doing this, however, it must be remembered that the oppression had begun at an earlier date, with some resultant loss of share value..."[425]

Accordingly, what the court had to do was fix the value which the shares would then have had, but for the effect of the oppression. The court noted that the 1952 figures were the best guide, but there would inevitably be an arbitrary element in the choice of a final figure. The Society appealed but the House of Lords approved of the First Division's findings, confirming the price of L3.15s.

A recent decision provided the first opportunity for the court to determine a question of valuation under section 459 of the 1985 Act. In *Re Bird Precision Bellows Ltd.*,[426] Nourse J. stated that it was evident that the approach of the court must be the same as it was under section 210 of the 1948 Act, a predecessor of section 459. In addition, although both sections 210 and 459 were silent on the point, "it was axiomatic that the price fixed by the court must be fair". The decision is chiefly concerned with the question of the

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424 *Ibid.* at p. 136.
425 *Ibid.* at p. 156.
426 1984 1 Ch. 419

appropriateness of a minority discount and posits varied circumstances where a minority shareholder would be "forced" to apply for relief under section 75. Nourse J. concluded that, while there is no rule of universal application, there is a general rule where the company is a quasi-partnership and the shares to be purchased are those of a quasi-partner. It would be most unfair to allow the quasi-partner to be bought out at any price which involved a discount. The court rejected the submission that the question of a minority discount is a matter of valuation to be decided on the evidence of valuers. Such a question is a question of law, to be decided by the court. If, as a matter of law, there is a case where a minority discount is appropriate, then the amount of the discount is a valuation question.

Chapter 6

Conclusion

The appraisal remedy has become the focus of a number of outstanding issues between the minority and majority shareholders. The existence of such a remedy has been seen in the American jurisdictions as justifying conduct on the part of the majority shareholder which would in other jurisdictions raise concerns as to the propriety of the proposed course of action. The amalgamation squeeze-out or going private transaction is commonplace in the United States and the frequency of such transactions in Canada is increasing. Given that it is not unusual for Canada to lag behind commercial developments in the United States, a continuing rise in the popularity of such corporate procedures may be forecast. It is perhaps timely to consider whether some further analysis should be given to the present Canadian legislation, in terms of the use of amalgamation squeeze-out. It cannot be disputed that the appraisal remedy introduces a degree of flexibility to Canadian corporate law, but it would appear that whether the benefits of this flexibility accrue chiefly to the corporation or its minority shareholders depends upon the type of corporate reorganization being proposed.

The Canada Business Corporations Act and the various provincial statutes modelled on it have all adopted a broad range of fundamental changes which will give rise to appraisal rights. There is no narrowing of the right to dissent to stock which is not listed on a national exchange or is not widely traded, as is common in the United States. However, this in itself may not provide much assistance to a minority shareholder in a large public company. Market value is still, notwithstanding the legislative mandate of fair value, of considerable influence. The temptation to succumb to the view that it is not an "estimation" of value but an actual "price" and that therefore this very concreteness is definitive of fair value, is evident in the early decisions. Yet there is a discernible trend away from this "short-cut" approach to valuation. Admittedly, situations where there was no active market encouraged the courts to examine in great detail the types of operations and assets of the companies before them. Indeed, it has been in the areas of the scope of the remedy and the valuation of shares that the courts have shown no small ability to flesh out the bare bones of the legislation and provide a meaningful remedy for the dissenting shareholder.

The legislation, however, leaves the courts little power to mitigate the harsh effects of the procedural aspects of the appraisal remedy. Given the various pitfalls in the process which all work against the dissenting shareholder, one may question whether appraisal figures as a shareholder remedy or rather as a protracted procedure which the company must endure in order to fashion new enterprises. Granted, the company has legitimate concerns which the procedure addresses, such as notification of dissent and demand for payment. Nonetheless, it would appear that in the balancing of conflicting interests the legislation has come down firmly on the side of the company's need for certainty. The time periods in which a dissenting shareholder must act are very short, particularly for the unsophisticated investor or one who lacks immediate access to professional advisors. The company is not even under an obligation to notify its shareholders of the right to dissent and what the right entails. Admittedly, if a company is about to enter into a "triggering transaction" it must include in the notice of the meeting being called to authorize such action a statement that dissenting shareholders are entitled to be paid the fair value of their shares in accordance with section 184. However, there is no obligation on the company's part to explain what this means and failure to include the statement does not result in any sanction against the company. The legitimacy of the transaction itself is not impaired.

