

THE APPRAISAL REMEDY FOR DISSENTING SHAREHOLDERS IN CANADA: IS IT EFFECTIVE?

ANDERS BRUUN*
MICHAEL LANSKY*

PREFACE

In explaining and analyzing the appraisal remedy for dissenting shareholders in Canada, the following specific issues will be discussed. Following the historical Introduction, the events which give rise to the application of the remedy, the Triggering Events, will be outlined. Procedural issues in the application of the section 184 remedy include who may dissent, notice of objection, access (or lack of) to financial information, solvency test, and suspension of rights. A discussion of the method of valuation of shares comprises date of valuation, whether the effect of the resolution is to be included or excluded, methods of valuation (including mention of public and private corporations, market value, net asset value and investment value, and minority discount), purpose of the valuation, the effect of a predetermined method of valuation, and income tax considerations. Lastly, the issue of costs will be dealt with.

INTRODUCTION

The appraisal remedy is essentially a statutory creation to enable shareholders who object to certain fundamental changes to dissent and to require the corporation to buy their shares at the value immediately prior to the approval of such resolution and thus to withdraw from the corporation.¹

The appraisal remedy was not available at common law and has only recently been introduced into the Canadian² and Manitoban³ Corporations Acts. The remedy was first made available to shareholders of companies in some American states in the early part of the century and is now available in all but one state: West Virginia. It should be noted that, though the corporate changes giving rise to the remedy and the procedural matters may vary with the jurisdiction, the dearth of Canadian jurisprudence on this new remedy necessitates occasional reliance on American case law where similarity in the statutes warrants such reliance.⁴

* Students, Faculty of Law, University of Manitoba.

1. Henn, *Law of Corporations*, (2nd ed. 1970).
2. *Canada Business Corporations Act* S.C. 1974-75, c. 33 (hereinafter cited as the C.B.C.A.). Proclaimed in force December 15, 1975.
3. *The Corporations Act*, S.M. 1976, c. 225 (hereinafter cited as the M.C.A.). Proclaimed in force November 1, 1976.
4. *Re Wall and Redekop Corp.* (1975), 50 D.L.R. (3d) 733 (B.C.S.C.). In this appraisal case 6 of the 7 cases referred to in the judgment were American.

The rule at common law, apparently derived from the law of partnership, was that unanimous shareholder consent was necessary to effect a change in the corporate charter. Dickerson suggests that this rule was based on the concept that a shareholder had a "vested right" from which the majority could not derogate.⁵ Then statutory provisions were enacted, allowing the majority to amend the articles of association, usually by a special resolution, and this meant that the shareholder's rights under the contract evidenced by the share certificate could properly be modified. However the only checks on the majority in its exercise of the statutory amendment power arose from the common law. The "vested rights" concept evolved into one based on "equitable rights" which were enforceable against the majority in certain circumstances. These "equitable rights" are, most simply put, the exceptions to the rule in *Foss v. Harbottle*.⁶ Under the authority of *Foss v. Harbottle* the courts adopted an attitude of non-interference in regard to the internal management of a corporation. If a particular proposal had majority support and the majority was acting honestly and in good faith "the Court will not substitute its opinion for the decision of the shareholders unless very strong grounds are shown for doing so"⁷. The exceptions to the rule in *Foss v. Harbottle* are most succinctly listed by Jenkins L.J. in *Edwards v. Hallivell*:

1. Ultra Vires Acts: "... in cases where the act complained of is wholly ultra vires the company or association the rule has no application because there is no question of the transaction being confirmed by any majority."
2. Fraud on the Minority: "... where what has been done amounts to what is generally called in these cases a fraud on the minority and the wrongdoers are themselves in control of the company, the rule is relaxed in favour of the aggrieved minority who are allowed to bring what is known as a minority shareholders' action on behalf of themselves and all others."
3. Special Majorities: "An individual member is not prevented from suing if the matter is one which could be validly done or sanctioned not by a simple majority of the members ... but only by some special majority."
4. Personal Rights: Where "the personal and individual rights of membership of the plaintiff have been invaded", the rule "has no application at all".⁸

While the minority did have these rights, actions to enforce them rarely resulted in the shareholder receiving the appraised value of his interest in the corporation. The minority could also, in certain circumstances apply under the Old Companies Acts for a just and equitable winding up.⁹ It is probable that a dissenter's

5. Dickerson, *Proposals for a new business corporations law for Canada*, (1971) 114.

6. (1843), 2 Hare 461; 67 E.R. 189 (Ch.)

7. *Ibid.*

8. [1950] 2 All E.R. 1064 at 1067 (C.A.).

9. *The Companies Act* S.M. 1964 c.3, s.340(d).

threat to seek this remedy would be more beneficial to him than an actual winding up order. It is a drastic remedy and would defeat the shareholder's intention of protecting his investment by keeping the business enterprise viable. It is also possible that dissenting shareholders may have some form of relief available to them in the terms of a shareholder's agreement, but prior to the new corporations acts such provisions would be subject to the rule in *Trevor v. Whitworth* prohibiting a company from purchasing its own shares.¹⁰ In summary it would appear that prior to the new corporations acts the majority shareholders could derogate from the rights of the minority where the proposed modification was *bona fide* for the benefit of the corporation as a whole. The majority shareholders acting in good faith, and not the courts, were to determine what was good for the benefit of the corporation as a whole.¹¹

The common law requirement of unanimous approval to a fundamental change was inconsistent with the dynamics of business enterprise which may make changes and growth desirable. All shareholders would suffer if any change, regardless of its merits, could be blocked by a minority. The forceful application of the unquestionability of majority rule concept set out in *Foss v. Harbottle* resulted in real injustice to the minority in many cases. Also, a shareholder of a company implementing a fundamental change holds, after the change, shares in a company which is different from the one he chose to invest in. Shareholders in privately held corporations stand to suffer the greater injustice due to the restricted market for their shares. For these reasons Dickerson proposed the statutory adoption of the appraisal remedy so that a minority interest can withdraw from a corporation and receive the independently appraised value of his shares. Dickerson's proposal was, for the large part, adopted in the new corporations acts.

Both the M.C.A. and the C.B.C.A. contain provisions which expand the powers and legal capacity of the corporation and its directors. A corporation can now adopt pre-incorporation contracts, buy its own shares, and is no longer subject to the doctrine of *ultra vires*. It is therefore submitted that a further purpose of the right to dissent provision is to ensure that the rights of a minority shareholder are adequate protection against the potential powers of the majority. That is, an increase in the powers and capacities of the majority necessitates an increase in the protective rights of a dissentient minority if justice is to be done for all parties concerned. One aspect of this essay will be a speculative analysis of the potential effectiveness of the appraisal remedy as a means of protecting the interests of

10. (1887) 12 App. Cas. 409 (H.L.). See also M.C.A. s. 32 and C.B.C.A. s. 32.

11. Dickerson, *supra* n. 5, at 114.

minority shareholders.

TRIGGERING EVENTS

The events which may give rise to a shareholder's dissent and right to an appraisal are set out in s. 184(1) of the Manitoba and Canada statutes. Note that the two sections are not identical. Certain changes giving rise to the appraisal remedy under the provincial statute are not included in the federal section 184. It would also appear that the right to dissent and receive an appraisal in a Manitoba company may be subject to "any unanimous shareholders' agreement." That is, a unanimous agreement can remove the availability of the appraisal remedy for shareholders who might otherwise object to fundamental changes in the future. Section 184(1) of the C.B.C.A. does not contain such a provision. However, it is submitted that the shareholders of a federal corporation can exclude the operation of s. 184 by way of a unanimous agreement. Section 6(2)(b) of the C.B.C.A. permits the inclusion of such an agreement in the articles of incorporation.

