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The Shareholders' Appraisal Right in Canada: A Critical Reappraisal

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The Shareholders' Appraisal Right in Canada: A Critical Reappraisal

Jeffrey G. MacIntosh*

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I. ORIGINS OF THE MODERN APPRAISAL RIGHT: THE DICKERSON COMMITTEE	

The enactment in 1975 of a statutory appraisal right in the *Canada Business Corporations Act*¹ that allowed shareholders to insist, upon the happening of certain events, that the corporation buy their shares was intended to substantially alter the balance of rights between majority and minority shareholders on fundamental changes.² Pointing to the reluctance of courts to intervene to protect minority shareholders where there is no fraud or bad faith, and the absence of any effective control

¹ S.C. 1974-75, c. 33, s. 184 [hereinafter "CBCA"].

² The CBCA appraisal provisions are far from being Canada's first. The earliest example of such a provision appears to have been in the reconstruction provisions adopted in a number of Canadian statutes in the latter half of the nineteenth century, including one adopted in Ontario's *The Joint Stock Companies' Winding-up Act*, S.O. 1878, c. 5, s. 13. In 1953, Ontario adopted an appraisal right in respect of private corporations in *The Corporations Act, 1953*, S.O. 1953, c. 19, s. 99. The

over the behavior of majority shareholders, the Dickerson Committee concluded that “the present state of the common law is at best unsatisfactory, at worst downright unjust.”³ The appraisal right, adapted from similar provisions of New York’s *Business Corporations Law*,⁴ was intended to strike a new balance between majority and minority shareholders. While the majority could, “if they go through the proper formalities, and if they pay any dissenting shareholders, effect almost any fundamental change with impunity,”⁵ the minority would have the right to opt out of the enterprise on the undertaking of the change and, if enough shareholders dissented, the further ability to block the fundamental change altogether. In the Committee’s view, “[t]he result is a resolution of the problem that protects minority shareholders from discrimination and at the same time preserves flexibility within the enterprise, permitting it to adapt to changing business conditions.”⁶

Discrimination was not the only problem to which the new tool was addressed. The Committee envisioned the appraisal provisions as performing a second distinct function: allowing the minority to escape fundamental changes that “change fundamentally the nature of the business

first modern appraisal provisions applying to a variety of fundamental changes in public corporations were adopted in the British Columbia *Companies Act*, S.B.C. 1973, c. 18, s. 228.

In the *CBCA*, appraisal rights or procedures arise in a variety of contexts. Section 184 enumerates a number of fundamental changes in which a shareholder may insist on an appraisal as a matter of right; see *ibid.*; see also *ibid.* at s. 217 (sale of assets for securities or distribution of assets *in specie* on winding up). A shareholder may also insist on an appraisal in respect of a compulsory acquisition of shares; see *ibid.* at s. 199. In at least two other contexts, an appraisal may arise not *as of right* but pursuant to a court adjudication of entitlement. Under the oppression provision the court may, as a remedial tool, order the corporation or any security holder to buy the shares of the complainant; see *ibid.* s. 234(3)(f). Similarly, where a statutory arrangement is undertaken, the court has authority to order that any shareholder or shareholders may dissent under section 184; see *ibid.* s. 184; see also *ibid.* s. 185.1(4)(d).

The *Business Corporations Act, 1982*, S.O. 1982, c. 4 [hereinafter “*OBCA*”], the appraisal provisions are based on those in the *CBCA* and are broadly similar; see *OBCA* ss. 181, 184, 187, 203, 247. However, the *OBCA* also allows a shareholder to require the corporation to buy his shares if any security holder acquires 90 percent or more of that class of shares and provides an appraisal procedure similar to that in *CBCA* at s. 184 to determine fair value; see *OBCA* at s. 188. In addition, although the *OBCA* expressly allows “going-private” squeezeouts (other than under the “compulsory acquisition” provisions), it allows a dissenting shareholder to require an appraisal of his or her shares on such a transaction; see *CBCA* s. 189.

The *CBCA* provisions have been adopted in the same or substantially similar form not only in Ontario, but in Alberta, Manitoba, Saskatchewan, and New Brunswick. See Alberta, *Business Corporations Act*, S.A. 1981, c. B-15 [hereinafter “*ABCA*”]; Manitoba, *The Corporations Act*, S.M. 1976, c. 40 [hereinafter “*MCA*”]; New Brunswick, *Business Corporations Act*, S.N.B. 1981, c. B-9.1 [hereinafter “*NBCCA*”]; Saskatchewan, *Business Corporations Act*, R.S.S. 1978, c. B-10 [hereinafter “*SBCA*”].

³ R.W.V. Dickerson, J.L. Howard & L. Getz, *Proposals for a New Business Corporations Law for Canada*, vol. 1 (Ottawa: Information Canada, 1971) at 114-15 [hereinafter “*Dickerson Report*”].

⁴ Ch. 4, Consolidated Laws, Law 1961, ch. 855.

⁵ *Dickerson Report*, *supra*, note 3 at 115.

⁶ *Ibid.*

in which the shareholder invested.”⁷ Thus, the changes that trigger the appraisal right include such fundamental changes as a sale of all or substantially all of the assets of the business; removal, addition, or alteration of restrictions on the business or businesses the corporation may carry on, or of the right to transfer shares; alteration of the terms of outstanding securities; continuance in another jurisdiction; and amalgamation (which may substantially alter the *nature* of the business carried on in addition to its profitability).⁸

I have styled the two rationales identified above the “anti-discrimination” and “bail-out” rationales for the appraisal right.

Although the appraisal right was to be of pivotal importance in the overall design of the fundamental change provisions, it was nonetheless designed to *supplement* and not *supplant* alternative remedies to which the shareholder might have resort. The provisions of the Draft Bill of the Dickerson Committee and the *CBCA* provide that the shareholder’s appraisal entitlement may be exercised “[i]n addition to any other right he may have”⁹ Thus, the appraisal right is non-exclusive of other remedial techniques available to shareholders.¹⁰

⁷ *Ibid.*

⁸ See *CBCA*, *supra*, note 1 at s. 184.

⁹ Dickerson Report, *supra*, note 3, vol. 2 at cl. 14.17(3); *CBCA*, *supra*, note 1 at s. 184(3). This provision has been copied in the *OBCA*, *supra*, note 2 at s. 184(4), and in Alberta (*ABCA*, *ibid.* at s. 184(3)), Saskatchewan (*SBCA*, *ibid.* at s. 184(3)), Manitoba (*MCA*, *ibid.* at s. 184(3)), and New Brunswick (*NBBCA*, *ibid.* at s. 131(3)). But *cf.* the British Columbia *Companies Act*, *supra*, note 2, as am. *Company Act*, R.S.B.C. 1979, c. 59, s. 231.

¹⁰ There are few reported decisions on the issue of exclusivity. In *Re Brant Investments Ltd. v. Keeprite Inc.* (1983), 5 D.L.R., (4th) 116 (Ont. H.C.), the plaintiff commenced an action for oppression while simultaneously claiming the appraisal right. The defendants argued that, *per CBCA* s. 184(11), the dissenting shareholder sacrificed all interests as a shareholder “other than the right to be paid the fair value of his shares” and that the plaintiff was thereby disenabled from simultaneously alleging oppression. The court rejected this contention in view of the wording of section 184(3), *supra*, note 7 and accompanying text, holding that although the shareholder claiming the appraisal right lost certain *rights*, he did not lose his *status* to assert oppression. The court pointed also to the fact that the oppression remedy is expressly extended to current and *former* shareholders of the corporation *per CBCA* s. 231(a) (definition of “complainant”). See also *In The Matter of M. Loeb, Limited and In The Matter of Loebex Limited*, (1978) Bulletin of Ontario Securities Comm. 333, in which the Ontario Securities Commission held that the appraisal right was not intended to be the shareholder’s exclusive redress in a freezeout amalgamation.

However, in *McConnell v. Newco Financial Corporation* (1979), 8 B.L.R. 180 (B.C.S.C.) the court, in *obiter dictum*, held that the loss of shareholder status accompanying a claim under the appraisal provision would preclude an oppression application. In *Jepson v. The Canadian Salt Co. Ltd.* (1979), 7 B.L.R. 181 (Alta. S.C.), there are further *obiter* remarks suggesting that the appraisal right is the shareholders’ exclusive redress.

An exclusive appraisal right strikes a very different balance in the relative entitlements of majority and minority and has not secured much support amongst academics. The clearest statement of the rationale for a non-exclusive appraisal right is to be found in J. Vorenburg, “Exclusiveness of the Dissenting Stockholder’s Appraisal Right” (1964) Harv. L. Rev. 1189. See also N.D. Lattin, “Minority and Dissenting Shareholders’ Rights in Fundamental Changes” (1958) 23 Law & Cont. Prob. 307; Note (1979-80) 84 Dick. L. Rev. 543.

Although the Dickerson Committee intended to facilitate the accomplishment of fundamental

The appraisal right was part of another important design of the Dickerson Committee—that of making the *Act* “self-enforcing,” by means of private action rather than administrative oversight or penal sanction.¹¹ In this sense, the appraisal right was in part a substitute for the removal of the requirement to obtain supplementary letters patent on fundamental changes.

This article critically reevaluates both the theoretical premises upon which the statutory appraisal right is based and the practical success it has had in achieving these goals. Part II of the article considers the theoretical rationales for an appraisal right and suggests that the Dickerson Committee correctly identified the reasons why shareholders may desire to have this protection. In Parts III and IV these rationales are ex-

changes by majorities (*see supra*, note 4 and accompanying text), it clearly intended to preserve for minority shareholders potential resort to other remedial tools to *block* fundamental changes that were unfair or in breach of relevant legal obligations. The non-exclusivity of the appraisal right only emphasizes that *absent unfair discrimination or other unfair or inequitable conduct* the majority shareholders have a *right* to proceed with the fundamental transaction. This view is confirmed by one of the principal drafters of the Dickerson proposals; see J.L. Howard, “The Proposals for a New Business Corporations Act for Canada: Concepts and Policies” (1972) L.S.U.C. Special Lectures 17 at 47-50.

There is a potential inconsistency between the Committee’s expressed desire of allowing a majority to proceed with the fundamental change free of any hindrance by the minority and the policy of non-exclusivity. If the statutory appraisal right was intended to augment the existing entitlement of a majority of shareholders by allowing them to proceed *more easily* with fundamental changes, this logically leads in the direction of exclusivity. By relegating the minority shareholder’s claim to the status of a liability (and dispensing with his or her entitlement to block a proposed transaction) the majority is afforded maximal freedom to engage in fundamental changes short of a taking without compensation.

Exclusive resort to the appraisal right on fundamental changes may also result in substantial savings in litigation costs. See *infra*, part V. Further, to the extent that exclusivity may result in increased risks to shareholders, one would anticipate that this would simply be incorporated in the price investors would be willing to pay for the company’s shares, leaving shareholders with a normal risk-adjusted expected return. Fischel has suggested other reasons in favour of an exclusive appraisal right; where each shareholder can block the transaction, the corporation must buy out the entitlement of each, generating holdout problems and significant transaction costs. See D.R. Fischel, “The Appraisal Remedy in Corporate Law” (1983) 4 A.B.F. Res. J. 875 at 898-901. Although the point is well taken, Fischel appears to have overlooked the likelihood of the joinder of numerous plaintiffs as well as the effect that issue estoppel would have in barring successive litigations of the same issue by new plaintiffs. Fischel also suggests that an exclusive appraisal right would comport with the usual rule that injunctive relief is not available where damages are an adequate remedy. In cases involving public corporations, the “damages” awarded pursuant to the appraisal cashout will almost always be an adequate remedy. This may not be true, however, in cases involving private corporations.

It has been suggested that the appraisal right transforms the shareholder’s interest into a mere liability, de-individualizing his or her entitlement. B. Manning writes: “[w]e are all accustomed to observe, or to have pointed out to us, the rolling ground swell during this period [roughly the last century] from a law of fixity to a law of mobility, from a law centering on ownership to a law centering on claim, from a law focusing on the individual to a law focusing on groups.” B. Manning, “The Shareholder’s Appraisal Remedy: An Essay for Frank Coker” (1962) 72 Yale L.J. 223 at 229. From the above discussion it should be clear that this transformation of entitlement is only true if the appraisal right is the exclusive redress of the shareholder.