While the Canadian provisions oblige the shareholder to send a notice of his objection to the proposed change to the company, provided the company has given him notice of the purpose of the meeting and his right to dissent, failure on the company's part to furnish this information has no serious consequences. Instead the shareholder merely has twenty days after he learns that the resolution has been adopted to demand the fair value of his shares. This raises the possibility of the argument of constructive notice being used by the company against the shareholder. Subsections 184(5) and (7) should be drafted in a more positive tone, clearly imposing upon the company an obligation to provide the information regarding dissenters' rights. Such a change would create no hardship for the company. It is in control of the timing of fundamental changes and generally will not act without taking legal advice. Furthermore, with the company providing information to its shareholders on the steps necessary to enforce their rights, the vigorous effect of the time periods within which a shareholder must act in order to qualify as a dissenting shareholder becomes more reasonable. There is much to recommend the Delaware and California practice of requiring the company to inform its shareholders of the existence of the right to dissent, usually by sending a copy of the appraisal legislation with the notice of the shareholder's meeting.

With the complex procedure to enforce the appraisal right working against the shareholder, the development of the remedy from a dissenter's perspective has been taken up by the courts and can best be seen in those cases which bear upon the scope of the remedy and the fixing of "fair value". These two aspects of the appraisal process are inextricably linked. This is due to the nature of the transaction from which the shareholder dissents. Where the transaction is not a freeze-out and the shareholder dissents voluntarily, the appraisal remedy will protect that shareholder's investment. The valuation of his shares as at the close of business on the day before the resolution was adopted is entirely appropriate. By choice, the shareholder is disassociating himself from the new enterprise and should receive the value of his investment without regard to the anticipated results of the change. The situation differs when the shareholder is forced to resort to the appraisal mechanism when he is being "squeezed-out" of the new enterprise by the majority. Appraisal is his only recourse in such a situation. Although the courts have shown a marked displeasure with corporate freeze-outs, they have been unable to characterize them as oppressive or even unfairly prejudicial to the minority's interest, owing to the apparent legislative sanction of such arrangements. However, apart from obiter statements as to the offensive nature of these transactions, the courts have demonstrated their displeasure with the effect of a freeze-out upon the minority by imposing a "forcing-out" premium as a component of the fair value of the minority shareholding.

The development of the "forcing-out" premium is a natural reaction to the essential unfairness of the amalgamation squeeze-out. The reorganization is characteristically undertaken in furtherance of some financial benefit, whether it be increased operational efficiency, access to new markets or tax advantages, which the majority does not wish to share with the minority. A valuation of minority shares which did not acknowledge the existence of the anticipated benefits would hardly accord with the mandate of "fair value".

Although the courts have voiced their unease with the implications of the amalgamation freeze-out, they are constrained by the appraisal legislation in the help that can be given to the minority. Such amalgamation operates as an expropriation of the interests of the minority, yet the protection of section 199, which deals specifically with compulsory acquisition of dissenters' shares is not available.

It is interesting to postulate whether in the courts' development of the oppression remedy, the legislative authorization of amalgamations and mergers to eject a small but significant minority will be questioned. With the emphasis on fair value and fair treatment for the minority, the authorization of different treatment for holders of the same type or class of shares is difficult to justify, especially since this result is sanctioned by implication only and would appear to render the compulsory acquisition provision redundant.

Notwithstanding the problems created by this type of amalgamation, the appraisal remedy works well in those situations for which it was designed, that is, where the shareholder has the choice of participating in the new enterprise or dissenting. The courts have taken a broad view of the nature of fair value, to the benefit of the the dissenter. The drawbacks of the complicated procedure could be lessened by minor legislative amendments. It is apparent that the appraisal process could never function as the sole remedy for dissatisfied shareholders but it provides a significant alternative action for the minority with the emphasis correctly placed on the amount of money that minority will be allowed to remove from the corporation.

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