There are a number of fundamental changes which will give rise to the right to dissent under both the Manitoba and the Canada statutes. Section 184(1) provides that "... a holder of shares of any class of a corporation may dissent if the corporation resolves (a) to amend its articles under section 167 or 168 to add, change or remove any provisions restricting or constraining the issue or transfer of shares of the class ..." If a corporation resolves "... to amend its articles under section 167 to add, change or remove any restriction upon the business or businesses that the corporation may carry on ..." a shareholder has a right to dissent under section 184(1)(b). It should be noted that only those changes under sections 167 and 168 which also fall within section 184 give rise to the right to dissent. If the majority votes, on a special resolution, to amalgamate with another corporation, shareholders have the right to dissent unless the merger is effected under section 178.¹² Section 178 provides for the merger of a holding company and one or more of its wholly owned subsidiaries and for a merger between two wholly owned subsidiary corporations of the same holding company. A special resolution "to be continued under the laws of another jurisdiction under section 182 ..." will give rise to the right to dissent.¹³ A decision on a special resolution "... to sell, lease or exchange all or substantially all the property of a corporation other than in the ordinary course of business ..." will trigger the right to the appraisal remedy for the dissenting minority.¹⁴ Under the Manitoba act, but not under the Federal statute, a corporate resolution, under section 184(1);

12. C.B.C.A. s. 184(1)(c); M.C.A. s. 184(1)(c).

13. C.B.C.A. s. 184(1)(d); M.C.A. s. 184(1)(d).

14. C.B.C.A. s. 184(1)(e); M.C.A. s. 184(1)(e).

- (f) to amend its articles under subsection 167(2) to convert the corporation from a corporation with share capital into a corporation without share capital; or
- (g) to amend its articles under section 167(2) to convert the corporation from a corporation without share capital into a corporation with share capital, where the articles contain a provision that upon dissolution the remaining property is to be distributed among the members as provided in section 277; or
- (h) if it is a corporation without share capital, to amend its article under section 167 to prevent a distribution to the members on dissolution

will give dissenters the right to the fair value of their shares.¹⁵

Another interesting distinction between the Manitoba and Federal statutes arises in the further right to dissent set out in section 184(2). This section allows a shareholder to dissent if the majority resolves to alter the rights attaching to any shares or the share structure of a corporation. These amendments may be effected under section 170(1)(a) to (h) in both Acts. Section 184(2.1) of the Manitoba act provides that an amendment of the articles under section 170(1)(a) will give rise to the right to dissent only if this right is set out in the articles of the corporation. Section 170(1)(a) permits amendment of the maximum number of authorized shares of a class. This potential limitation of the right to dissent is not placed on the shareholders of a federal corporation.

It is possible that the articles of incorporation may set out, pursuant to a shareholders' agreement, additional circumstances which would give rise to a right in a shareholder to receive fair value for his shares. These circumstances may include corporate changes not presently covered by section 184 or the death of a shareholder for example.¹⁶ However, it is submitted that, if the right to an appraisal arises outside the scope of section 184 then the procedure set out in that section would not be applicable. The argument for this submission is that the appraisal remedy set out in section 184 is available only to those who are specifically entitled to dissent under that section. The words of the section do not appear to support any other conclusion.

A comparison of the two statutes supports, to some degree, the criticism of internal inconsistency which has been raised by American writers.¹⁷ This criticism focuses on the fact that a

15. "An Act respecting Canadian non-profit corporations", S-3, 30th Parl., 3rd Sess. (1977). Section 171 of this Bill, presently in the committee stage, contains provisions which are similar to those set out in ss 184(1)(f)(g) and (h) of the M.C.A.

16. It should be noted that section 32(1) of the C.B.C.A. and the M.C.A. permits a corporation to acquire its own shares.

17. E.R. Latty, "Some Miscellaneous Novelties in the New Corporation Statutes." (1958), 23 Law and Contemporary Problems 363, 389.

statute may allow the appraisal remedy for some corporate transactions while withholding it for other transactions similar or even more harmful in result and in their effect on minority shareholders. For example, it may be possible for a company without stated objects to completely alter the direction of their business endeavours without triggering the right to the section 184 remedy. On the other hand, where a corporation has adopted a set of stated objects a resolution to "add change or remove any restriction" upon the business will give the dissenting minority the right to an appraisal even if such an amendment never changes the corporation's operations in any way. The distinctions between the Manitoba and the Canada statutes also raise the question of which of the two alternative provisions is more likely to ensure justice for the minority shareholder and the corporation.

All resolutions giving rise to the appraisal remedy require a majority of two-thirds of the votes cast to become effective. It is therefore possible that the dissenting minority may consist of at least one-third of the voting shareholders. Despite the solvency test that is set out in section 184(26), a large dissenting group could have a very harmful effect on the remaining shareholders and the corporation. For this reason all resolutions giving rise to the appraisal remedy, except under section 170, can be phrased to give the directors authority to revoke the resolution if they feel revocation would be in the best interests of the corporation.¹⁸

PROCEDURAL ISSUES UNDER S. 184

Who May Dissent?

Under section 184(1) "... a holder of shares of any class of a corporation may dissent ..." if corporate changes falling within that section are passed.¹⁹ It is important to note that shareholders in corporations whose shares are publicly traded and shareholders in private corporations are both entitled to dissent under section 184. This is not the case in Ontario where the remedy is available only to shareholders in privately (or closely) held corporations. A "holder of shares of any class" may dissent. This means that a shareholder does not have to hold voting shares as a condition precedent to the right to dissent. This is not the situation if the articles are amended under section 184(2) in which case only shareholders entitled to vote under s. 170 may dissent.

Only "a holder of shares" may dissent under section 184. This means that only a registered holder of shares as indicated in

18. C.B.C.A. ss. 167(2), 168(4), 177(6), 182(6) and 183(8); M.C.A. ss. 167(8), 168(4), 177(6), 182(6) and 183(7).
19. In the absence of an indication to the contrary a reference to section 184 is a reference to that section in both the C.B.C.A. and the M.C.A.

the corporation's share registry is entitled to dissent. Where shares are held in trust a duty is placed on a registered owner to vote at shareholders' meetings if instructed to do so by the beneficial owner under section 147 of the C.B.C.A. and the M.C.A.. Section 184(4) states that the dissenting registered shareholder must dissent with respect to all shares held by him on behalf of the beneficial owner. However there is no indication in either act that the registered owner must dissent if directed to do so by the beneficial owner. And as only a "holder of shares" may dissent a beneficial owner cannot send in the notice of objection on his own behalf.²⁰ It is submitted that, where the registered owner refuses to dissent on behalf of a beneficial owner, the beneficial owner has no remedy under the C.B.C.A. or the M.C.A. but would perhaps be able to get an order based on equitable principles compelling the registered owner to comply with the terms of their trust arrangement. The availability of this equitable relief would, of course, be contingent on the terms of the trust agreement and whatever other relevant factors there may be.

Must the "holder of shares" personally dissent or can he appoint an agent? Section 184(5) requires that "a dissenting shareholder shall send to the corporation . . . a written objection to the resolution . . .". In interpreting a similar provision the Supreme Court of Delaware held that an objection in writing could be made through an agent.²¹ This was based on the reasoning that the purpose of the section was merely to give notice of the number of dissenters and this could be done by an agent as well as by the shareholder himself. Where an objection is filed by an agent it may be possible for the corporation to question the agent's authority at some point in the proceedings and it would therefore be prudent for the agent to have some evidence of his authority.

Notice of Objection

In the normal course of events shareholders who have received proper notice of the meeting, its purpose, and their right to dissent, and are in compliance with section 184(5), will have placed a written notice of objection in the hands of the proper officers of the corporation before or at the meeting at which the resolution giving rise to the dissent is to be voted on. However, the American cases indicate that things do not always happen that smoothly. It is possible that the notice of objection may be mailed well in advance of the meeting but get lost in the mailing process so that it arrives late or not at all. In *Carl M. Loeb, Rhoades and Co. v. Hilton Hotels Corp.*²² where the statute

20. *Coyne v. Schenley Industries*, 155 A. (2d) 238 (Del. S.C. 1954); *Salt Dome Oil Corp. v. Schenk* 41 A. (2d) 583. (Del. S.C. 1945).

21. *Zeeb v. Atlas Powder Co.*, 87 A (2d) 123. (Del. S.C. 1952).

22. 222 A (2d) 789 (Del. S.C. 1966). The Delaware Corporations Code was the statute in question.

in question required that the letter be "filed" with the corporation, it was held that there must be actual receipt by the corporation before the vote in order to preserve the dissenter's rights. Under the C.B.C.A. and the M.C.A. the statute leans more in the favour of a shareholder. These statutes merely require that the shareholder "send" the written objection to the corporation. If the notice is not received before the meeting the shareholder would probably still have a right to the appraisal remedy if he could prove that he had acted reasonably in sending the notice as he did.

Under section 184(5) it would seem that a shareholder dissenting to a fundamental change need not send in a notice of objection if he was not notified of the purpose of the meeting or of his right to dissent. However in this event the shareholder's remedy would not be under section 184. If the corporation fails to give notice of the meeting to a person who wishes to dissent that person may apply for relief under section 234 of the C.B.C.A. and the M.C.A.. Under this section ". . . the court may make any interim or final order it thinks fit . . .". To get this relief the complainant must prove that the failure to give notice was "an act or omission" on the part of the corporation which had an effect that was "oppressive or unfairly prejudiced or unfairly disregards" his interests as security holder. As the right to dissent is now a very important shareholder right it is submitted that even an inadvertent omission to give notice would be an unfair disregard of the shareholder's interest such as to entitle him to relief under section 234. It is further submitted that the availability of the section 234 remedy and the lack of provision in section 184 for the rights of shareholders who did not receive notice would lead a court to conclude that the only remedy available to a shareholder who was not notified of his right to dissent is that available under section 234.