¹¹ Dickerson Report, *supra*, note 3 at 158, 160, 168.

amined more closely. It is suggested that three valuation objectives are possible when valuing the shares of minority shareholders: pre-transaction value based on market price, and hence, publicly available information; pre-transaction value based on inside information; and post-transaction value, including any synergies or benefits that may arise as a result of the fundamental change. The most suitable valuation objective will depend on whether the right is claimed under the bail-out or anti-discrimination rationale. Both the utility of the appraisal right to shareholders and the optimal valuation objective may also depend on the type of fundamental change and corporation type. The *CBCA* and cognate statutes do not currently make these distinctions.

The practical problems of designing and administering an effective appraisal right are considered in Part V; these include the allocation of the burden of costs, taxation of the award, questions of procedure, and other issues relating to the workability of the current statutory appraisal right. It would appear that the current provisions are inadequate in a number of important respects. Suggestions are made for improvements.

Part VI considers the relationship between the appraisal right and other remedial techniques which might serve the same interests. The focus in this Part is on identifying some of the potential deficiencies of these other remedies and the features of the appraisal right that differentiate it from other remedial techniques.

Two major revisions to the statutory form of appraisal right are suggested in Part VII. First, the appraisal right should be made non-mandatory. The second suggestion is that instead of employing a single form of appraisal right, corporate law statutes ought to offer multiple competing forms of appraisal right. Each corporation might choose the form best suited to its needs, a custom-designed appraisal right or no appraisal right at all. Both these suggestions derive from the conviction that securities markets operate with sufficient informational efficiency that the market, and not legislators or administrators, should be the final arbiter of the efficiency of the appraisal right. The statutory appraisal right serves an enabling function in an informationally efficient market; where the statute furnishes a standard form of appraisal right, it becomes unnecessary for the corporation to take the time and expense of drafting an appraisal right into its constitutional documents, eliminating transaction costs that in the aggregate may be fairly substantial. It is suggested that the default valuation objective (that which applies if the corporation has not indicated to the contrary) should be pre-transaction market value for all public corporations. In the case of private corporations, the presumptive valuation objective should include an assessment of any latent values in the enterprise discoverable only on the basis of inside information, as well as any transaction gains or synergies.

Part VIII evaluates the current valuation practice in Canada under the appraisal provisions in light of the earlier recommendations.

Part IX sketches out some preliminary thoughts on a unified theory

of those transactions that ought to serve as triggers for the appraisal right. It is suggested that the current statutory selection of triggering events can be rationalized by reference to a small number of defining principles.

II. WHAT INTERESTS ARE PROTECTED BY THE APPRAISAL RIGHT?

The interest of the majority of shareholders in maintaining the ability to undertake fundamental changes is relatively clear. The exigencies of business often demand a great deal of flexibility in adapting the enterprise to changing fortunes or business conditions. Such changing environments may demand an internal re-casting of the capital structure of the enterprise, perhaps including an alteration of the relative rights of outstanding securities, or the addition or even elimination of a class of securities. Business conditions may also dictate a rescaling of the enterprise either by corporate combination or by increase or reduction in the size or scope of the enterprise. Finally, markets may suggest a partial or wholesale change in the nature of the business carried on by the enterprise.

The potential interests of the minority are more problematic. The minority may desire protection against fundamental changes resulting in an alteration of the risk of the business but not impairing the value of the firm's securities, as well as unwise business decisions impairing enterprise value and thus diminishing the market value of the firm's securities. The minority may also value protection against discriminatory changes in the relative rights of security holders, which diminish the value of the securities held. One form of discriminatory transaction that may be seen as posing particular dangers to the minority is the going-private transaction.¹²

In broad form this taxonomy of interests to be protected parallels that of the Dickerson Committee. In the two Parts that follow, these potential rationales for an appraisal right are examined in more detail in light of relevant insights supplied by modern capital theory.

III. FUNDAMENTAL CHANGES IN THE NATURE OF THE BUSINESS: ALTERATIONS OF RISK OR ENTERPRISE VALUE

Shareholders may wish to protect themselves against being forced "to participate in ventures beyond their initial contemplation",¹³ that is, to continue to invest in an enterprise that has altered its character in some material respect from the investment initially contemplated. The appraisal right may furnish such protection. It is therefore important to

¹² As with alterations of the terms (or relative terms) of outstanding securities that nevertheless leave minority shareholders within the enterprise, going-private transactions may be a way of effecting a discriminatory redistribution of values amongst classes of security holders in the enterprise.

¹³ F. Iacobucci, M.L. Pilkington & J.R.S. Prichard, *Canadian Business Corporations* (Agin-court, Ontario: Canada Law Book Ltd., 1977) at 169.

understand just what sorts of alterations investors may be concerned about (and in what situations).

One such alteration is a change in the risk of the enterprise. Some investors may be more risk averse than others; for them, an increase in risk may make continued investment in the enterprise unattractive. Equally, a diminishing of risk may make the investment unattractive for shareholders who are less risk averse or are risk preferring.¹⁴ Further, views of shareholders may differ as to the efficacy and profitability of a given fundamental change. In the view of some investors, the change, whether or not it alters the risk of the enterprise, may threaten to diminish the value of the enterprise. In either case, the appraisal right may provide an "exit" option to avoid the perceived undesirable consequences for the investor of remaining in the fundamentally changed enterprise.¹⁵

A. *Alterations in the Risk of the Enterprise not Diminishing Security Values*

Generally speaking, investors in public companies¹⁶ will not be very concerned with shifts in the risk of the enterprise that do not diminish the market value of the class of securities held by those investors.¹⁷ In contrast, investors in small, private firms may have good reason to be concerned, even where there is no adverse effect on the value of the class of securities held. In the former case the appraisal right is likely to be of little value, but in the latter it may be of great value.

Two factors are central to this conclusion: modern capital theory,

¹⁴ Perhaps the most important empirical datum about the market is that most investors are risk averse. All other things being equal, a less risky security will therefore command a higher price. The degrees of investor risk aversion will clearly vary, however, and investors *may* therefore have differing preferences with respect to those factors that determine enterprise risk, such as the nature of the business, the degree of financial leverage, *et cetera*. The circumstances in which risk may be controlled externally by the shareholder alone, rather than only internally (by means of adjusting the activities or structure of the enterprise), are discussed at *infra*, note 23 and accompanying text.

¹⁵ Since the economic value of an investment may be completely characterized by its risk and expected return, investors will be primarily (and in the greatest number of cases, exclusively) concerned about these two determinants of value. Hence, concern about protecting shareholders on fundamental changes must necessarily focus on changes in either risk or expected return (or both) arising out of the change. Elaboration of specific shareholder protections must therefore take into account the effect on the investor of changes in risk or expected return and must as well be grounded in some normative theory of shareholder entitlement (or "just desert") against which the propriety of the remedy may be measured.

¹⁶ In this article, the term "company" is used interchangeably with "corporation." The legal definition of a "private" corporation, as distinguished from a "public" or "publicly-traded" corporation (again used interchangeably), will differ from one jurisdiction to another. However, a workable definition of a private corporation is an incorporated firm which does not offer (and has not offered) its securities for sale to the public, has a small number of shareholders, restrictions on the transferability of shares, and a high degree of coincidence between those who are the officers, directors, and shareholders. *Cf.* the Ontario *Securities Act*, R.S.O. 1980, c. 466, s. 1(1)(31).

¹⁷ Since the value of an enterprise (and its securities) can only be determined when both the risk and expected return are known, the effect of a change in risk, by itself, will produce an indeterminate effect on value.

including both portfolio diversification theory and the capital asset pricing model; and the existence or non-existence of a market-exit option.

1. Changes in the risk of the enterprise, modern capital theory, and shareholder welfare

Modern capital theory¹⁸ gives us some indication of when shareholders are likely to be concerned with shifts in the risk of the enterprise that do not adversely affect security values. Financial economists divide the risk facing investors into two types. This division reflects the fact that some risks are specific to a given company while other risks facing the enterprise are broadly derivative of general economic conditions and trends that affect the market as a whole. For example, in the case of a company engaged in manufacturing and selling children's toys, the company (and its shareholders) face a risk that the market will not react favourably to a new product line. Entirely aside from the success of the new product line, however, the company's fortunes will be tied to the health of the economy as a whole, which will determine, for example, how much money is available for new investment, the level of consumer demand, and other factors affecting the company's profitability. The former type of risk passes under a variety of names, including *unsystematic*, *company specific*, or *diversifiable* risk. The second is referred to as *systematic*, *market*, or *undiversifiable* risk.

Unsystematic risk can be diversified away by holding a portfolio of securities. For example, if an investor holds a portfolio of the common shares of ten companies, some of these companies will succeed and some will not. The effect of a fluctuation in the price of any single security in the portfolio arising from unsystematic influences will, on average, be offset by contrary movements in the prices of the other securities in the portfolio. Diversification is, in a sense, little more than avoiding the hazards that extend from "putting all your eggs in one basket." The larger the number of securities in the portfolio, the less the investor will care about the unsystematic risk of any given security. In fact, it has been demonstrated that adequate diversification can be achieved with as few as ten or fifteen securities in a portfolio.¹⁹

Thus, investors in a position to diversify their holdings will be sub-

¹⁸ See, e.g., T.E. Copeland & J.F. Weston, *Financial Theory and Corporate Policy*, 2d ed. (Reading, Mass.: Addison-Wesley, 1983); R. Brealey & S. Myers, *Principles of Corporate Finance* (New York: McGraw-Hill, 1981); S.M. Tinic & R.R. West, *Investing in Securities: An Efficient Markets Approach* (Reading, Mass.: Addison-Wesley, 1979). A good introduction to the theory is F. Modigliani & G.A. Pogue, "An Introduction to Risk and Return" (1974) 30:2 *Fin. Anal. J.* 68.

¹⁹ See E.F. Fama, *Foundations of Finance* (New York: Basic Books, 1976) at 253-54. Some institutional investors will not be indifferent to such shifts in risk because the shift may render the investment non-conforming for the purposes of satisfying statutory investment requirements. See, e.g., the *Pension Benefits Act*, R.S.O. 1980, c. 373, s. 38(d), R.R.O. 1980, Reg. 746, s. 17; *Loan Companies Act*, R.S.C. 1970, c. L-12, s. 60(1); *Trustee Act*, R.S.O. 1980, c. 512, ss. 26-27. Nevertheless, as long as the risk shift involves no diminution in market price, such investors will suffer no loss of capital and will incur only the transaction costs of disinvesting and reinvesting.

stantially unconcerned with changes in the *unsystematic* risk of the enterprise.²⁰ Only investors that are unable to diversify their investment portfolios will be concerned about changes in *unsystematic* risk not adversely affecting security values.

Systematic or market risk, on the other hand, is not diversifiable. This is because, in general, the securities of *all* companies will tend to be affected in the same *direction* by general economic conditions. Even if an investor holds a large portfolio of securities, a change in market conditions will induce correlated changes in the values of each of the portfolio securities. Thus, there will be no offsetting changes in security price movements.²¹ Because investors have different risk preferences, changes in systematic risk, whatever the source,²² may be of concern to some investors—including those with diversified portfolios.

The value of the appraisal right against pure changes in risk that do not adversely affect security values will therefore depend on the ability of investors to diversify their holdings. It will also depend, as the following sections make clear, on the existence of a “market-exit option”; that is, the ability of a shareholder to sell his or her holdings in the market in response to changes in risk that do not suit his or her risk preferences.

2. Public companies with deep markets

For public companies with well-developed markets, the appraisal right is likely to be of little value in protecting investors against risk shifts that do not adversely affect security value.

On a practical level, a dissentient shareholder may simply sell his or her shares in the market without loss of capital and purchase a more satisfactory investment. In any case, there is little reason for a well-diversified investor in a public company to be concerned about such risk shifts. As noted, a shift in *unsystematic* risk is not of great concern to the diversified investor. At first sight, a shift in *systematic* risk that does not alter the value of the security may nevertheless cause some investors to sell their shares if the investment no longer conforms to their risk preferences. It is axiomatic both that investors have heterogeneous risk prefer-

²⁰ Reductions in both unsystematic and systematic risk may effect a redistribution of enterprise value in favour of creditors and at the expense of shareholders, without altering aggregate enterprise value. See C.W. Smith & J.B. Warner, “On Financial Contracting: An Analysis of Bond Covenants” (1979) 7 J. Fin. Econ. 117. This is why I have assumed in this section that the change in risk does not affect the value of the class of securities held by the potential dissenter rather than the value of the enterprise as a whole.

²¹ A change in the nature of the business carried on may alter either the systematic or unsystematic risk of the enterprise.

²² A wide variety of fundamental changes may effect changes in the systematic risk of the enterprise. For example, an amalgamation or an issuance of securities may alter the debt-equity ratio of the enterprise, which in turn may affect the level of systematic risk. Likewise, a change in the articles of incorporation may remove restrictions on the nature of the business the corporation may carry on, allowing it to engage in a business with a higher systematic risk than before. These changes may, of course, also alter the unsystematic risk of the enterprise.

ences and that these preferences will influence an investor's investment choices.²³ However, the relevant risk confronting an investor with an adequately diversified portfolio is the systematic risk of the *portfolio*. Changes in the systematic risk of a single security in the portfolio are unlikely to have such a substantial impact that the portfolio requires rebalancing. Moreover, changes in the systematic risk of portfolio securities occasioned by fundamental changes will be uncorrelated, leading to diversification against the danger of changes in systematic risk. *Changes in risk* will tend, over time, "to come out in the wash." An appraisal right providing protection against changes in systematic risk will therefore have little value.²⁴

In those unlikely cases where a risk shift not affecting security value causes an investor to sell his or her holdings, the appraisal right could confer an advantage over the market-exit option only where the right is designed to afford superior tax consequences to the latter or a payment to mitigate the *unexpected* tax burden or brokerage costs incurred by the shareholder on disposition. Modern statutory appraisal rights typically do not furnish such advantages.²⁵

3. Public companies with thin markets

The vast bulk of Canadian publicly traded corporations are corporations whose securities are inactively traded.²⁶ As in the case of public corporations with deep markets, investors in these corporations are likely

²³ The capital asset pricing model suggests an optimal investment strategy for investors with any given risk preferences. That strategy is to determine a desired level of risk experience and to adjust portfolio risk to that level by buying a combination of a "risk-free" asset (such as government bonds) and the "market" portfolio. The market portfolio consists of a weighted average of all capital investments available in the market in the proportion that the value of each bears to the aggregate value of all capital investments. Although transaction costs and indivisibilities clearly inhibit purchase of the market portfolio, the insight yielded is that comparatively risk-averse and risk-prefering investors will, in theory, differ in their investment strategies only in respect of the portion of the portfolio invested (or disinvested, by borrowing) in the risk-free asset.

²⁴ The *de minimus* character of a change in portfolio systematic risk resulting from a change of risk of an individual security, and the tendency for offsetting changes in risk to cancel out, will be especially true for investors with very large portfolios, such as institutional investors. It will also be true for individuals who invest through an institution such as a mutual fund.

²⁵ Arguably they should not do so; see Part V.B.1.-2., *infra*. It should be noted that where changes in the risk of a given security prompt an investor to rebalance his portfolio, the rebalancing need not involve the sale of that particular security in respect of which the fundamental change occurred: it might just as well involve the buying or selling of other investments to rebalance the risk characteristics of the *portfolio*. This may involve disinvestment of any of the risky securities in the portfolio in favour of a "riskless" asset such as Treasury Bills or investment in a bank account, or *vice versa*.

²⁶ See D.J. Fowler, C.H. Rorke & V.M. Jog, "Thin Trading and Beta Estimation Problems on the Toronto Stock Exchange" (1980) 12 J. Bus. Admin. 77; D.J. Fowler, C.H. Rorke & V.M. Jog, "Heteroscedasticity, R² and Thin Trading on the Toronto Stock Exchange" (1979) 34 J. Fin. 1201; D.J. Fowler, C.H. Rorke & V.M. Jog, "A Note on Beta Stability and Thin Trading on the Toronto Stock Exchange" (1981) 8 J. Bus. Fin. Acct. 267.

to be well diversified.²⁷ Again, there is a market-exit option. Nevertheless, the quoted price may not be an entirely reliable gauge of fair value. Where a company's securities are thinly traded, there is a greater risk of short-run fluctuations of the market price of the security away from the equilibrium value.²⁸ Arguably, shareholders might wish to be protected against this risk by being assured of a reliable and fair exit option as supplied by the appraisal right.

However, the argument is weak. As in the case of public companies with deep markets, shareholders are not likely to be concerned about changes in risk (either systematic or unsystematic) that do not adversely affect security value. As well, given the relative costs of the appraisal option as opposed to a market sale, it is almost inconceivable that the appraisal right would be a valued protection for shareholders against changes that do not affect security value.

4. Privately held companies

Investors in private businesses for which there exists no public market may have a very different attitude toward shifts in enterprise risk than investors in public companies. Such investors are often significantly underdiversified since a large part of their wealth (including their employment) is tied up in the enterprise. In the face of significant underdiversification, individual investor welfare will depend on the *total* risk of the enterprise. Therefore *all* risk shifts, whether company specific and systematic, may be of profound concern whether or not such shifts affect security value.

In most such enterprises, there is no reliable market-exit option. Shares of private companies will generally be difficult to sell and may in fact be subject to strict restrictions on transferability, reflecting the quasi-partnership status of many small, incorporated enterprises.²⁹

5. The appraisal right as a remedial substitute for the doctrine of *ultra vires* and other constraints on the corporation's line of business

An interesting parallel may be drawn between the risk-shifting rationale for the appraisal right and other, now mostly defunct, corporate law doctrines that protect shareholders and creditors against the consequences of changes in the company's line of business. The requirement to enumerate objects and powers in the constitutional documents of the company was one form of protection against such changes as was the

²⁷ At the very least such investors will, in most cases, have the option of diversifying their holdings and have only themselves to blame for failing to do so.

²⁸ See *infra*, notes 43-53 and accompanying text.

²⁹ An alternative protection is that conferred by private ordering arrangements. See Parts VII.C. and IX.

doctrine of *ultra vires*, which sprang out of this requirement.³⁰ These statutory and judicial proscriptions against changing the nature of the business were, at least in part, attempts to protect shareholders from changes in the risk of the enterprise whether or not enterprise value was affected. At least insofar as protection from risk shifting is concerned, the appraisal right may be seen as a remedial substitute for these doctrines.

B. *Unwise or Opportunistic Fundamental Changes Diminishing Enterprise Value*

Whether or not the risk of the enterprise changes, the risk-adjusted value of the enterprise and its securities may be adversely affected by the fundamental change.³¹ This might be true if the market fails to share the sanguine expectations of management (or majority shareholders) as to the value of the change. This disparity may be attributable to either a lack of managerial (or majority shareholder) business acumen or the possession of information about the value of the change that the market does not possess.³²

There is another reason why managers may undertake fundamental changes that diminish the value of the enterprise: the *welfare* of managers may be increased even though firm value (and shareholder wealth) is diminished. This might happen if one or more of the firm's managers are substantially underdiversified; for example, if the manager's principal financial asset is his or her job. Where this is the case, and where the risk of the enterprise affects the value of the manager's compensation package or security of tenure (where, for example, added risk increases the probability of bankruptcy and the loss of the manager's job) a manager

³⁰ The earliest predecessors of our modern corporate law statutes contained requirements to enumerate the objects or intended businesses of the corporation. In the English legislation, see *An Act for the Registration, Incorporation, and Regulation of Joint Stock Companies*, 7 & 8 Vict., c. 110, s. IV.2. See also ss. VII.2. and LVIII.2. In Canada, *An Act to Provide for the Formation of Incorporated Joint Stock Companies, for Manufacturing, Mining, Mechanical, or Chemical Purposes* (Can.), 13 & 14 Vict., c. 28, s. I. The first Ontario legislation in 1874 contained a similar requirement; see *An Act Respecting the Incorporation of Joint Stock Companies by Letters Patent*, 37 Vict., c. 35, s. 4.2. The judicial doctrine of *ultra vires*, first clearly stated in the signal case of *Ashbury Railway Carriage v. Riche* (1875), 7 L.R.H.L. 653, sprang out of the statutory requirement to enumerate objects. One reason motivating both the statutory requirement and the judicial doctrine that it spawned was the protection of investors against shifts in the risk of the enterprise. See L. Getz, "Ultra Vires and Some Related Problems" (1968) 3:3 U.B.C.L. Rev. 30.

³¹ The value of the enterprise is the *sum* of the net present values of each of its productive activities. Net present values are computed by discounting the prospective cash flow of an activity by a discount rate that is derived from the risk of the activity. Nevertheless, the risk of the activity, or changes in risk associated with a fundamental change, do not by themselves indicate whether the change will increase, decrease, or leave unaffected the wealth of the enterprise's current shareholders. See those authorities in note 18.

³² In such a case, while the change may not be "unwise," it will be difficult for shareholders to distinguish between this situation and an unwise change, and shareholders may desire to cash out rather than waiting to see if management was right.

will benefit from selecting a level of enterprise risk that conforms to his or her own risk preferences whether or not this has a favourable effect on firm value.³³ This would be an instance of opportunistic behaviour effected by managers at the expense of other shareholders (assuming that no shareholder is similarly underdiversified and benefits in like fashion).

The degree to which shareholders will desire protection against either unwise or opportunistic fundamental changes that diminish enterprise value will likely depend on the nature of the enterprise. Since the argument for such protection is probably strongest in the case of private corporations, this type of corporation will be considered first.

1. Private companies

In private companies, the dangers of both unwise and opportunistic fundamental changes diminishing enterprise value are heightened. In respect of the former, there is no market price to indicate the market's verdict on the proposed fundamental change. This will deprive all shareholders of one significant piece of evidence as to the wisdom of the fundamental change, rendering majority approval of an unwise fundamental change more likely. Moreover, many managers of small, private concerns may lack the skill of their counterparts in larger public enterprises and make more errors in judgment.

Opportunistic fundamental changes designed to accommodate the risk preferences of managers or majority shareholders are also more likely to occur. The managers of private corporations will often be significantly underdiversified, given that both their private wealth and employment will be tied up in the enterprise, thereby compounding the dangers of opportunism. Even if the managers are not themselves significant or controlling shareholders, the likelihood of the existence of a controlling shareholder or coalition of shareholders is great. These shareholders may again be underdiversified, leading them to spearhead fundamental changes that suit their risk preferences and increase their welfare at the expense of enterprise value and the wealth of minority shareholders. As a result, events provoking a minority shareholder to desire to bail out of the enterprise in response to an anticipated diminution in value are likely to arise with some frequency.

The absence of a market-exit option increases the value of the appraisal right. If protection is desired against unwise or opportunistic fundamental changes that the majority have approved, the appraisal procedure is likely to be—aside from private ordering arrangements to

³³ Aside from shareholder control exercised through the voting (or other) mechanism, the market for managers necessarily constrains the degree to which managers will sacrifice profits for a level of risk that suits their own preferences. Excessive slack or diversion of corporate resources may ultimately cost the manager his or her job or imperil chances for future employment. See E.F. Fama, "Agency Problems and the Theory of the Firm" (1980) 88 *J. Pol. Econ.* 288.

effect the same result³⁴—the *only* exit option available.

The argument is incomplete, however, without considering the effect of statutory requirements for shareholder approval of the fundamental change. Most fundamental changes must be approved by the change by a supra-majority of shareholders.³⁵ Should the majority withhold approval, there will be no occasion to enlist the protection afforded by the appraisal right. There is typically no requirement, however, that the fundamental change be approved by a majority of the *disinterested* shareholders of the corporation.³⁶ Thus, voting approvals are far from foolproof minority shareholder protections where interested shareholders control sufficient shares to determine the outcome of the vote. This will frequently be the case in respect of private corporations.³⁷

2. Public companies with deep markets

At first sight (as in the case of simple risk shifts) it would appear that shareholders in a large, public corporation can always liquidate their holdings in the market, obviating the need for the exit afforded by the appraisal right. M.A. Eisenberg has suggested, however, at least two reasons why the market-exit option may not be an adequate protection for shareholders.³⁸ First, large shareholders who are forced to sell quickly to escape the fundamental change may realize an inferior price in the market because of the hurried liquidation of the large block.³⁹ Second, all shareholders, whether large or small, may only be able to realize a price that already reflects the market's anticipation of the effect of the funda-

³⁴ See Parts VII.C. and IX., *infra*.