Section 184 sets out a step by step procedure for the corporation and the shareholder to follow in the event of a dissent and a demand for payment of the "fair value" of the shares. There are a number of sections requiring that certain things be done within a fixed number of days. There are a number of factors which could result in failure to meet the statutory deadlines. Failure by a corporation to meet a deadline would certainly not affect the shareholder's rights and may subject the corporation to a penalty under section 244. It is submitted that a shareholder may, if he can prove that the delay was unavoidable, be excused for exceeding a deadline with one exception. That exception arises under section 184(9) under which a shareholder forfeits his right to the appraisal remedy if he does not send his share certificates to the corporation within 30 days of making his demand for payment under section 184(7).

Access To Information

Having received an offer from the corporation to buy his shares, pursuant to s. 184(12), the dissenting shareholder is then faced with one of the most difficult problems arising from the appraisal remedy: namely, is the corporation's offer a fair one which should be accepted or should the dissenter resort to a court-ordered appraisal? The financial ramifications of this decision could be staggering. Accepting an unreasonably low offer could cost the dissenter a great deal of money. Yet, on the other hand, if he contests an offer which is quite close to the actual fair value of the shares, he could (and probably would) be forced to pay substantial legal and appraisal costs. If he contests an offer which is higher than fair value, the court-ordered appraisal will force him to accept a price lower than that which he could have settled for. Resorting to litigation would also delay payment and deprive the dissenter of the use of the money pending the outcome of the lengthy litigation, even though this loss of use may be somewhat compensated for if the court exercises its discretion in s. 184(23) to award him interest.

This is a central problem in the application of the appraisal remedy. In instances where the dissenter feels that the corporation's offer is low, but he is not absolutely sure of this because he does not have enough information to make an informed decision, the effectiveness of the appraisal remedy may be so undermined that it does not in effect benefit the dissenter at all. If a lack of information combined with potential high legal and appraisal costs will deter the dissenter from applying to the court for an appraisal and will force him to accept the corporation's offer which may be unreasonably low, then the effectiveness of the appraisal remedy would be severely compromised. As has been stated in the Introduction to this paper, the appraisal remedy in theory benefits both the majority by giving them more flexibility in management, and the dissenting minority, by allowing them to be bought out at fair value. Theoretically, the appraisal remedy confers balanced statutory power upon each side, in a mutually beneficial way. If, however, the procedural application of section 184 is not comprehensive enough to allow the dissenter to make effective use of the remedy, then one can only conclude that the appraisal remedy has created an imbalance of power by conferring a benefit upon the majority but not upon the dissenting minority. If such practical implications preclude the application of the remedy, then from the dissenter's point of view the words of the section are merely hollow ones, without real substance.

Section 184(12)(a) requires the corporation to offer to pay the dissenter what the directors of the corporation consider to be the fair value of the shares, and to accompany this offer with a

statement showing how the fair value was determined. It must be remembered that the appraisal remedy will usually arise from antagonistic circumstances, circumstances in which there has been dissension about a special resolution on a fundamental matter. The dissenter might be trying to cause management problems by dissenting or might be seeking a windfall on his shares which he might not otherwise be able to receive; or the majority might be trying to "freeze out"²³ that minority shareholder to consolidate the majority position. In this context where two parties intend to go their separate ways once an agreement as to price has been reached, it is apparent that each side will try to get the best possible financial settlement. It is unlikely that in practice the statement as to how the corporation determined the value will reveal much at all about the financial affairs of the corporation. The corporation may simply want to disclose as little information as reasonably possible. If, for example, there is anticipated profit which only management knows about and which has not yet been recorded on paper, it is likely that management will not want to disclose this. Furthermore, there may be impending appreciation in the corporation's assets which will be known only to those who are aware first of the nature and location of these assets and secondly of the market trends in such assets. For example, if the dissenter is provided with a balance sheet indicating assets in the form of land at a certain value, this will be of little use to him for several reasons. First, the figure will be historical cost which is misleading with respect to land. Secondly, the dissenter will probably not know specifically what land is referred to. He will not be able to investigate the particular pieces of land and their market values (including investment value). In this way the financial statements effectively, though not illegally, tell the dissenter nothing.

The dissenter must make a reasoned judgment as to whether the corporation's offer actually reflects the fair value of the shares, and to do this he must have access to sufficient information to form an overall picture of the corporation's financial state. The dissenter has at least two possible options, but there are difficulties involved in both. First he might get his own valuation of the corporation's worth and therefore his share value. This may not always be possible, however, especially if the corporation is simply unwilling to allow the dissenter's

23. In a "freeze out" situation the majority is trying to alter the rights attached to a particular class of share with the intention of eliminating from the corporation holders of that share. This can be accomplished in at least several legal ways. Two corporations might amalgamate and convert their share capital from a large number of shares, for example one million, to a small number, for example 1000. This would result in some shareholders receiving fractions of shares. As the corporation may redeem fractions, these shareholders would be frozen out.

Another method is to convert all shares to redeemable shares. The directors could then redeem these at their discretion. A variation would be to convert all the majority's shares to common shares and the minority's shares to redeemable shares.

appraiser sufficient access to information for a proper valuation. Therefore, even if the dissenter is willing to pay the high costs of appraisal, he is still not guaranteed enough information for a proper valuation. Alternatively, the dissenting shareholder might go straight to court for the determination of fair value. This is also potentially dangerous. First, the court is not obliged by the statute to appoint an appraiser, but rather has the discretion to do so (s. 184(21)), and therefore an independent appraisal is not guaranteed. Secondly, the corporation's appraiser(s) will probably testify as to the correctness and fairness of their valuation. This could be either the only testimony to that effect, if the court does not appoint an appraiser, or it could be in direct contradiction to the court ordered appraisal. If he concludes that the offer is fair or slightly below fair, he might well accept it as the alternative of litigation is costly in terms of time and costs, legal and appraisal both of which might be awarded against him. Surely the alternative of litigation should be resorted to only when the dissenter feels that the value determined by the court would be sufficiently higher than the corporation's offer to justify the expense of litigation.

The extent of the dissenting shareholder's right to access to this information seems to be an open question. The corporation might refuse access on a statutory basis. First, the requirement in s. 184(12)(a) that a statement of how the fair value was determined must be sent to the dissenter may be said to satisfy his need for this information. It could be argued that had Parliament intended the dissenter to have more specific information, it would have prescribed steps in s. 184. The section does contain many procedural requirements in its 26 subsections and could be seen to be exhaustive of the procedural requirements.

Also, it may be argued that the dissenter ought to have no access to this information because s. 184(11)²⁴ suspends all of his rights as a shareholder, except that to be paid the fair value of his shares. While the right to be paid fair value may envisage a right of access to documents supporting the determination of this fair value figure as offered by the corporation, the dissenter still has recourse to an independent appraisal as ordered by the court. Technically speaking the dissenter does have the right to an impartial appraisal, but only if he does not settle, but forces the matter into court.

As of the time of writing, there has been very little judicial interpretation in Canada as to whether the requirement that the corporation include with its offer a statement showing how the

24. This subsection will be amended by *An Act to Amend the Canada Business Corporations Act*, S-2, 30th Parl., 3rd Sess. (1977), para. 56(3), but this amendment will not alter the issue of access to information.

price was arrived at should be simply a brief explanation or whether this envisages a detailed financial outline. This requirement could receive a broad or a narrow judicial interpretation. The extreme view would be that there is an onus on the corporation to prove that the price it offers is fair and reasonable. This extreme view has not been discussed judicially with respect to s. 184. However, the Ontario case of *Re Ripley International Ltd.*²⁵ may provide some guidance. In that case, the issue was somewhat different from the appraisal remedy question. The corporation was applying to court for approval of a consolidation of capital arrangement and the Ontario High Court held that there was an onus on the corporation to prove that the proposed arrangement was fair and reasonable and that as the corporation had not obtained an independent valuation and had not produced evidence on taxation ramifications, the burden was not discharged. Though this case is not on all fours with the s. 184 remedy, it may indicate that when the majority is proposing a fundamental change from which there is some dissent (as there was in both situations) the corporation should be required to verify the fairness of the price offered. This requirement would seem to contradict the business principle of free, unfettered negotiation, yet the purpose of the appraisal remedy is at least partially to benefit the dissenting minority shareholder and such an onus is consistent with this purpose. The *Ripley* example may be distinguished because the onus on the corporation was to satisfy the court, not the shareholder, whereas the present problem is to give the dissenter access to reasonable information long before litigation commences.

This issue was discussed in the very recent decision of *Neonex International Ltd. v. William Kolasa et al.*²⁶ In that decision, Mr. Justice Bouck, citing the common law policy to protect the rights of the minority as against the abuse of an unreasonable majority which was not changed in any way by the new C.B.C.A., placed a "heavy burden" upon the corporation to show that it has offered the dissenters a fair value for their shares. The court then accomplished the placement of this onus upon the corporation by putting the corporation into the position of plaintiff. This then gave the dissenters access to information by means of discovery of documents and examination for discovery. This does not seem to place such an onus upon the corporation in every case, though. Under subsections 184(15) and 184(16), depending upon the circumstances, either the corporation or the dissenter may apply to a court to fix a fair value. In this case, upon the *Neonex* reasoning, the onus would be placed upon the plaintiff, to show either that the offer was fair

25. (1977), 1 B.L.R. 269 (Ont. H.C.).

26. [1978] 2 W.W.R. 593, currently under appeal.

or, if the plaintiff is the dissenter, that it was unfair. The question is therefore still not clearly settled.

There is American authority, on a similar issue, enabling the dissenting shareholder to compel the corporation to produce certain documents relating to the value of the shares. In *Application of Marcus*²⁷ the dissenter, in preparing for a trial at which appraisers were to value the stock, subpoenaed all the books and documents of the corporation, including its subsidiaries. The court allowed the subpoena but to a more limited extent, namely books, records and ledgers used in the preparation of the relevant financial statements, real estate ledgers, appraisal reports, an investment ledger, a fixed asset ledger, and appraisal reports received by the corporation. Documents from subsidiaries were excluded. Although this authority arises from a context slightly different from the procedure involved in invoking the s. 184 appraisal remedy, it may still be useful in pointing toward a principle of interpretation of the appraisal remedy in Canada. The *Marcus* case differs from the Canadian appraisal remedy in that the dissenter needed the documents in order to prepare adequately for an appraisal at trial. Under s. 184, a court appointed appraiser presumably has full access to the corporations documents and for the purpose of appraisal itself, the dissenter would not need to have access to such information.

While it may be asserted that this authority, like that of the *Ripley* case, cannot apply in a case where the dissenter is simply at the stage of deciding whether or not to accept the company's offer, and has not yet initiated litigation, it still shows the need for the dissenting shareholder to have sufficient information to properly prepare his case. Similarly, the dissenter should be sufficiently apprised of the relevant facts when faced with the decision of either accepting the offer or instigating court proceedings. If the corporation's offer is in fact fair, then access to information would preclude litigation which is costly to both parties, and if the offer is substantially less than fair, then a fair value would presumably be arrived at by court appointed appraisers, in which case the court may well exercise its discretion regarding costs against the corporation.

This procedure seems to be aimed at settlement out of court and to that end, a broad interpretation should be taken of the provisions for access to information. Reasonable access to detailed corporate documents, such as those subpoenaed in the *Marcus* case, as to the fair value of the shares could save both parties the expense and time involved in litigation.

27. 77 N.Y.S. 2d 529 (N.Y.S.C. 1948).

Solvency Test

The application of the appraisal remedy is expressly restricted, by s. 184(26), where the corporation is insolvent, or would become insolvent by paying the dissenting shareholder. If this subsection applies, the dissenting shareholder then has several alternatives available to him, as will be discussed later. The purpose of this solvency test is largely to protect creditors.

Initially, however, it must be pointed out that there is some difficulty in interpreting this solvency test. It is a twofold test, both requirements of which must be satisfied for the corporation to be declared "solvent" and able to make the payment to the dissenting shareholders. The second part of the test is very basic and straightforward: the realizable asset value must exceed liabilities (s. 184(26)(b)). The first part of the test is not as clear. It requires that the corporation be able to pay its liabilities as they become due. The question which arises from the first part of the test is whether it envisages the corporation liquidating some, though not necessarily a substantial amount, of its capital assets in order to pay off its liabilities as they become due, or whether the test renders the corporation insolvent if it is not able to pay these liabilities from current assets, in the usual course of business.

Assuming that the corporation meets the second part of the solvency test, but would have to sell a small portion of its equipment in order to pay its liabilities as they become due, would the court hold that the corporation is insolvent and therefore not required at that time to pay the dissenting shareholder the fair value of his shares? Is the intention of this solvency test such that a relatively minor liquidation of capital assets in order to pay liabilities would preclude the application of the appraisal remedy?

In ascertaining the intention of Parliament in enacting this subsection the wording must be analyzed closely. The B.C. *Corporations Act*²⁸ provides that the corporation must be able to pay its liabilities as they become due "in the usual course of its business." This would indicate a stricter test whereby if the corporation is forced to liquidate a capital asset in order to pay current liabilities, it would be insolvent. It could be argued, by the *expressio unius* principle of statutory interpretation, that the omission of this phrase from the C.B.C.A. and M.C.A. was deliberate and that therefore a more lenient test was envisaged whereby the sale of a capital asset would not render the corporation insolvent. It would still be required to pay the dissenting shareholders.

28. S.B.C. 1973, c. 18, s. 228.

While this problem may seem, at first glance, to be a purely academic one, it has significant practical effect in that the corporation may well want to argue that it does not meet the solvency test and therefore need not redeem the shares of the dissenting shareholder. The solvency test could preclude the application of the appraisal remedy, but it does not render the resolution in question invalid. The majority would still be able to effect the resolution, but would not be subject to paying off the dissenter. The advantage of this would be that it would not be subject to a possible large drain of capital which might otherwise restrict the corporation from planning and effectively implementing the fundamental change. One writer²⁹ argues that such a cash drain on the company is very detrimental in that it affects the corporation at a time when cash is most needed. In maintaining that it would be, or would become by virtue of paying the dissenter, insolvent the corporation would argue that the stricter interpretation of the solvency test should be applied.

Failure to meet this solvency test does not completely preclude the application of the appraisal remedy. Under s. 184(25), if the solvency test is not met, the dissenting shareholder has the option either of withdrawing his objection and being reinstated to his full rights, or of maintaining his objection and waiting to be paid "as soon as the corporation is lawfully able to do so." The decision as to which option to choose would most likely depend upon the extent of the corporation's "insolvency" and upon the amount owing to the dissenter. If he would have to wait a very long time before being paid off in full, he may well prefer to withdraw his objection and go along with the change. Though he would probably be entitled to interest as ordered by the court under s. 184(23), he might still prefer to be restored to his full rights as a shareholder, in order to receive dividend payments. Being paid slowly, as the corporation becomes lawfully able, would preclude the dissenter from reinvesting the full amount of his money in other ventures. Not being paid in a lump sum, immediately, may well have detrimental effects upon the dissenter's general investment plans.

A further complication might arise from the question of whether or not the dissenting shareholder is entitled to receive this payment before further dividends are declared. Subsection 184(25)(b) permits the dissenter to maintain his claim and it specifies that "in a liquidation, (the status of the dissenter-claimant is) to be ranked subordinate to the rights of creditors of the corporation but in priority to its shareholders." Again applying the *expressio unius* principle of interpretation, it may be argued that in the case of normal business other than in a

29. Manning, "The Shareholder's Appraisal Remedy: An Essay for Frank Coker." (1962), 72 Yale L. J. 223.

liquidation, this claimant does not have such priority over the shareholders because Parliament has expressly given this priority in a liquidation situation but has seemingly intentionally refrained from doing so with respect to payment while the business is ongoing. The extension of this argument would result in the possibility of management paying dividends in order to keep from becoming able to pay the dissenter the fair value of his shares. It is submitted, however, that this reasoning would not be followed, for several reasons. First, dividends would not be paid until the corporation had resumed its position of solvency. Therefore, the dissenter's claim would be payable chronologically at least as soon as, if not before the dividends could be paid. Secondly, such action would deprive the dissenter of his right to be paid the fair value of his shares as maintained under s. 184(11), and he would probably have a remedy against the corporation on the basis of fraud and/or oppression.

Therefore, practically speaking, this solvency test could preclude the application of the appraisal remedy, depending, of course, upon the circumstances of each case.

Suspension of Rights

Under s. 184(11), once a shareholder has sent a notice to the company demanding payment for his shares, he ceases to have any rights as a shareholder except the right to be paid the fair value of his shares. This subsection is currently being amended,³⁰ so that his rights are reinstated if any of the following events occur: the shareholder withdraws his notice of objection either before the company has made its offer; the corporation fails to make an offer under subsection (12); or the directors revoke the resolution under certain sections of the Act. In any of these cases, his rights as a shareholder are reinstated as of the date he sent the notice referred to in subsection (7).

An important issue could arise from this suspension of the dissenter's rights with regard to dividend payments. Assuming that the parties do not agree on a valuation of the shares and they go to court for the determination of "fair value," it could be several years before the litigation is finally resolved. During this time it is likely that the corporation would pay dividends, but not to the dissenting shareholder as his rights as a shareholder have been suspended, except the right to receive payment of "fair value" for his shares. If the dissenter were reinstated for one of the reasons outlined in the amendment, it is likely that he would then be entitled to receive his portion of these dividend payments because the amendment specifically reinstates his rights as of the date he filed the notice of objection.

30. *An Act to Amend the Canada Business Corporations Act*, S-2, 30th Parl., 3rd Sess., para. 56(3).