³⁵ Such required voting approvals are typically by a special resolution; that is, two-thirds of all shareholders normally entitled to vote. In some cases, all the corporation's shareholders may vote, whether or not they have been given a vote by the company's articles. See for example, *CBCA*, *supra*, note 1 at ss. 36 (reduction of capital; no enfranchisement of otherwise non-voting shares), 170 (amendment of articles; provides that non-enfranchised classes may vote), 177(3) (amalgamation; non-voting shares participate in a company-wide vote), 182 (continuance out of jurisdiction; non-voting shares participate in company-wide vote), and 183(4)-(5) (sales of all or substantially all the corporation's assets; non-voting shares participate in company-wide vote). These provisions also generally require a class vote where shareholders of any class stand to be affected by the fundamental change differently from other classes of shareholders, whether or not the class is normally entitled to vote. The *OBCA*, *supra*, note 2, has similar provisions, but does not enfranchise otherwise non-voting shareholders except in respect of a required class vote. See *OBCA* ss. 34, 169, 175, 180, 183(3)-(8). In most cases, a majority of the minority voting approval is not required, but see *OBCA* s. 189 (going private), and Ontario Securities Commission Policies 1.3 (issuance of restricted voting or non-voting shares) and 9.1 (going private). The stock exchanges may also require a majority of the minority approvals in some circumstances. See generally J. MacIntosh, "Some Changing Patterns of Minority Shareholder Protection on Fundamental Changes in English, Federal, & Ontario Company Law" (on file at the Osgoode Hall Law Journal).

³⁶ *Ibid.*

³⁷ Further discussion of this point may be found at *infra*, Part VI.A.1.

³⁸ M.A. Eisenberg, *The Structure of the Corporation* (Boston: Little, Brown, 1976) at 79-84.

³⁹ The same may result if a flood of sell orders of small shareholders come to the market at the same time, disadvantaging *both* large and small shareholders. *Ibid.* at 82.

mental change.⁴⁰

These two claims are potentially inconsistent; in an efficient securities market, one would indeed expect that once an announcement of the proposed fundamental change is made, the anticipated effect of the change on firm value (based on all publicly available information) would be quickly and completely reflected in the price of the firm's securities. However, one would also expect the quantity of securities offered for sale in secondary markets to have little or no effect on price. The sole determinants of security value will be the risk and expected return, and the volume of securities offered for sale (or orders for purchase) should not ordinarily affect either of these factors.⁴¹

Evidence from the securities markets in both the United States and Canada does, in fact, suggest that new information is reflected rapidly and completely in securities prices.⁴² There is also evidence, however, that the sale of a large block of securities may temporarily depress stock prices.⁴³ The magnitude of the price depression associated with block trades is typically no more than a few percentage points of stock price and in most cases only a fraction of a percentage point.⁴⁴ The source of

⁴⁰ *Ibid.*

⁴¹ In an efficient market, securities of equal risk will be perfect (or near perfect) substitutes. Assuming that the block sale does not in fact have any influence on underlying risk or expected cash flows (and is not a signal of inside information: see *infra*, note 45 and accompanying text), any downward movement of security price will increase the expected return of the security, yielding a higher risk-adjusted expected return than on other securities of comparable risk. This will quickly summon forth purchases by those seeking arbitrage profits, driving the price back to its original value and restoring an equilibrium to the expected return given the risk of the security. See authorities in note 43, *infra*.

⁴² A market that responds rapidly and completely to new publicly available information is said to be efficient in the "semi-strong form." Evidence in both Canada and the United States suggests that the securities markets are indeed efficient in this form. See *infra*, note 197.

⁴³ L.Y. Dann, D. Mayers, & R.J. Raab Jr., "Trading Rules, Large Blocks and the Speed of Price Adjustment" (1977) 4 J. Fin. Econ. 3; N. Close, "Price Reaction to Large Transactions in the Canadian Equity Markets" (1975) 31:6 Fin. Anal. J. 50; A. Kraus & H.R. Stoll, "Price Impacts of Block Trading on the New York Stock Exchange" (1972) 27 J. Fin. 569; M.S. Scholes, "The Market for Securities: Substitution Versus Price Pressure and the Effects of Information on Share Prices" (1972) 45 J. Bus. 179. See generally Copeland & Weston, *supra*, note 18 at 327-32; K.D. Garbade, *Securities Markets* (New York: McGraw-Hill, 1982), at 256-59, 454-60, 475-76.

⁴⁴ See *supra*, note 43. Evidence suggests that in some respects the Canadian securities markets are less transactionally efficient than the American markets. See *infra*, note 197; S.M. Tinic & R.R. West, "Marketability of Common Stocks in Canada and the U.S.A.: A Comparison of Agent Versus Dealer Dominated Markets" (1974) 29 J. Fin. 729. However, Close found that price depreciation associated with block sales was usually less than 5 percent of share price, with the average about 0.5 percent (Close, *supra*, note 43). The figure may be overly conservative: it would appear that many of the larger block trades take place through the American markets, where the cost of liquidity services is lower. See J.E. Walter & J.P. Williamson, "Organized Securities Exchanges in Canada" (1960) 15 J. Fin. 307. The accessibility of the American trading route tends to vitiate the argument that because block trades are expensive in Canada, the appraisal right has a value to Canadian holders of large equity positions.

It is probably also true that the transactional efficiency of the stock exchanges has improved with the introduction of negotiated commissions and an increase in dealer market making. In re-

the price effect appears to be an attribution by the market of informational content to a block sale by a shareholder who may be in possession of inside information bearing on stock value combined with the cost of liquidity services supplied by block positioners.⁴⁵ These figures do not completely rule out the possibility that some large shareholders may value the appraisal right as protection against the cost of sale of a large block. However, the cost of liquidating the block, *simpliciter*, is likely to overstate the true cost to the dissenter. The cost of liquidating an investment would be borne in the normal course of events by the security holder *at some point in time* when the investment is sold. Thus, the cost to the shareholder of the accelerated liquidation is not the *entire* cost of the liquidation, but the difference between the liquidation cost and the net present value of the liquidation cost that would have been anticipated in the normal course of events. Further, the larger the block, the more likely it is that the holder will be able to use his or her voting power to defeat the fundamental change, obviating the need for an appraisal right. And, if the block is not large enough to carry sufficient voting power to influence the vote, the market is less likely to interpret the sale as a signal of unfavourable inside information. This is because the shareholder is less likely to have access to such information. As a result, the magnitude of the decrease in price associated with sale of the block will be less. Finally, as I will suggest below, there may be a good reason to leave this cost, in any event, in the hands of the shareholder rather than add it to the appraised value of the shares.⁴⁶

Thus, for both small and large shareholders, the market will be an insufficient resort not because of the costs of liquidating the investment, but because the speed of adjustment of share prices to the announcement of the fundamental change will prevent the shareholder from escaping the effects of the proposed change.

Despite this inability to outrace the market, an appraisal right furnishing protection against unwise or opportunistic fundamental changes is less likely to be of value to shareholders in a public corporation than to those in a private corporation. Managers and shareholders have at their disposal a convenient and low-cost gauge of the wisdom of the proposed fundamental change—market price. Should the market reflect un-

spect of the latter, see for example, Toronto Stock Exchange by-law 338, Dec. 13, 1983, effective Feb. 8, 1984; by-law 387, effective May 7, 1985 amending *The General By-Law* ss. 11.67-11.68 dealing with principal transactions. See generally 4 Can. Sec. L. Rep. (CCH) para. 815-821.

⁴⁵ Block sales will often be by insiders or those whom the market might rationally anticipate to have superior access to privileged information about the firm. As in the United States, Canadian markets have not been found to be efficient assimilators of insider information. See D.J. Fowler & C.H. Rorke, "Insider Trading Profits in the Canadian Equity Market" (May 1985) [unpublished]; J.B. Baesal & G.R. Stein, "The Value of Information: Inferences from the Profitability of Insider Trading" (1979) 143 *J. Fin. Quan. Anal.* 553; D.J. Fowler, *et al.*, "A Preliminary Examination of Insider Trading in Canada," (Proceedings, Administrative Sciences Association of Canada, 1977). This evidence does not refute the claim that markets are efficient as to *publicly* available information.

⁴⁶ See *infra*, Part V.B.1-2.

favourably on the proposed change, share prices will drop.⁴⁷ Although it has frequently been suggested that management control of the proxy machinery and rational shareholder indifference may lead shareholders to approve actions that are not strictly in accord with their best interests,⁴⁸ the reputations of the managers will not be enhanced by continuing to champion an apparently unwise change; management is therefore likely to abandon the proposal. Should management stubbornly cling to the unsound proposal or persevere for opportunistic reasons⁴⁹ (if, for example, the proposal would effect a change in risk that increases the utility of the managers at the expense of the wealth of shareholders, as suggested *supra*), shareholders (particularly institutions with significant holdings) are less likely to vote in its favour.

Nonetheless, there is good evidence that shareholders sometimes approve fundamental changes that are not in their interests.⁵⁰ This evidence suggests that an appraisal right giving protection against unwise fundamental changes will have some value to shareholders in public corporations although the case may not be overwhelmingly strong.

3. Public companies with thin markets

The situation in respect of thinly traded public companies is little different from that of public companies traded in liquid markets. There are two differences worth noting, however. The first is that the speed of adjustment of share prices to the announcement of the proposed fundamental change may be somewhat slower than in the case of widely traded companies, allowing shareholders a greater opportunity to outrace the market adjustment in selling the company's shares. This difference in speed of adjustment, however, is not likely to be material.⁵¹

Second, should the appraisal right have some value to large shareholders insofar as the sale of a block may depress prices, this value will

⁴⁷ The price signal may not be entirely unambiguous where other confounding events potentially affecting market price occur at or around the public announcement of the proposed change.

⁴⁸ It is rational for many shareholders to be apathetic because of the small value of their holdings, the relatively great cost of investigations required to make an effective use of the vote, the marginal effect on the outcome, and the fact that each shareholder has an incentive to free ride on the efforts of other shareholders in uncovering information and voting effectively. See generally R.C. Clark, "Vote Buying and Corporate Law" (1979) 29 Case W. Res. L. Rev. 776; F.H. Easterbrook & D.R. Fischel, "Voting in Corporate Law" (1983) 26 J. Law & Econ. 395; H.G. Manne, "Some Theoretical Aspects of Share Voting" (1964) 64 Col. L. Rev. 1427.

⁴⁹ Opportunistic risk shifts designed to suit management risk preferences are probably less likely in public corporations than in private corporations. In many cases, the wealth of the managers will be less concentrated in the enterprise, ameliorating the problem of underdiversification. Majorities or controlling shareholders are also more likely to be well diversified.

⁵⁰ For example, the evidence discloses that, on average, share prices drop on the enactment of "shark repellent" charter amendments which must be approved by shareholders. See *infra*, notes 80-82. A partial explanation (in addition to those explanations noted in the text) may be the cooption of institutional investors by means of management threats to withdraw business from those institutions failing to vote in favour of the amendment.

⁵¹ See those authorities noted *infra*, note 197.

likely increase as the market in the company's securities becomes thinner. In a thin market, the price of the liquidity services offered by block positioners will increase, since dealers who perform this role will anticipate holding an inventory of the stock for a longer period of time than in a liquid market and will increase their bid or ask spreads to cover the added risk. Similarly, thin markets tend to be characterized by greater uncertainty as to the equilibrium price of the security given the relatively infrequent trading. This, too, might be expected to increase dealer risk and hence bid or ask spreads.⁵² Many Canadian exchanges (including the Toronto Stock Exchange) are still conducted primarily as broker auction markets without significant market making by dealers. This may increase the cost of liquidating a large block.⁵³

Aside from the price of marketability, the perceived informational content of block sales may be larger in respect of thinly traded companies for which a deep pool of evaluative information may not be constantly available. Thus, the seller of a large block may be stuck with the very loss he or she seeks to escape simply by virtue of the act of selling in response to the proposed fundamental change.

Nevertheless, the little evidence available suggests that even in thinly traded companies the costs of liquidating a block may not be substantial.⁵⁴ Thus, as with public companies trading in deep markets, this factor may not significantly increase the value of the appraisal right to large shareholders.

C. Majorities and Minorities on the Exercise of the Appraisal Right

The *potential* value of the appraisal right lies in holding a put option that arises on the happening of specified triggering contingencies. The put option enables the shareholder who would not otherwise be able to do so to cash out of the enterprise (in the case of private corporations) or to cash out at a better price than the current market price (in respect of public corporations) and (in both cases) to avoid the effects of the fundamental change. This prospectively protects shareholders against certain risks. *Prima facie*, this protection should have some value to shareholders.

It must not be forgotten, however, that *ex ante* it may not be entirely clear to a shareholder whether he or she will be in the majority or minority in respect of any given fundamental change. If the shareholder is in

⁵² Price volatility will also be a determinant of bid or ask spreads. There are comparatively more speculative (and hence volatile) stocks on the Canadian exchanges than the American, leading (on average) to higher bid or ask spreads. See Tinic & West, *supra*, note 44. The widening of spreads associated with greater volatility will not be a problem unique to block trades but may supply potential block traders with another reason for preferring a non-market exit alternative.

⁵³ See Tinic & West, *ibid.* Even on the Toronto Stock Exchange, registered traders will often lack sufficient capitalization to participate in large block trades. But see Close, *supra*, note 43.

⁵⁴ The study by Close, *ibid.*, was performed on securities trading on the Toronto Stock Exchange, the great majority of which are thinly traded companies. See *supra*, note 26.

the majority seeking to undertake the fundamental change, he or she will bear part of the cost of cashing out the dissenters.⁵⁵ Thus, prospectively, it may not be clear whether the appraisal right will represent a benefit or a cost.

Nevertheless, by reducing the probability of unprofitable fundamental changes, the appraisal right may be of value to all shareholders. In the situation where either an unwise or opportunistic fundamental change diminishes enterprise value, the appraisal right may function as a backstop if the requirement to secure voting approval of fundamental changes fails. Should the existence of a controlling shareholder, management control of the proxy machinery, or shareholder apathy⁵⁶ result in the approval of a value-decreasing fundamental change, widespread exercise of the appraisal right may nevertheless abort the change. At the same time, the existence of an appraisal right will not deter many value-generating transactions. It is certainly true that in some cases widespread dissent may occur in a value-generating transaction where shareholders are unable to share the inside information possessed by managers or majority shareholders. Shareholders may not be in possession of the information that would show the change to be a productive one; but in this case, managers have an incentive to reveal the information to shareholders as long as revelation will not harm the company's competitive interests.⁵⁷ If harm would result and disclosure is impossible, the company should have little difficulty in raising money to pay out the dissenters, since it can share the confidential information with its bankers.

D. Is the Appraisal Right an Efficient Protection Against Changes in the Nature of the Business?

Thus far, I have focused on reasons why shareholders *might* value the appraisal right as a protection against fundamental changes that either alter the risk of the business without altering security values or that adversely affect security values.⁵⁸

⁵⁵ See *infra*, note 117 and accompanying text.

⁵⁶ See *infra*, Part VI.A.1.

⁵⁷ In private corporations, where the number of shareholders is small, it may be possible to reveal the information to all shareholders while avoiding public disclosure. This will tend to ensure both that the fundamental change will be approved by shareholders and that few if any shareholders will exercise dissent rights. Thus, it is even less likely in private corporations that value-increasing transactions will be deterred by the existence of an appraisal right.

⁵⁸ It should not be overlooked that there may be private ordering alternatives to the appraisal right to achieve this protection. For example, an alternative means of protection against unwise fundamental changes is to insert a proviso in the articles of the company stating that no fundamental change may be consummated if it causes the market price of the firm's securities to drop. This would protect shareholders against fundamental changes that decrease security values. However, there are practical problems that would attend such a provision, including the determination of whether or not the company's securities diminished in value as a *consequence* of the proposed change. Only sophisticated regression techniques will yield an answer to this question. Courts, as a practical matter, would be substantially unable to review this factual question without resort to

However, whether or not a security with an appraisal right will constitute an efficient financial contract cannot be determined without regard to additional factors. Aside from the *benefits* that may result from an appraisal right (and, as noted, the cost to non-exercising shareholders and the potential discouraging effect on productive fundamental changes) there are a host of potential costs associated with its exercise. Foremost amongst these are the mechanical costs of the appraisal right, including tax and brokerage costs to the shareholder, the costs of inevitable delays and uncertainties associated with the determination of value, and settlement or adjudication costs. These issues are reserved for further discussion below.⁵⁹

It will be suggested that no *a priori* conclusion may be stated in respect of whether or not shareholder risk preferences will lead shareholders to prefer a contract with an appraisal right to one without. This is fundamentally an empirical matter and the answer may vary with different types of corporations and different types of fundamental changes. This conclusion will form the basis for a suggested multiple option regime of statutory appraisal rights.

IV. CHANGES IN THE RELATIVE RIGHTS OF SECURITY HOLDERS: THE APPRAISAL RIGHT AS PROTECTION AGAINST DISCRIMINATION

A. *Discrimination Defined*

Fundamental changes often involve discriminatory treatment of shareholders. Indeed, discrimination is a commonplace of corporate existence. Discrimination may arise in respect of shareholders of a single class or shareholders of different classes, and it may arise in a variety of contexts. In the life of an enterprise, business, economic, or financial considerations may dictate that the enterprise undergo reformation. This reformation may well involve, *inter alia*, discriminatory cancellation of arrearages of dividends of a class of shares, removal of a retraction feature, issuance of a class of securities superior to an existing class or classes (thus derogating from their relative interest in the enterprise), or even elimination of a class of securities. A corporate amalgamation may result in discriminatory treatment of shareholders, as may reincorporation in a new jurisdiction, or virtually any other corporate fundamental change.

Although the word "discrimination" usually carries with it a pejorative connotation, it is clear that the fact of discrimination by itself is not always objectionable. The discrimination may be of a formal but not substantive character. For example, where there is a single class of

expert testimony, leading to difficult and expensive litigation. Of course, the appraisal right may also generate costly litigation (see *infra*, Part V.B.6).

⁵⁹ See *infra*, part V.

shareholders in a corporation and the corporation undertakes a statutory arrangement whereby the majority shareholders receive common shares in the reorganized enterprise but the minority receive cash, the majority and minority have clearly been treated in a *formally* disparate manner. Nevertheless, as long as the *economic value* of the consideration received by both majority and minority is essentially equivalent⁶⁰—that is, shareholders are treated in a *substantively* equal manner⁶¹—minority shareholders can have little objection.

Even substantively unequal treatment is not necessarily *unfair* treatment. Minority shareholders may be willing to accept substantively unequal outcomes *ex post* if this maximizes share prices *ex ante* (which might be the case, for example, if productive fundamental changes are rendered more probable by a rule permitting substantively unequal treatment of minority and majority). The correct perspective from an economic point of view is the *ex ante* bargain, and it is this perspective that will be used in this article.

This Part addresses the extent to which the appraisal right may function as a device for preventing or affording relief from instances of substantive discrimination associated with fundamental changes. The extent of the protection afforded may vary. The appraisal right may be based on a principle of unrestricted substantive equality where the appraisal valuation will be conducted with a view to ensuring that dissentient shareholders receive substantive equivalents to majority shareholders. Alternatively, the right might permit substantive discrimination to the extent of preserving from encroachment the *pre-transaction* value of the shareholders' entitlement.⁶² Other intermediate solutions are possible.

The difficulty in formulating a principle of permissible and impermissible discrimination results primarily from the tension between the facilitation of the economic gains which may arise from permitting substantively unequal treatment on fundamental changes, and the dangers of opportunistic redistribution (and the associated economic losses) engendered by such a rule. Thus, the discussion in this section will focus on

⁶⁰ "Equivalence" must be understood in a relative sense; that is, relating the prior relative economic interests of shareholders.

⁶¹ Conversely, the receipt of formal equivalents does not guarantee that all shareholders or classes of shareholders will be treated in a substantively equal manner. Fundamental changes carried out with scrupulous attention paid to formal equality may have a widely differing *impact* on groups of shareholders (whether within a class or in different classes). See, for example, *Re Ferguson and Imax Systems Corp.* (1983), 43 O.R. (2d) 128 (Ont. C.A.); *Greenhalgh v. Arderne Cinemas Ltd.* (1950), [1951] Ch. 286 (C.A.); *Re Mackenzie & Co., Ltd.* (1916), [1916] 2 Ch. 450 (Ch. Div.).

⁶² These two possibilities are not exclusive of *other* types of appraisal right but are perhaps the two most likely variants. As indicated below, "pre-transaction" value is not entirely self-defining, since value depends on the information set used in performing the evaluation. Two variants canvassed below are value based on publicly available information as reflected in the market price of the firm's securities, and value informed by the additional understanding derived from possession of inside information about the company.

the risks of opportunistic redistribution (by *either* majority or minority) under alternative substantive discrimination principles; whether the realization of gain from the fundamental change *depends* on, or will occur with greater frequency under, a rule of unequal distribution; and the transaction costs generated by the rule, including costs of bargaining, costs associated with alterations of the bargain, policing the bargain, and dispute resolution. This last will depend upon the relative ease with which the rule may be applied in practice by the parties and by a court.⁶³ These three matters will be evaluated in a variety of transactional contexts and in light of the *type* of corporation involved.

It will be suggested that a rule of unequal sharing of benefits will in some circumstances tend to maximize the size of the corporate pie available for distribution and will economize on adjudication and dispute resolution costs. However, this leaves open a possibility of appropriation of values latent in the enterprise by majority shareholders. Where this is the case, an appraisal right designed to uncover hidden values may afford shareholders an opportunity to recapture such values. If the dangers of opportunistic appropriation are pronounced, an appraisal right with a full gain-sharing rule may conduce to a lower corporate cost of capital. The relative likelihood of opportunistic redistribution and the facilitation of gains will vary with different types of transaction and different corporate types.

B. *A Rule of Unequal Distribution: Promoting Productive Fundamental Changes*

In respect of corporate control transactions, it has been vigorously argued by F.H. Easterbrook and D.R. Fischel that a rule permitting an unequal distribution of benefits—subject to the minority being no *worse* off than before (as measured by the pre-transaction market price of the minority's shares)—will, *ex ante*, make *both* majority and minority shareholders better off.⁶⁴ The unequal distribution makes changes of control more likely both because controlling shareholders are more likely to part with their interests when they can capture a larger share of the gain and because the acquiror's costs of gaining control will tend to be reduced. Such control transactions produce economic gains as control moves to the hands of those best able to manage the corporate assets. Inefficient management may be removed. Even where management is not actually removed, the *threat* of removal promotes better management. This enlarges the size of the corporate pie available for distribution.

⁶³ Does it involve complex and difficult calculations? Difficult evidentiary questions? Is it likely to provoke difficult and expensive litigation, whether by minority shareholders acting *bona fide* or opportunistically?

⁶⁴ F.H. Easterbrook & D.R. Fischel, "Corporate Control Transactions" (1982) 91 Yale L.J. 698.

According to this argument, minority shareholders will participate in the resulting gains through at least two mechanisms. The first is simply by virtue of participating in better-run companies: the capital market discipline of managers will be facilitated, benefitting all shareholders. A second is by means of holding diversified portfolios of both parent and subsidiary companies. As shareholders of subsidiary companies, minority shareholders may fail to participate directly in the gains generated by corporate control transactions. However, as shareholders of parent companies (majority or controlling shareholders of the disenfranchised subsidiaries), the minority will participate in the gains since these benefit the *entire* company. Moreover, any added risk of variability in returns experienced by minority shareholders under an unequal distribution rule may be diversified away.⁶⁵

Fischel has independently suggested—consistent with the above theory—that it is appropriate in appraising the value of dissentient shares to exclude any gains which may arise from undertaking the control transaction by awarding pre-transaction market value.⁶⁶ In principle, the argument in *favour* of a rule allowing substantive discrimination, subject to protecting the pre-transaction value of the minority shares from encroachment, may be extended to all corporate fundamental changes. Protecting the pre-transaction value of minority shares while allowing the majority to capture the economic gains generated will arguably produce more of all types of productive fundamental changes.