However, in another situation, it is questionable whether or not he would be entitled to receive his portion of the dividends paid while his rights had been suspended. Assuming that after the court had determined a fair value for the dissenter's shares the corporation found that it was unable to meet the solvency test in s. 184(26), the dissenter would then have two options. Under s. 184(25), he could either wait to be paid until the company was lawfully able to do so, or he could withdraw his dissent and be "reinstated to his full rights as a shareholder" (s. 184(25)(a)). It must be noted that this section does not say reinstated "as of the date he sent the notice", and there is therefore no statutory authority that his reinstatement would be retroactive. In view of this will the dissenter be legally entitled to receive the dividends paid to others during the suspension period?

It could be argued that, strictly construed, s. 184(25)(a) does not reinstate his rights retroactively because Parliament has expressly done so in the amendment of s. 184(11) but has not in s. 184(25) and must therefore be presumed to have intentionally omitted it. It must be remembered, however, that there is American authority³¹ to the effect that the appraisal remedy should be liberally construed in order to properly effect its purpose of benefiting the dissenting shareholder. A liberal construction of a section designed at least in part for the protection of the dissenting minority would conclude that this suspension of rights should not serve to deprive the dissenter of dividend payments if he is subsequently reinstated to his full rights as a shareholder.

The following interpretation of the meaning of s. 184(11), which suspends the dissenter's rights, also favours retroactive reinstatement whereby he would be entitled to the dividend payments. Upon demanding payment the dissenter must send his shares to the corporation which, after noting on the shares that the holder is a dissenting shareholder, sends the shares back to the dissenter. Dividends are paid out according to shares, not shareholders as such, and s. 27(2) of the C.B.C.A. and the M.C.A. requires all the shares of a series of the same class to participate rateably in respect of accumulated dividends. Therefore if the dividends had been paid to other shares of the same series, they would also be owing to the shares which are involved in the dissent. As dividends are paid on the shares until the shares are actually redeemed, a rateable payment would have to be paid on these shares. The dissenter could therefore claim the dividend payments accruing to his shares even though his rights as a shareholder had been suspended.

31. *Huntsville Ind. Assoc. Inc. v. Cummings*, 292 Ala. 391; 295 S. 2d 251 (Ala. S.C. 1974).

If this argument were adopted, it would imply that the payment would be made to the shares and then held in trust for either the dissenter if his rights were reinstated or for the corporation if the shares were redeemed. A statutorily created trust in respect of these dividend payments may well solve this problem, and it is submitted that in view of the above arguments a reinstatement of the dissenter's rights as a shareholder ought to be retroactive.

VALUATION OF THE SHARES

Determination of the criteria to be used in valuation is a complex issue involving a mixture of legal, accounting, and business questions. As such, a number of different approaches are used, not only in the accounting aspects of valuation but also in the legal aspects, as propagated by the different statutory and judicial tests used. Briefly stated, the main issues are: As of what date is the valuation to be made? Are the effects, be they beneficial or harmful, of the anticipated adoption of the resolution dissented from to be included in or excluded from share value? Regarding methods of valuation, should different principles be applied to private and public corporations? Should market value be the sole or even dominant consideration? To what extent should net asset value and investment value (as a going concern) be considered? Should the principles of valuation differ according to the purpose of the valuation, for example valuation for succession duty purposes as opposed to valuation under the appraisal remedy? What effect should a predetermined valuation procedure as set out either in the corporation's articles or in a unanimous shareholders' agreement have upon a court-ordered valuation? Lastly, what are the income tax considerations of valuation?

Date of Valuation

Including or Excluding the Effect of the Resolution?

The two issues of date of valuation and whether or not to include or exclude any effect on share value of the resolution, are inseparable in that inclusion of the effect of the resolution will in practice extend the date of the valuation because anticipated effects must also be examined. Changes caused by the anticipation of the resolution may not be apparent as of the valuation date, but as will be seen, it seems the wording indicates that these changes must be analyzed as of the valuation date anyway.

Looking first to legislative authority, one finds not only that the Canadian statutes are not in agreement, but also that some amendments are currently being enacted. At the time of writing, both the C.B.C.A. and the M.C.A. contain identical

provisions in s. 184(3) that the fair value be "determined as of the close of business on the day before the resolution was adopted, but in determining the fair value of the shares any change in value reasonably attributable to the anticipated adoption of the resolution shall be excluded." A similar exclusion exists in Delaware.³²

It is apparent from the wording of this subsection that appraisers, in valuing the shares, are to put themselves back to the business day immediately preceding the date the resolution was adopted and from that hypothetical perspective determine any change which they feel is reasonably attributable to the *anticipated adoption* of the resolution. They are therefore to look back to determine whether at that time there was any change beneficial or detrimental to share value, be it evidenced in ledgers, income statements, stock exchange quotations (if the corporation is publicly traded) or simply a change in value which may be perceived as real but for which there is no concrete evidence. This would evidently be a difficult task even if it were performed on the day before the date of the resolution, yet the fact that it must be done in retrospect compounds the difficulty. In retrospect the appraiser sees the actual effect of the resolution and it must surely be difficult to divorce the actual effect from the anticipated effect as prescribed in the statute. The effect of the resolution must, under s. 184(3), be both "reasonably attributable" and reasonably attributable to the "anticipated adoption" of the resolution. The second requirement presumably also encompasses any effect which is attributable to the actual adoption of the resolution, particularly as the date of valuation is before the resolution is adopted.

Following is an example of the difficulty appraisers might be faced with. If, a week before the resolution, shares had a market value of \$10 per share and if, on the day before the resolution, the value increased or decreased by \$2 due to the anticipated adoption of the resolution and a further \$2 due to other business reasons, the value of that share would have changed by a total of \$4 on that day. In analyzing this an appraiser might conclude that the \$4 variation is attributable either wholly to the proposed resolution or wholly to normal business reasons. In this case, all financial information must be closely examined to determine the actual cause(s) of change in share value.

The C.B.C.A. is currently undergoing amendment³³ whereby the express exclusion of any change in value reasonably attributable to the adoption of the resolution will be dropped. It must be noted that Parliament is not adding a clause which

32. Delaware Code Ann. (1953), tit. 7, s. 262(b).

33. *An Act to Amend the Canadian Business Corporations Act*, S-2, 30th Parl., 3rd Sess., para 56(2).

expressly *includes* the effect of such change, but rather it is simply dropping the exclusion. In opposition to this amendment, it may be argued that the value of the dissenter's shares should not be affected by the resolution because he is opposed to the resolution and obviously wants no part of it. His investment was presumably made without such a fundamental change in mind and the value of his shares should be determined without regard to that change. The investment value of the dissenter's shares should therefore be valued according to the predictions as to future growth as of the day before the resolution, not including future growth or decline attributable to the resolution which he objects to strongly enough to want to have his shares redeemed. In this view, the dissenting shareholder should have the investment value of the corporation as he had envisaged it would be run. If the dissenter wanted to have the benefits of the resolution as reflected in increased share value, he should not have objected, but should rather have supported the change.

This approach has been adopted in two recent Canadian cases, both from British Columbia. In *Diligenti v. R.W.M.D. Operations*³⁴, the B.C. Supreme Court, following *Re National Building Maintenance Ltd.*³⁵ held that the oppressive or unfairly prejudicial conduct which gave rise to the right to be bought out should not affect the value of the shares. "The shares are to have the value they would have had had there been no oppression."³⁶

However, a distinction must be drawn between this remedy for oppressive or unfairly prejudicial conduct as granted in *Diligenti* under s. 221 of the *Companies Act* of British Columbia³⁷ and the appraisal remedy. Section 221 of the B.C. statute is silent with respect to whether or not the effect of a change in value should be reflected in the valuation of shares. Also, since oppressive conduct by the majority will often benefit the majority directly, for example by paying themselves higher management fees and thereby reducing the value of the dissenter's shares, it seems that a rule excluding the effect of this prejudicial conduct is for the benefit of the dissenting shareholder's position.

In contrast to the idea that if the dissenter wanted the benefit of the effect which the resolution would have on his share value, he should then not have objected but rather supported the change, is the reality that minorities do not always have a choice. In a "freeze-out" situation as described earlier, the minority has no choice about remaining in the corporation. He has been forced out and hopes, at best, for a remedy under s. 184. In this case it may be more equitable to confer upon the

34. Sept. 22, 1977, unreported.

35. [1972] 5 W.W.R. 410 (B.C.C.A.).

36. *Diligenti*, *supra* n. 34, at 6.

37. S.B.C. 1973, c. 18.

dissenter's shares the benefit which the resolution would have upon the shares generally, because he has been frozen out against his will. This is an open question, for it can be forcefully argued that the benefit to the corporation's shares generally has not been conferred by virtue of that minority's efforts, but rather by the efforts of the majority. This majority rule position, not unlike the control premium concept, would assert that the majority only should benefit from the change which they themselves instigated, and which the minority could not achieve alone. However, it must be remembered that the minority did have a proportionate interest in the corporation which would normally share rateably on a dissolution. Why then should majority action not only freeze out the minority but also deprive the minority of the benefits achieved through the fundamental change? In this situation, it is submitted that statutory silence as to the inclusion or exclusion of the effect of the resolution on share value is appropriate, leaving the issue to the court's discretion in each individual case. As was mentioned, in *Re Ripley International Ltd.*³⁸ the court placed an onus upon the corporation to produce evidence of the taxation benefits resulting from the consolidation of capital arrangement from which the minority dissented. Again, though this case is not an example of the application of the appraisal remedy, it is nevertheless a useful guide when asserting that in some circumstances the dissenter should have the benefit of the resolution.

As in the amendment to the C.B.C.A., the statute should give the court discretion so that an "equitable" value may be determined. If it sees fit in the circumstances, the court may include beneficial changes in value, but it is not *bound* to include changes and therefore if the resolution has detrimental effect, this may be excluded from the value of the dissenter's shares. The M.C.A. is currently worded in the same way as the C.B.C.A. regarding the effect of the resolution, but might well be amended, following the C.B.C.A.. The *Ontario Business Corporations Act*³⁹ is silent as to the effect of the resolution on share value.

The appraisal remedy under the *British Columbia Companies Act*⁴⁰ has gone to the other extreme. Subsection 228(5) requires that the valuation is to be determined including any appreciation or depreciation in anticipation of the vote upon the resolution. This method was used by the B.C. Supreme Court in *Re Wall & Redekop Corporation*⁴¹ but no reasons or

38. *Supra* n. 25.

39. *The Business Corporations Act*, R.S.O. 1970, c. 53, s. 100.

40. S.B.C. 1973, c. 18, s. 228.

41. *Supra* n. 4.

explanation were given, presumably because the court simply followed the rule in the statute. While it appears reasonable, as asserted above, that the court is to have discretion as to the inclusion or exclusion of the effect of the resolution on valuation, it is submitted that the mandatory inclusion of this effect is in contradiction to the appraisal remedy itself. As mentioned above, the dissenter does not want the change and is leaving the company. He should therefore not be bound to have any beneficial or detrimental effects of the change included in his share value. It is submitted that, in view of the equities of the circumstances, allowing judicial discretion is the best approach to take.

Methods of Valuation

Public and Private Corporations

There is some Canadian case law and considerable American case law on the meaning of "fair value" of the shares. Opinions differ as to which of the three methods of market value, net asset value, or investment value is the most appropriate. In some cases a combination was used, in some it depended upon the type of corporation involved, for example industrial or financial, and in some it depended upon the purpose of the valuation.

Some jurisdictions treat the valuation differently if the shares are publicly traded. In Ontario, for example, the appraisal remedy is expressly restricted to apply only to private corporations, whose shares are not offered to the public.⁴² The rationale for this would seem to be that if a shareholder objects to a fundamental change in a public corporation he can simply sell his shares on the market. On the other hand, the shareholder of a private corporation does not have this option, short of the difficult course of agreeing to sell to the majority, and he therefore needs the relief granted under the appraisal remedy. In the case of publicly traded shares the practical effect of this is to include in the market value of the shares any changes which are attributable to the resolution objected to. Even if the dissenter sells his shares before the resolution is passed, there is still a considerable likelihood that the news of the proposal will have already affected the market price, as notice of the proposal will be sent to shareholders before the meeting. As Iacobucci points out,⁴³ news of the proposal and the dissent would probably weaken the market price which would be quite detrimental to the dissenting shareholder. It is likely that if he objects to the resolution, he may well have trouble finding a buyer on the open market who would not also object and who would therefore be

42. *The Business Corporations Act*, supra n. 39.

43. Iacobucci, Pilkington, Prichard, *Canada Business Corporations* (1977) 170.

unwilling to buy the shares at a price that is not appropriately discounted.

The dissenting shareholder might have to suffer a price reduction in a sale on the market for two further reasons. First, the price of the shares would probably be automatically subject to a minority discount as they are not controlling shares. Paradoxically, the share price might also be reduced if it is a large block of shares, even though still a minority, as the sale of a large block could depress the market for those shares generally.⁴⁴

The option of the appraisal remedy even in the case of publicly-traded corporations would solve many of these problems, providing of course that the method of valuation were not restricted solely to market value. A further advantage, from the minority shareholder's point of view, of allowing the appraisal remedy for shareholders of public corporations is that it would probably provide some sort of a check on management in that the majority would want to minimize the number of dissenters. As explained by Iacobucci, management would be more careful in its proposals because a large number of dissenters would cause liquidity problems if the corporation were forced to redeem their shares.

Market Value

Supporters of the view that where a shareholder has the option of selling on the market he should not be entitled to the appraisal remedy might also argue that in jurisdictions where the appraisal remedy is available to shareholders of publicly-traded corporations the method of valuing the shares should be restricted to the market value only. After all, where else can one find a better embodiment of the principle often used in determining fair value, that the fair value should be the price which a willing buyer would pay to a willing seller? Realistic trading of shares takes place on the stock exchange, and for obvious reasons, the trading price is often viewed as the most realistic price.

In *Bexley et al. v. Dunning*⁴⁵ it was held that the "value" of shares in an option to purchase agreement should be determined according to market value, and that this should encompass goodwill. In that case, though, the court explicitly stated that its task was to define the word "value," standing alone, without any modifying word attached to it. This indicates the importance of analyzing the phrase "fair value" as used in s. 184 of the C.B.C.A. and M.C.A.. It is submitted that had Parliament intended market value to be the exclusive method used in valuing the shares,

44. Iacobucci, *supra* n. 44, at 170.

45. [1976] 4 W.W.R. 446 (B.C.S.C.).

it would have used the phrase "fair market value", as used in the *Income Tax Act*.⁴⁶ This not being the case, one can conclude that the valuation in the appraisal remedy was not intended to be restricted only to the market value method. The word "fair" as an adjective of value connotes fairness in the circumstances. Therefore, if the circumstances are such that market value alone does not accurately represent the intrinsic worth of the shares (for reasons including a depressed price because of the dissension as mentioned above, or a low price due to recent conservative dividend payments), then other methods of valuation should be used, either by themselves or along with the market value method, so that a fair assessment of the share value will be made. Fair value will certainly never be lower than market value, but it might well be higher. If any generalization can be made in this area, it is that the courts have demonstrated a willingness to consider all factors which might be relevant to determining share value.

Net Asset Value and Investment Value

The intrinsic or "real" values of shares, as opposed to market value, is calculated by a combination of, among other things, the net asset value and investment value. The determination of both is presumed to be calculated with a knowledge of all relevant data. One author⁴⁷ distinguishes this from market value as the latter is not always based upon a full knowledge of the facts by both parties, whereas real value is based on the assumption that the hypothetical buyer and seller each have the same knowledge. Adamson cites judicial criticism of the assumption that what a willing buyer would pay is synonymous with what a willing seller would reasonably expect to receive. He states that "it is not sufficient to rely only upon the buyer's maximum price or upon the seller's minimum price. The valuer must consider both buyer and seller and endeavour to determine where their ideas should meet."⁴⁸

The net asset value, if it is to be calculated properly, is rather complicated as numerous factors must be considered. While a detailed analysis of this and the investment value approach is not appropriate for the purposes of this paper, net asset value can be briefly described as follows: the replacement cost of the corporation's assets determined with consideration given to depreciation, intangibles such as goodwill and options, the effect of taxation, and the important fact that the corporation is being valued as a going concern, not as in a dissolution.⁴⁹

46. R.S.C. 1970, c. I-5.

47. Adamson, *The Valuation of Company Shares and Business* (5th ed 1975) 22.

48. *Id.*, at 23.

49. For a more detailed discussion of valuation methods see "Valuation of Dissenter's Stock Under Appraisal Statutes" (1966), 79 Harv. L. Rev. 1953.

The investment value of the corporation is important to a dissenting shareholder because he had initially bought shares for the purposes of appreciation and dividends which would develop from how he saw the corporation was to be run. He is now dissenting from a fundamental change in the corporation which is in fact a fundamental change in the nature of his investment. Therefore, investment value cannot be ignored in a share valuation. To determine the investment value of a corporation one must first determine the average annual earnings and then apply to this a capitalization ratio which reflects predicted future earnings. (This would include or exclude the effect of the resolution dissented from, depending on the jurisdiction.)