C. *The Rule of Unequal Sharing in Canadian Capital Markets*

The argument advanced by Easterbrook and Fischel in favour of a rule of unequal sharing in order to foster economic gains rests in part on the assumption that both minority and majority have an opportunity to participate—whether directly or indirectly—in the gains arising from the non-sharing rule. To the extent that majority and minority shareholders are *not* overlapping classes in the market but form discrete classes of capital contributors, the argument weakens.

Canadian capital markets are characterized by a high degree of concentration of share ownership. Few companies of significant size are “management controlled”; a small number of corporate and private shareholders hold a startlingly large portion of all marketable securities

⁶⁵ It is not clear that the variability (and hence the risk of the returns to minority shareholders) is *increased* under an unequal sharing rule. In fact, the opposite appears to be the case. A rule dividing gains unequally tends to result in a more rather than less certain return to the minority shareholders. Since corporate control transactions are uncertain future events, a gain-sharing rule would tend to carry with it the uncertainty of realization or non-realization of potential gains. A non-sharing rule eliminates this uncertainty. See A.M. Polinsky, “Risk Sharing Through Breach of Contract Remedies” (1983) 12 J. Leg. Stud. 427. Of course, if the risk is diversifiable, it matters little, an increase *or* a decrease in diversifiable risk will be of little concern to diversified shareholders.

⁶⁶ Fischel, *supra*, note 10.

publicly traded in Canada⁶⁷ and in many cases control vast corporate empires. Moreover, many subsidiaries are held by privately owned parents. In these circumstances, an asymmetrical distribution of the gains from corporate control transactions will occur, with insiders benefitting with much greater frequency and to a greater extent than outsider minority shareholders. Thus, the benefits of a non-sharing rule to minority shareholders are apparently reduced.

However, as a matter of theory, it is not clear that minority shareholders *must* be able to hold the securities of parent companies in order that a non-sharing rule constitute the most efficient rule. Minority shareholders will be indifferent to the character of the rules as long as any change makes them no worse off. If a non-sharing rule does indeed enhance the wealth of majority shareholders, while not detracting from the wealth of minority shareholders, moving to a non-sharing rule will effect a Pareto improvement. The degree of concentration of shareholdings may therefore only effect the *distribution* of the gains resulting from a non-sharing rule as between majority and minority shareholders rather than the magnitude of the gains.

D. *The Economic Costs of a Rule of Unequal Distribution: The Transaction Costs of Opportunistic Redistribution and Potential Diminutions in Enterprise Value*

1. The economic costs of opportunism

Allowing majority shareholders to appropriate the gains flowing from fundamental changes may not have the uniform property of producing more productive fundamental transactions. It may also tend to produce a large number of unproductive (and possibly wasteful) transactions. Discriminatory alterations of the enterprise may have a purely redistributive motive. The change may be nothing more than a gambit by managers or majority shareholders to effect a redistribution between classes of shareholders, or between shareholders within a class, under the guise of a change putatively for the benefit of the company as a whole.

The risks of opportunistic redistribution are heightened due to asymmetric possession of information regarding company value. The majority shareholders or managers may possess inside information disclosing *hidden values* that are not reflected in the market price of the company's securities and may wish to capture these values for themselves by excluding the minority.⁶⁸

⁶⁷ See, for example, L. Hunter, "Notes for an Address to the Conference on the Changing Regulatory Environment for Canadian Financial Institutions" (U. of T. and O.E.C. Conference on Canadian Financial Institutions, 23 May 1985); D. Hatter, "Charmed Circle Still Firmly in Control" (Summer, 1985) *The Financial Post* 50 at 58; *Report of the Royal Commission on Corporate Concentration*, (Ottawa: Queen's Printer, 1978) (Chair: R. Bryce) ch. 7. See also J. Porter, *The Vertical Mosaic* (Toronto: University of Toronto Press, 1965).

⁶⁸ The term "minority" is used here to refer *both* to a minority of shareholders within a class

There are a variety of economic losses that will result from undertaking purely redistributive fundamental changes. One is the direct costs of the transaction; the company will typically have to send out notices to shareholders, prepare proxy materials, hold shareholder meetings, and comply with other regulatory burdens associated with shareholder and other mandated approvals. Management time will be diverted from managing the corporation's business interests. Some transactions that may be undertaken with purely redistributive motives may adversely affect the corporation's capital structure, cash flows, or ability to raise capital. A leveraged buyout, for example, might burden the corporation with excessive debt, exposing it to unreasonable risks of bankruptcy and co-opting cash flow to service the debt while depriving the corporation of access to the public equity markets.

In a world that permits substantively unequal treatment, the anticipation of a higher level of purely or partly redistributive fundamental changes will lead to a higher level of monitoring of the activities of the corporation by shareholders. This is also an economic cost.

The familiar problem of adverse selection gives rise to another cost. Public shareholders may not be able, *ex ante*, to observe the likelihood of any particular company or majority shareholder engaging in opportunistic redistribution. Thus, in setting a company's cost of capital, the market will assume that each issuer will engage in an *average* amount of opportunistic redistribution. In fact, some companies will engage in *less* and some companies in *more* redistribution than the average. Those companies engaging in *less* ("high quality issuers") will be penalized by having a cost of capital reflecting an inappropriately large risk premium.⁶⁹ Coincidentally, companies engaging in *more* opportunism ("low quality issuers") will have an inappropriately *low* cost of capital.

This inability of investors to differentiate the quality and character of corporate issuers will have both a distributive and an allocative effect. A redistribution of wealth will be effected from relatively high quality issuers to those of relatively low quality. This in turn will result in a diminution of investment in high quality enterprises (those with lower agency costs).

In an efficient securities market,⁷⁰ however, minority shareholders will be indifferent *ex ante* to the increased prospects of redistribution. In such a market, the character and magnitude of redistributive events and their probability of occurrence will be fully anticipated and reflected in the price paid by shareholders for their shares.⁷¹ Thus, the full cost of

and to classes of shares without voting power or whose votes are overmastered by those of other classes.

⁶⁹ G.A. Akerlof, "The Market for 'Lemons': Quality Uncertainty and the Market Mechanism" (1970) 84 Q.J. Econ. 488.

⁷⁰ The evidence, on balance, favours the view that securities markets are indeed informationally efficient. See *infra*, note 197 and accompanying text.

⁷¹ See M.C. Jensen & W.H. Meckling, "Theory of the Firm: Managerial Behavior, Agency

anticipated redistributions will be borne by the issuer. This generates a potent incentive for the issuer to offer shareholders a financial contract which reduces the probability of redistributive events. *Prima facie*, any protective feature which prospectively reduces the economic costs associated with such events by more than the cost of the protection will be adopted since it will enlarge the size of the corporate pie available for distribution to all claimants.⁷² In this way, private ordering will answer the problem of adverse selection.

If fundamental changes had a predominantly redistributive character, the preferred rule would be a prohibition of all fundamental changes in the interests of avoiding all the above costs. This alternative is, of course, untenable given the manifest gains that result from many fundamental changes.⁷³ Prohibition, which may be self-imposed or imposed by statute, will be a real alternative only in those cases where the prospective gains of a particular *type* of fundamental change are dominated by the risks of redistribution and attendant economic costs.⁷⁴ The focus must therefore be on the evolution of arrangements (whether statutory or extra-statutory) that *permit* such discrimination as will facilitate productive fundamental changes while eliminating or, more realistically, *reducing the probability* of changes having purely redistributive effects.

The appraisal right may be one such mechanism. An appraisal right that allows a shareholder to secure an independent appraisal of the fair value of the shares subject to the transaction can serve as both a cure for and prevention of the harms caused by redistributive fundamental changes. It is a cure in the sense that if redistribution occurs, the right will serve to make the shareholder whole. It is a prevention in the sense that an appraisal right that effectively protects shareholders from redistribution will remove the incentive to engage in redistribution.

Thus, the firm may find it profitable to covenant against redistribution by incorporating protections against discrimination in its constitution. As suggested below, a corporate law statute can serve the same function (while simultaneously reducing transaction costs) in the form of enabling provisions that replicate the most usual form of private bargain.

2. Three possible valuation principles

One of the greatest difficulties in designing an appraisal right arises in respect of the optimal form of valuation objective. If the appraisal right is to protect against redistribution, what is an event of redistribution? It is clear that the term must be used with great care, for embedded

Costs and Ownership Structure" (1976) 3 J. Fin. Econ. 305. Part of this risk may be diversifiable risk that will not affect share prices. See Part III.A.I., *supra*.

⁷² *Ibid.*

⁷³ See, for example, M.C. Jensen & R.S. Ruback, "The Market for Corporate Control: The Scientific Evidence" (1983) 11 J. Fin. Econ. 5; B. Espen Eckbo, "Mergers and the Market for Corporate Control: The Canadian Evidence" (1986) 2 Can. J. Econ. 236.

⁷⁴ A "pure" going-private transaction presents the strongest argument. See Part IV.E.1., *infra*.

in it are norms of shareholder entitlement. It is only possible to effect a redistribution if values currently "belonging" to one group of shareholders are appropriated by another. The senses in which values may be redistributed define the three types of valuation objective that this article focuses on.

One standard protects against discriminatory fundamental changes that adversely affect the current market value of the securities with an appraisal right. A valuation objective geared to pre-transaction market value protects vested shareholder expectations based on publicly available information bearing on the firm's earnings prospects. Another possible standard is the protection of pre-transaction value based not only on publicly available information, but on insider information as well. This valuation objective protects against the appropriation of *hidden values* known only to insiders.

These two standards are similar in that they seek to protect *pre-transaction* values—in the former case, the values are known to the market, in the latter, they are not. A third standard is possible. This is a rule of full substantive equality. Under this rule, whatever gains arise from the transaction (in addition to any hidden values) must be shared *pro rata* among all shareholders.

The first and third standards are related. The market price of the firm's securities will reflect any anticipation of participating in future values. Thus, a rule protecting current market value protects these expectations and in effect awards the expected participation in transaction synergies. This rule yields no protection, however, in respect of *unanticipated* transaction synergies. The third valuation principle goes the extra distance and awards participation in even these values. The second and third valuation principles are also linked. Transaction synergies that are not anticipated by the market may have been anticipated by insiders, drawing a connection between protection of hidden values and a rule allowing for full participation in all transaction synergies. These three valuation principles will be referred to respectively as "pre-transaction market value," "hidden values," and "transaction synergies."

In the section immediately following, the role potentially served by the appraisal right is evaluated in a variety of transactional circumstances. It will be suggested that the value of the appraisal right to shareholders and the optimal form of valuation objective will depend on the relative danger of opportunistic redistribution associated with different types of fundamental changes and the degree to which the appraisal right (and the associated valuation principle) is likely to reduce the frequency of productive fundamental changes.

E. Trading Off Encouragement of Fundamental Changes and the Economic Costs of Opportunism: The Appraisal Right as Protection Against the Plundering of Hidden Values on Shareholder Freeze Outs

1. Pure going-private transactions

a) *Pure going-private transaction defined*

A "going-private transaction" is one that forcibly evicts participating shareholders from the enterprise so as to concentrate corporate control and the residual interest in earnings and assets in the hands of a single shareholder or small group of shareholders. A "pure" going-private transaction is a going-private transaction effected by insider managers or majority shareholders. It includes neither two-step freeze outs effected by an acquiror initially at arm's length with the target nor parent-subsidiary amalgamations.⁷⁵

b) *A role for the appraisal right*

At least in theory, it would appear that there exists significant danger of opportunism associated with pure going-private transactions. As noted earlier, an invitation to opportunism arises from the asymmetric possession of information by insider majority (or controlling) shareholders and public shareholders. It is absolutely clear that, however efficiently securities markets assimilate publicly available information in security prices, those with access to inside information will have a better informed view of the "true" or "intrinsic" value of the company than will the market in which minority holdings are priced.⁷⁶ It cannot be an infrequent event that insiders become aware that the corporation is relatively underpriced by the market. In such a situation, a going-private transaction may be engineered in order to capture these hidden values. Indeed, the majority may be able, by judiciously metering the flow of

⁷⁵ The taxonomy of transactions and related terminology in this article are adopted in broad form from V. Brudney & M.A. Chirelstein, "A Restatement of Corporate Freezeouts" (1978) 87 Yale L.J. 1354. See also Brudney, "A Note on 'Going-Private'" (1975) 61 Va. L. Rev. 1019.

Evictions of non-participating and non-voting shareholders from the enterprise are not the usual form of "going-private" transaction, but they present substantially the same issues as evictions of participating or voting shareholders and could easily be accommodated in an expanded definition of "going-private" transaction. However, compare the definitions of "going-private" transaction in the *OBCA*, *supra*, note 2 at s. 189(1) and in Ontario Securities Commission Policy 9.1—"Going-Private Transactions, Buyer Bids and Insider Bids."

⁷⁶ In respect of the Canadian markets, see Fowler and Rorke, *supra*, note 45; Baesal & Stein, *supra*, note 45; Folwer *et al.*, *supra*, note 45. There is a great deal of evidence from the American markets as well: see generally J.H. Lorie, P. Dodd & M. Hamilton Kimpton, *The Stock Market: Theories and Evidence*, 2d ed. (Homewood, Illinois: Richard D. Irwin, 1985); Brealey & Myers, *supra*, note 18 at 254-73; Tinic & West, *supra*, note 18. The classic review, although necessarily dated, is E.F. Fama, "Efficient Capital Markets: A Review of Theory and Empirical Work" (1970) 25 J. Fin. 383. An account aimed at the layman is B.G. Malkiel's *A Random Walk Down Wall Street* (New York: W.W. Norton, 1973).

information that reaches the market, to depress security values in anticipation of a future going-private transaction, further exacerbating the potential for transfer of values from minority to majority shareholders.⁷⁷

At the same time, the number of ways in which corporate gains can be generated by a pure going-private transaction is reduced in number. These transactions do not involve operating synergies. Nor do they usually involve transfers of control or any of the benefits attending such transfers.⁷⁸

The apparently attenuated prospects for the production of real economic gains coupled with the accentuated dangers of purely redistributive freeze outs would at first appear to render the pure going-private transaction a strong candidate for a rule of outright prohibition.⁷⁹ As suggested earlier, where the redistributive motive dominates the potential gains in respect of a given transaction type, such transactions are likely to do little but generate dead weight social losses.

⁷⁷ As indicated above, this includes transfer of values both between a majority and minority within a given class and between a majority and minority of *different* classes.

⁷⁸ It seems clear that *some* gains might be expected to arise from pure going-private transactions. Real economic gains include reduction of the legal, regulatory, and administrative costs of running the corporation (including the opportunity cost of executive time devoted to regulatory matters). These are transaction costs that are a pure deadweight social loss. Going private may also yield an increased ability to protect valuable confidential and competitively sensitive information and may eliminate troublesome conflicts of interest that fetter the activities of management, or opportunistic or vexatious minorities whose activities are detrimental to the corporation and increase the corporation's debt capacity. Gains may arise from the realignment of managerial incentives with the profit objective; this may be the product of the increased equity interest of management in the enterprise, or the ability to undertake efficient schemes of compensation that would be unacceptable to (at least some) public shareholders. The concentration of financial interest in third party investors also improve monitoring of the corporation's activities. See generally DeAngelo *et al.*, *infra*.

Alternatively, the corporation may experience gains that are not truly economic. Into this category fall reductions in the burden of taxation that may flow from going-private: *Income Tax Act (ITA)*, R.S.C. 1952, c. 148, as am. S.C. 1986, c. 6, s. 125. See generally E.G. Kroft, "The 'Going-Private' Transaction—Some Income Tax and Corporate Aspects of a Public Company Becoming Private" (1980) 12 *Ott. L. Rev.* 49. Other statutory benefits, such as those relating to the *Investment Canada Act*, S.C. 1985, c. 20, or those relating to trade licences *et cetera* may also be secured. See generally Easterbrook & Fischel, *supra*, note 64; J.C. Glover Jr. & A.M. Schwartz, "Going-Private in Canada" (1978) 3 *Can. Bus. L.J.* 3; A.M. Borden, "Going-Private—Old Tort, New Tort or No Tort?" (1974) 49 *N.Y.U.L. Rev.* 967 at 1006-13. See also *Gregory v. Canadian Allied Property Investments Ltd.* (1979) 11 *B.C.L.R.* 253 at 264-65, [1979] 3 *W.W.R.* 609 at 620 (C.A.). But *cf.* E.F. Greene, "Corporate Freeze-out Mergers: A Proposed Analysis" (1976) 28 *Stan. L. Rev.* 487; Brudney, *supra*, note 75.

There is little empirical evidence, but the evidence that does not exist supports the proposition that there may be real economic gains from going private. See H. DeAngelo, L. DeAngelo & E.M. Rice, "Going-Private: Minority Freezeouts and Stockholder Wealth" (1984) 27 *J. Law & Econ.* 367, discussed at *infra*, note 83. With respect to the costs incurred by a public corporation in excess of a private corporation, see C.W. Schneider, J.M. Manko & R.S. Kant, "Going Public: Practice, Procedure and Consequences" (1981) 27 *Vill. L. Rev.* 1.

⁷⁹ As noted above, this would eliminate the direct costs associated with going-private transactions as well as costs of monitoring against redistribution, bonding, and dispute resolution. The sometimes very costly exercise of resorting to an appraisal right for protection against discrimination would be entirely avoided.

However, while there are cogent reasons to *theorize* that a ban on going-private transactions might be the preferred rule *ex ante*, there is evidence to suggest otherwise. If the optimal rule were a prohibition of going-private transactions, one would anticipate the evolution of private ordering arrangements that accomplish this end. Further, if such arrangements are beneficial, they should have a positive effect on share prices. A number of American (but so far, comparatively few Canadian) corporations have indeed adopted charter amendments requiring a demanding supra-majority shareholder approval of amalgamations or other corporate combinations (or asset sales) involving insiders (sometimes supplemented by a requirement for approval of the transaction by a majority of the disinterested shareholders).⁸⁰ These provisions are not designed, however, to give protection to minority shareholders in a pure going-private transaction. Rather, it would appear that many of these provisions are adopted as “shark repellent” designed to thwart hostile two-tier takeover bids⁸¹ by destroying an acquiror’s ability to force through the second-step cashout. The evidence suggests that share prices drop with management’s announcement of a proposal to adopt such provisions.⁸² Other empirical evidence suggests that going-private transactions produce very real economic gains and not merely private gains that arise from the possession of inside information by those engineering the transaction.⁸³ The weight of the evidence therefore suggests that it

⁸⁰ See “Shark Repellants and Stock Prices: The Effects of Antitakeover Amendments Since 1980,” July 24, 1985, Office of the Chief Economist of the U.S. Securities and Exchange Commission. This study analyses a range of provisions including “fair price” and “non-fair price” varieties. The former have a supra-majority voting requirement but dispense with it should the board of directors so decide (a “board out” clause) or if shareholders on the second-step cashout are paid the highest price paid by the bidder within a specified period of time. The latter include a pure supra-majority requirement, a supra-majority with a board out, the authorization of blank-cheque preferred stock, and classification of the board of directors.

⁸¹ The absence of two-tier bids in Canada may explain the relative dearth of these provisions.

⁸² *Supra*, note 80. Although these provisions are aimed at two-step takeovers initiated by arm’s length outsiders, rather than insider bids that constitute pure going-private transactions, they mechanically apply to both types of transactions. Thus, evidence as to their purpose and effect is useful in analysing the propriety of pure going-private transactions. See also G. Jarrell, “Shark Repellants and Stock Prices: The Role and Impact of Antitakeover Amendments” SEC [1984-85 Decisions] *Federal Securities Law Reporter*, (CCH), 1984, para. 83,714. But see also H. DeAngelo & E. Rice, “Antitakeover Amendments and Stockholder Wealth” (1983) 11 J. Fin. Econ. 329 (finding no significant effects from the adoption of shark repellent); S. Linn & J. McConnell, “An Empirical Investigation of the Impact of ‘Antitakeover’ Amendments on Common Stock Prices” (1983) 11 J. Fin. Econ. 361 (finding share price increases on the adoption of shark repellent provisions). The SEC study, *supra*, note 80 includes the largest number of sample firms, the most recent data, and is probably the most reliable.

⁸³ DeAngelo, DeAngelo and Rice, *supra*, note 78. The authors found that in the two days surrounding the announcement of a going-private proposal, the price of the publicly traded stock increased by an average of 22.3 percent (abstracting from risk-adjusted market movements). In the two months before the announcement (and including the announcement) the price rise was 30.4 percent. Most of the firms in the sample experienced positive price increases, and the results were not attributable to dramatic price increases in a small number of cases. On the basis of their data, the authors rejected a “signalling” explanation of the price increase (that is, that the price increases

would not be in the best interests of shareholders to prohibit going-private transactions.

In Ontario, all forms of going-private transactions have been given the *imprimatur* of both the corporate legislation and the Ontario Securities Commission.⁸⁴ The *Ontario Business Corporations Act* requires, *inter alia*, that in a going-private transaction dissentient shareholders have the opportunity to exercise an appraisal right.⁸⁵ Thus, the appropriate question to ask is which (if any) of the three valuation standards identified above is most appropriate in the case of pure going-private transactions.⁸⁶

The first alternative is to protect shareholders against an expropriation at less than current market values. Awarding pre-transaction value on an appraisal would protect shareholders against appropriation of known values based on publicly available information. While an appraisal right with this valuation standard might well have some value to shareholders, it will fail to protect shareholders against a potentially more serious danger; the plundering of hidden values known only to insiders. Where opportunistic redistribution (an attendant costs) is a serious worry, an appraisal right affording shareholders the opportunity to test the value of the corporation against relevant insights possessed only by insiders may be of value to shareholders. Although the empirical evidence supports the proposition that, *on average*, going-private transactions tend to produce gains for all shareholders,⁸⁷ it may still be the case that *some* of these transactions are purely redistributive in character.⁸⁸ It is again significant, however, that private ordering arrangements based on this valuation standard have not evolved in the marketplace.⁸⁹

could be attributed purely to new information about the intrinsic value of the company). The authors also found that when a going-private proposal was withdrawn, the market price of the publicly traded securities slumped by an average of 8.9 percent. The median pre-offer management equity ownership was 50.9 percent for the firms in the sample. The authors concluded that the source of the increases was real economic gains arising out of the going-private transaction and the market's anticipation that the firm would be worth more as a private than as a public firm. See also Schneider, Manko & Kant, *supra*, note 78.

⁸⁴ *OBCA*, *supra*, note 2 at s. 189; Ontario Securities Commission Policy 9.1.

⁸⁵ *OBCA*, *ibid.* s. 189(7).

⁸⁶ The value of the appraisal right as protection against discrimination depends on the degree to which other market and legal devices constrain opportunism. This question is reserved for Part VI.A.1, *infra*.

⁸⁷ See *supra*, note 83.

⁸⁸ The study by DeAngelo, DeAngelo & Rice, *supra*, note 78, did not, in measuring the gains arising from going-private transactions, distinguish between going-private transactions in which managers alone (or key shareholders) obtained 100 percent of the equity and those that involved the acquisition of a significant equity position by outside investors. The former may present greater dangers of exploitation of inside information.

⁸⁹ This is not conclusive, however, against the value of an appraisal right with this valuation objective. One explanation may be that such private arrangements have been rendered unnecessary by the statutory appraisal right. Another is that the cost of drafting such protection into the corporation's charter may exceed the prospective benefit. See Parts VII.C. and IX., *infra*.

The case in favour of the third valuation objective is considered below.

2. Two-step freeze outs effected by initially arm's-length acquirors
 - a) *Two-step freeze out defined*

A two-step freeze out consists of a takeover bid followed immediately, or shortly thereafter, by a second-step transaction (frequently a freeze out amalgamation) forcing out those shareholders who declined to tender to the initial takeover bid.

- b) *The appraisal right: prospective gains and losses*

The issues raised in two-step freeze out transactions effected by initially arm's length acquirors are fundamentally different from those raised by pure going-private transactions.⁹⁰ The potential economic gains are far greater, and the dangers of opportunistic exploitation of minority shareholders are considerably reduced.