Though there is some American authority for the proposition that in the case of a publicly-traded corporation market value is the best and sometimes exclusive criterion for determining share value, the current trend in both Canadian and American case law is moving toward a willingness on the part of the courts to examine all criteria thought to be relevant to valuation. In *Matter of Fulton*⁵⁰ the Court of Appeals of New York held that "as there was no established market . . . the respondent was entitled to receive the actual value of his stock."⁵¹ This implies that had there been a market, the market value alone would have been used in the valuation. *Jones v. Healy*⁵² followed this view with a slight, but important variation: "market value, where it fairly reflects the opinion of informed buyers and sellers, is the best evidence of value for all purposes" unless the market is not truly "representative of informed opinion or intrinsic value." It will be observed that even where market value is held to be the determining criterion as in *Jones v. Healy*, it is stated to be dependent upon the fact that buyers and sellers be informed. This is consistent with Adamson's suggestion that buyers and sellers are not always adequately informed. Furthermore, the condition that market value must be a true "representation of informed opinion or intrinsic value" suggests weakness in the market value criterion. It may be more realistic to use market value concurrently with other criteria, and to attach an appropriate weight to market value depending upon how representative of intrinsic value it is thought to be.

It is appropriate here to point out a distinction made in *Jones v. Healy* between the types of corporation whose shares are being valued. The court held that market value is more appropriate in valuing the shares of an investment corporation, but is not as useful with respect to industrials. Again, this would

50. 257 N.Y. 487; 178 N.E. 766 (C.A. 1931).

51. *Supra. Id.*, at 496.

52. 55 N.Y.S. 2d 349, 359 (S.C. 1945), *aff'd*, 62 N.Y.S. 2d 605 (App. Div. 1946).

go to the weight to be assigned the market value criterion in each set of circumstances.

In the *Diligenti* case, the court, echoing American authority, held that it was concerned with "the fair value or price to be set in the circumstances."⁵³ This test would presumably envisage a selection of appropriate valuation criteria from all those criteria established as useful in the American cases. One case⁵⁴ held that notwithstanding an active market, the appraiser is to consider other elements. These other elements, as enumerated in several other cases⁵⁵ include: net asset value, investment value, nature of the enterprise, its management and reputation, and goodwill.

In considering these other elements, it must be remembered that investment value cannot be determined without regard to market value⁵⁶ and that net asset value ought to be given a weight appropriate to the circumstances.⁵⁷ Furthermore, the assets must be valued as a going concern, not as in a liquidation.⁵⁸

Another consideration suggested by Adamson⁵⁹ and given judicial authority in *Southdown Inc. v. McGinnis*⁶⁰ as cited in *Re Wall and Redekop Corp.*⁶¹, is that of the concept of "value to the owner." It connotes the amount of loss which he would suffer if he were deprived of his property, or what stockholders are to be paid for that which has been taken from them, their proportionate interest in a going concern.

In a privately held corporation, market value will not be a consideration in the valuation. Even if the court sought to establish a hypothetical market value, this would be based on the intrinsic value, which would be the dominant criterion anyway.

Minority Discount

Minority discount has been mentioned with respect to lowering the value of the dissenter's shares on the open market. In considering all the relevant factors, including market value of the shares, should the minority discount be applied? An American case⁶² applied the minority discount on the basis that what must be determined is the value which could reasonably be

53. *Supra* n. 34, at 40.

54. *Jacques Coe & Co. v. Minneapolis-Moline Co.*, 75 A 2d 244. (Del. Ch. 1950).

55. *American General Corp. v. Camp*, 190 A. 225 (Md. C.A. 1937) and *Roessler v. Security Savings and Loan Co.*, 72 N.E. 2d 259 (Ohio S.C. 1947) both of which are cited in *Re Wall and Redekop Corp.*, *supra* n. 4. See also *Tri-Continental Corp. v. Battye*, 74 A 2d 71. (Del. S.C. 1950).

56. *Application of Behrens*, 61 N.Y.S. 2d 179, 182 (S.C. 1946), *aff'd*, 69 N.Y.S. 2d 910 (App. Div. 1947).

57. *Id.*, at 183.

58. See *Chicago Corporation v. Munds*, 172 A 452 (Del. Ch. 1934); and *Diligenti v. R.W.M.D. Operations*, *supra* n. 34, at 4.

59. *Supra* n. 47, at 27.

60. 510 P. 2d 636 (Nev. S.C. 1973).

61. *Supra* n. 4.

expected at some time to have been realized by the shareholder. The *Diligenti* case however expressly declined to include the effect of minority discount, holding that in the circumstances a minority discount was not appropriate for several reasons. First the dissenter is not selling on the market, but rather to the corporation, so the minority discount which is applied on the stock exchange is inapplicable. Secondly, on an "equity" note, the court held that as the majority were consolidating their position, the dissenting minority should not be subject to the discount.

The particular circumstances are important as has been mentioned with respect to how realistically the figures arrived at by the different valuation criteria reflect the true value of the shares. In *Diligenti*, the court extended the meaning of circumstances to include equitable considerations based on the parties' conduct. Consequently the court refused to apply a minority discount and even refused to consider market value, looking instead to the fair value in the circumstances.⁶³ The fact that the majority had unfairly prejudiced the minority seems to have played an important part in determining criteria of valuation, and for this reason, those considerations might be found to be inapplicable to a valuation under the s. 184 appraisal remedy, with the exception of freeze outs giving rise to the appraisal remedy. The events which trigger the appraisal remedy are statutorily defined fundamental changes, not oppressive or fraudulent conduct (for which the aggrieved party may seek other remedies) and therefore one might well argue that the parties' conduct, absent fraud or oppression, should not be considered when valuing the shares. In this context, however, it might be appropriate to interpret a freeze out which gives rise to the appraisal remedy, as a triggering event for which the valuation should take into account the semi-oppression in the same way as was done in the *Diligenti* case. In the triggering events as delineated in s. 184(1) recognition of the distinction between freeze outs and events which the dissenter may choose to go along with and stay in the corporation should be made in the statute.

Purpose of the Valuation

The purpose of the valuation of shares, for example valuation under another remedy or for estate tax purposes, might be said to alter the method of valuation. In the case of *Re Wall & Redekop Corporation*⁶⁴ the court addressed itself to this issue, having been confronted with a Supreme Court of Canada decision⁶⁵ which held that market value is a safe guide for

62. *Root v. York Corp.*, 50 A. 2d 52 (Del. Ch. 1946).

63. *Diligenti*, *supra* n. 34, at 40.

64. *Supra* n. 4.

65. *Untermeyer (Untermeyer) Estate v. Attorney-General British Columbia*, [1929] S.C.R. 84.

succession duty purposes. *Re Wall & Redekop Corporation* distinguished *Untermeyer* on the basis that the purpose of valuation was completely different than in the case at bar, which involved share redemption as a result of oppression. As pointed out in an American article⁶⁶ valuation for tax purposes ought to envisage a different valuation technique as there the shareholder does not part with his interest in the earnings and growth of the company. Under the appraisal remedy, on the other hand, the shareholder is parting with his right to future earnings and must therefore be compensated appropriately. Furthermore, as mentioned above, a distinction might validly be drawn between an appraisal under the oppression remedy, which will consider the equities, as in *Diligenti*, and an appraisal under s. 184 which would not be as concerned with the parties' conduct.

The Effect of a Predetermined Method of Valuation

It is conceivable, particularly in a closely held corporation, that the shareholders may have decided on a prescribed method of valuation, for example, either market value or face value plus a proportion of accumulated undistributed profits, in the event of dissent under s. 184. They may have either included this in the corporation's articles or adopted it by unanimous shareholders' agreement. The question then arises: if one of the parties disputes the value, is the court likely to guide itself according to this predetermined method? The M.C.A., unlike the C.B.C.A., in subsection 184(1) expressly makes the section subject to any unanimous shareholders' agreement. However it is submitted that this was not intended to mean that the procedural application of s. 184 is subject to any unanimous shareholders' agreement, but rather that the triggering events listed in s. 184(1) in respect of which a shareholder may dissent are subject to such an agreement. The caveat would therefore apply to either completely limit or not the application of the entire section, but the wording of the particular subsection does not suggest that, once the appraisal remedy has been instigated, a unanimous shareholders' agreement could change the procedural application of the section.

Though it may be maintained that the shareholders' agreement is binding on the parties and therefore also binding on the court, s. 184(20) still compels the court to fix a fair value for the shares and it is therefore quite possible that the court may override the parties' agreement and itself establish a fair value, if it feels that the predetermined arrangement has not produced a fair value. At the time of writing there is apparently no case law on this point. The *North Carolina Corporations Act*⁶⁷ contem-

66. *Supra* n. 49.

67. N.C. Genl. Stat. (Supp. 1955) 55-113, s. 15-113(e).

plates this situation and provides that where a prescribed valuation method applies, the value of the shares "shall in no event be found to be less than two-thirds of the amount of the preference to which said shares would have been entitled on a voluntary liquidation."

It would seem that in the absence of similar statutory provision in Canada, the court would be bound by the prescribed agreement, as it has been unanimously consented to and therefore both parties in the dispute had at one time agreed to be bound by it. This issue is, of course, open to judicial determination (and possibly statutory amendment).

Income Tax Considerations

This last issue in the context of valuation of the shares deserves brief mention. In the *Diligenti* case, the price-earnings ratio of the shares, a ratio determined by dividing share price by its earnings, was applied to before-tax earnings rather than after-tax earnings. Though it is not the purpose of this paper to analyze in depth the accounting procedures of valuation, this issue is noted because it seems that, from the shareholder's perspective, the price-earnings ratio should be applied to after-tax earnings because the corporation must pay tax before distribution to shareholders. This is generally the case except where the refundable dividend tax applies.

One further taxation consideration mentioned in *Diligenti*⁶⁸ is worthy of note. In that case under the B.C. *Corporations Act* the court could order either the corporation or the majority shareholders to buy the dissenter's shares. The implications were explained to be that the dissenter's position would be better if the majority rather than the corporation bought his shares. The reason for this might be that the dissenter would then be subject to capital gains tax whereas redemption by the company would result in a deemed dividend under s. 84(3) of the *Income Tax Act*. Presumably the former would be preferable because of the dissenter's particular marginal rate. It should be noted that under the s. 184 appraisal remedy, redemption by the corporation of the dissenter's shares will always result in a deemed dividend under s. 84(3) of the *Income Tax Act*, which may or may not be preferable to the dissenter depending upon his marginal rate. Under the appraisal remedy, this taxation question will not be considered as it was in the *Diligenti* case, because s. 184 dictates redemption by the corporation, thereby precluding the possibility of capital gains treatment.

EXCLUSIVENESS OF THE APPRAISAL REMEDY

The problem of the exclusiveness of the appraisal remedy is

68. *Supra* n. 34, at 44.

one that has received some discussion by the American writers.⁶⁹ American cases dealing with transactions giving rise to the appraisal remedy and also containing elements of bad faith have under similar statutes, resulted in differing judgments. In *Blumenthal v. Roosevelt Hotel, Inc.*⁷⁰ a complaint based on bad faith was dismissed on the ground that the shareholder should have sought an appraisal. Under the New York statute, which contained no provisions regarding exclusiveness, an action in which bad faith is proved may result in an injunction prohibiting the transaction tainted by bad faith, if the appraisal remedy is also not available. In other jurisdictions similar statutes have been interpreted to mean that the availability of the appraisal remedy does not preclude actions under other statutory provisions similar to our section 234.⁷¹

Legislative foresight has minimized the problem of exclusiveness under the M.C.A. and the C.B.C.A.. Section 184 of both acts is expressly made subject to section 234. This means that, where the appraisal remedy is available, the shareholder is not precluded from basing an action on oppression or unfairness if those characteristics taint the transaction dissented from. In fact, it would appear that if a transaction is marked by unfairness and oppression and therefore gives rise to an action under section 234 then that transaction would not give rise to rights under section 184. The availability of the section 184 remedy is subject to the availability of the section 234 remedy. This is not a real problem to a shareholder as he can still get the appraised value of his shares under section 234. However it is possible that the unfair transaction may merely be set aside leaving the minority shareholder stuck with shares in a company that has tried to do him wrong. It is submitted that where the unfair dealings are likely to continue to affect a minority shareholder the court would, under section 234(3)(f), order the corporation to purchase the minority shareholders shares. It is further submitted that a shareholder who has an action under section 234 might, in addition to receiving the appraised value of his shares, also receive a damages award.⁷²

COSTS

The only statutory provision relating to the costs of the appraisal is section 184(18). This section provides that, where either the corporation or the dissenting shareholder applies to the court to fix a fair share value, the shareholder need not provide security for costs. The issue of costs is a very important

69. J. Vorenberg, "Exclusiveness of the Dissenting Shareholders Appraisal Right," (1964), 77 Harv. L. Rev. 1189.

70. 115 N.Y.S. 2d 52 (S.C. 1952).

71. *Sterling v. Mayflower Hotel Corp.*, 93 A. (2d) 107 (Del. S.C. 1952).

72. C.B.C.A., s. 234(3)(j); M.C.A., s. 234(3)(j).

one. The *Diligenti* case, in which three appraisers came up with three vastly different valuations, indicates a need for at least two independent appraisers. Lawyers' fees may be quite large. These costs increase with the size and complexity of the corporate holdings.

The general rule appears to be that, as in other civil cases, costs will be awarded on an equitable basis. If the corporation's offer to pay under section 184(12) turns out to be considerably lower than the appraised value then it would seem equitable that the corporation pay for the costs of the appraisal. Their low offer forced the shareholder to resort to a court ordered valuation to get what was rightfully his. If the shareholder rejects an offer that subsequently matches the appraised value then the shareholder should have to bear the costs. If the corporation's offer is too low and the shareholder's demands are too high costs may be divided in a manner that is fair to both. It must at this point be stressed that the corporation's actions gave rise to dissent in a person who might otherwise have been happy to remain as a shareholder. This might result in the court ordering the corporation to pay a larger part of the costs in a situation where both parties would otherwise be equally deserving.

The issue of costs becomes more complicated if the court orders that the actions of two or more dissenting shareholders be joined under section 184(20). One shareholder may dissent in respect of 100 shares while another has 1000 shares. One shareholder may be acting in good faith while the other is vexatious. In such a case it would seem most logical to assess appraisal costs rateably and, as between the corporation and an individual shareholder, make the award on the basis of the equitable considerations arising between them.

There is another aspect to the issue of costs that will play a large part in situations where a shareholder has a right to the section 184 remedy. Neither the shareholder nor the corporation stands to benefit from costly appraisal proceedings. There is strong incentive for both parties to arrive at an agreement without resort to the courts. If the corporation fails to make a reasonable offer the court may impose the full cost burden of subsequent appraisal proceedings on the corporation. The dissenter cannot refuse a reasonable offer for the same reasons. Awarding costs on an equitable basis makes sense in view of the above consideration. Mutual aversion to potentially costly proceedings will force the parties to adopt reasonable positions and will help bridge minor gaps in the proceedings. There are, of course, situations where share value has fluctuated greatly over a short period of time or where asset value is of a speculative nature. In such cases agreement may be impossible and an appraisal may very well be the best solution to the problem.

WHO BENEFITS FROM THE APPRAISAL REMEDY?

Fundamental changes produce conflicts between legitimate investor objectives. It is apparent that the conflicting investor objectives will be best served by a smoothly functioning method of conflict resolution that recognizes the rights and interests of both parties. It is submitted that the section 184 remedy could be as effective in that it has the potential to serve those objectives.

The rights set out in section 184(1) and (2) are basically a ratification of the common law concept of vested rights discussed in the Introduction. In contrast to the idea that a shareholder holds rights from which the majority cannot derogate stands the concept that a person i.e. the majority can do as he pleases with his property. Or put another way, why should a small minority be allowed to prevent the majority from making fundamental changes to the corporation if the majority sees fit to do so? The common law worked a hardship on the majority. Unlimited power in the majority to effect fundamental changes could work a hardship on the minority. The section 184 remedy allows the minority to emerge unaffected by certain fundamental changes which a majority might choose to make.

It may be argued that the availability of the appraisal right is a burden on corporate growth and that its technical difficulties make the cost unnecessarily high. On the other hand, it may encourage investment because of the protection it offers to would-be shareholders. In addition to their other rights shareholders now have the right to dissent in certain circumstances and this may encourage the hesitant investor. Section 184 provides the managers with an incentive to structure proposed changes in a way that will minimize dissension. It is also probable that section 184 will reduce the number of s. 234 actions alleging fraud, oppression of the minority or seeking a just and equitable winding up.

The minority shareholder in a privately held corporation is probably the individual who stands to gain the most from section 184. He would probably resort to the section 184 remedy where the fundamental change affected the market value of his shares or where the market value did not reflect fair value. The remedy is most beneficial if it can function smoothly and this, as submitted above, it can. The circumstances giving rise to the remedy are clearly and precisely set out in the act. Each step of the procedure is clearly defined. The possibility of an action based on section 234 forces the corporation to act in good faith. The possibility of an adverse award of costs forces both parties to act and negotiate in good faith and with a view to settlement. Finally, section 184(26) prevents corporate action or implemen-

tation of a court order when this would render the corporation insolvent.

However, there are some aspects of the right to dissent provision which are uncertain in meaning. Perhaps the most significant potential limitation on the effectiveness of the remedy arises from statutory ambiguity regarding the scope of the "statement showing how the fair value was determined" which the corporation must send to the dissenting shareholder along with its offer to purchase. If this statement is required to be sufficiently comprehensive so as to enable the shareholder to make an informed decision then it seems that most s. 184 disputes would be resolved out of court. Costly appraisals and litigation would be avoided. As the purpose of s. 184 appears to be the encouragement and facilitation of negotiated, rather than litigated settlements, judicial interpretation of the right to dissent provision will probably be supportive of negotiated settlements as well. If judicial interpretation of the s. 184 remedy tends to restrict its effectiveness and potential for smooth operation then, it is respectfully submitted, legislative amendment strengthening the position of the dissenting shareholder would be desirable.

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