It is generally acknowledged that corporate takeovers perform an important economic function. Takeovers may generate gains by exploiting operating synergies between acquiror and acquired, by replacing inefficient management, or simply by moving corporate assets to the hands of those best able to use them.⁹¹ Moreover, the acquiror in this instance is not initially an insider, but an outsider who is not in a position to exploit insider information bearing on hidden values.⁹² Because of these factors, the controversial issue in respect of two-step freezeout transactions is not whether minority shareholders should share in the *gains* arising from the transaction, but whether minority shareholders are entitled to the *same price* offered in the first step of the takeover,⁹³ something *incrementally*

⁹⁰ See *infra*, notes 93-95.

⁹¹ There is a considerable body of empirical evidence supporting the efficiency explanation of takeovers. Some of this evidence is reviewed in L.A. Bebchuk, "The Case for Facilitating Competing Tender Offers" (1982) 95 Harv. L. Rev. 1028; F.H. Easterbrook & D.R. Fischel, "The Proper Role of a Target's Management in Responding to a Tender Offer" (1981) 94 Harv. L. Rev. 1161. See also Jensen & Ruback, *supra*, note 73.

⁹² It must be recognized that the line between a two-step acquisition and an amalgamation between a parent and subsidiary of long standing is not an entirely clear one. As the period between the initial takeover bid and the subsequent cashout becomes longer, the former grows more and more to resemble the latter. Thus, it is impossible to be completely scientific about the interval of time after which a two-step takeover should be treated as a parent-subsidiary amalgamation. Greene suggests that where the second step is delayed longer than a year, the additional shareholder protection of a judicial hearing to determine the fairness of the offered price should be required. Greene, *supra*, note 78.

⁹³ Brudney and Chirelstein suggest that two-step 100 percent acquisitions (by whatever means) should be analogized to a "unitary asset acquisition" (a sale of assets) approved by the target's shareholders by a supra-majority, rather than viewing the second step on a par with other freezeout transactions. In a merger formally consummated as a sale of assets (or a statutory amalgamation), "majority rule" governs, and the minority are forcibly cashed-out of the enterprise. As long as there is no problem of side payments, the negotiated price is an arm's length price and bears the market's certification of fairness, allaying fears of mistreatment of minority shareholders. In a takeover,

less than this price,⁹⁴ the *market price* that prevailed before the first step of the takeover,⁹⁵ or that price which, when used to compute a weighted average of the takeover price and the cashout price, assures each tendering shareholder of securing pre-transaction market value for his or her shares.⁹⁶

In the federal legislation and cognate statutes, the "compulsory acquisition" provisions⁹⁷ allow an acquiror to forcibly cash out dissenters where 90 percent of the shares that are the subject of the bid, excluding those shares initially held by the acquiror, tender into the bid. These

where a similar majority of shareholders has "approved" the transaction by tendering their shares, the market has also rendered a verdict of fairness. Therefore, the acquiror ought to be able to go ahead and cash out the remaining shareholders at the same price.

See Brudney & Chirelstein, *supra*, note 75; Brudney, *supra*, note 75; V. Brudney & M.A. Chirelstein, "Fair Shares in Corporate Mergers and Takeovers" (1974) 88 Harv. L. Rev. 297.

Bebchuk's analysis of the problem conforms to that of Brudney and Chirelstein. However, Bebchuk proposes a different mechanism for ensuring that the degree of shareholder approval on a two-step acquisition conforms to that required in a unitary asset acquisition. He suggests that tendering shareholders ought to be able to make a *conditional* tender that would effectively transform the tendering process into the equivalent of a shareholder vote. Shareholders would be able to tender "no" to the takeover offer but with the condition that if a sufficient majority of shareholders tender favourably (and unconditionally), they should be bought out as well. In the usual case of shareholder voting approval by supra-majority, this condition is implicit. L.A. Bebchuk, "Toward Undistorted Choice and Equal Treatment in Corporate Takeovers" (1985) 98 Harv. L. Rev. 1695.

Under the federal compulsory acquisition provision, the second-step freezeout must be effected at the same price as the initial takeover. Shareholders also have the option of submitting their shares to an appraisal. Further, the courts appear now to have foreclosed the possibility of a two-step acquisition not effected under the compulsory acquisition legislation. See *Carlton Realty Comp. Ltd. v. Maple Leaf Mills Ltd.* (1978), 22 O.R. (2d) 198, 93 D.L.R. (3d) 106 (H.C.); *Alexander v. Westeel-Rosco Ltd.* (1978), 22 O.R. (2d) 21, 93 D.L.R. (3d) 116 (H.C.); *Burdon v. Zeller's Ltd.* (1981), 16 B.L.R. 59 (Que. C.S.). *CBCA, supra*, note 1 at s. 199.

The *OBCA* compulsory acquisition provision (*OBCA, supra*, note 2 at s. 187) confers comparable protection against low price cashouts. The *OBCA* confers additional protection against illiquidity lock-ins in some circumstances (*OBCA* at s. 188). The *OBCA* going-private provision also contains a mechanism, not substantially different in effect from the Bebchuk conditional vote, requiring approval of any going-private transaction (other than one effected under the compulsory acquisition provision) by a majority of the minority shareholders (*OBCA* at s. 189). In addition, dissenters may apply for a court appraisal of their shares (*OBCA* at s. 189(7)). The Bebchuk mechanism offers the possible important advantage of by-passing entirely the proxy machinery, the intercession of which may tip the scales in favour of the acquiror under the *OBCA* provisions. See the comparable protections in OSC Policy 9.1.

⁹⁴ Borden, *supra*, note 78. Otherwise, the incentive to tender to the takeover is impaired.

⁹⁵ Easterbrook & Fischel, *supra*, note 64.

⁹⁶ Fischel, *supra*, note 10. Thus, where the pre-takeover market price was \$75, and a takeover offer is made for 50.01 percent of the shares at \$100 per share, a cashout price of \$50 would ensure that a shareholder who tendered into the bid (assuming pro-rated pick-up of shares tendered as mandated in most jurisdictions) would receive an average consideration for all of his or her shares of \$75 per share (*ibid.* at 896-98). This mechanism clearly allows the corporation to whipsaw minority shareholders into tendering by offering a lower price on the second step cashout than the pre-takeover market price. This can be defended as a means of fostering productive fundamental changes by eliminating the incentive of shareholders to free ride by withholding tender.

⁹⁷ See *CBCA, supra*, note 1 at s. 199. The comparable provisions in the Ontario legislation are found in *OBCA, supra*, note 2 at ss. 187-88.

statutes allow shareholders who initially failed to tender into the bid to elect to take either the same consideration offered in the bid or a court determination of "fair value." Allowing shareholders to make this election may render successful takeover bids more difficult by offering the hope to minority shareholders of realizing a better price by declining to tender into the bid and claiming the appraisal right on an anticipated second-step cashout.⁹⁸ Coincidentally, because of the relative confidence in the fairness of the offered price (indicated by substantial majority acceptance of the offer), the appraisal right fails to serve a useful anti-discrimination function. Consequently, there appears to be little justification for retaining the appraisal election in the context of two-step takeovers undertaken by initially arm's-length acquirors. Paying dissenters the same price offered in the initial takeover offer is quite adequate.⁹⁹

3. Parent-subsidiary freeze outs where the parent is a public corporation

As with two-step freeze out transactions, parent-subsidiary amalgamations in many cases offer the promise of generating significant economic gains. Foremost amongst these are the attainment of operating synergies and the elimination of conflicts of interest that become particularly pressing in a parent-subsidiary relationship, especially where the parent and subsidiary carry on the same business.¹⁰⁰ However, as in pure going-private transactions, the insider (in this case, the parent) dictates a non-arm's length price to the frozen-out minority of the subsidiary, giving rise to the same dangers of opportunistic exploitation of inside information.

The difficulty of policing against redistribution are marginally less in a parent-subsidiary freeze out than in connection with a pure going-private transaction. A benchmark exists for evaluating the market's assessment of any hidden values of the market price of the parent's shares. On the assumption that any hidden values would be those that the parent wished to imminently exploit, the market price of the parent in some period—perhaps a year—following the going-private transaction could be consulted in order to reassess for hidden values.

⁹⁸ *Re Whitehorse Copper Mines Ltd. v. Lueck* (1980), 10 B.L.R. 113 (B.C.S.C.) amply illustrates the incentive of shareholders to withhold tender and claim the appraisal right. The appraised cashout price was \$6.50, as against a takeover offer of \$4.00. See also *Cyprus Anvil Mining Corp. v. Dickson*, (1982), 40 B.C.L.R. 180 (S.C.), discussed *infra*, note 148, not following prior jurisprudence that had placed a heavy burden of proof on the dissentient shareholder to show that the offered price was unfair in order to justify a higher appraised value.

⁹⁹ In fact, even this may be too generous. See *supra*, notes 94-96. The SEC study, *supra*, note 80, found that simple "fair price" amendments designed to ensure that shareholders cashed out on the second step of a two-step takeover received the same consideration as that paid to shareholders on the first step takeover bid cause share prices to fall. However, the drop was small (0.65 percent) and not statistically significant. This suggests that a "same price" standard may do little harm. It also suggests, however, that a more generous valuation standard is misconceived.

¹⁰⁰ See those articles in notes 93-95, *supra*.

This might be a perilous practice, however. Increases in the market price of the parent's shares subsequent to the going-private transaction might arise as a result of revelation of hidden values (by virtue of the exploitation of the hidden opportunities or otherwise). But an increase in price might as easily arise as a result of synergies, other economic benefits produced by the transaction, general market forces, or unanticipated good fortune in the company's business. Allowing the cashed-out minority a power of subsequent reassessment of the cash-out price creates the danger of allowing the minority to participate in the good fortune of the company or synergies of the transaction without taking any of the risk. Nevertheless, it will still be clear in some cases that an increase in the value of the parent's stock can only be attributed to values latent in the (former) subsidiary at the time of going private. Thus, it will be somewhat easier than in the case of pure going-private transactions to police for the opportunistic capturing of hidden values.

The likelihood that these transactions will be inspired by and produce real economic gains (rather than mere redistribution) is greater than in the case of pure going-private transactions. Equally, the ability to protect shareholders against poaching of hidden values through a rule of liability attaching to non-disclosures of material inside information is enlarged. Correspondingly, the need for an appraisal right with a valuation rule yielding participation in hidden values¹⁰¹ is weaker. Given the costs of conducting a valuation at the time of the transaction uncovering hidden values, a valuation objective based on pre-transaction market price is comparatively more attractive than in the case of pure going-private transactions.

4. Parent-subsidiary freeze outs where the parent is a private corporation

Parent-subsidiary amalgamations or other going-private transactions where the parent is a private corporation present an intermediate case between pure going-private transactions and going-private transactions effected by public parent corporations. Like parent-subsidiary amalgamations where the parent is a public corporation, parent-subsidiary amalgamations where the parent is a private corporation present the likelihood of real economic gains. But, as with pure going-private transactions, there are dangers associated with the exploitation of inside information. These transactions present the same post-transaction monitoring problem as pure going-private transactions do. Thus, the relative worth of a valuation principle yielding participation in hidden values (or full transaction synergies, discussed below) increases where the parent is a private rather than public corporation.

¹⁰¹ Or a rule awarding full participation in transaction synergies. See *infra*, Part III.F.

F. A Rule of Full Substantive Equality

To sum up thus far, the non-sharing rule advanced by Easterbrook and Fischel has certain attractive properties. It would appear to generate incentives that maximize the probability of productive transfers of control or other fundamental changes, benefitting all shareholders. The rule is simple and easy to apply and minimizes the costs of shareholder litigation disputing the "fairness" or "business purpose" of the transaction or attempting to capture a larger share of the corporate pie. Shareholders are merely entitled to pre-transaction market value, which is readily ascertainable. Moreover, if the rule allows for some opportunistic redistribution of values, as long as the possibility of redistribution is fully anticipated, share prices will simply adjust to the point where minority shareholders earn a normal risk-adjusted return. The appraisal right serves a relatively limited (although not necessarily unimportant) role in constraining opportunism by protecting pre-transaction security values (as measured by market prices) from encroachment.

This argument may be weaker in Canadian capital markets, where, owing to the considerable concentration of shareholding interests (and relatively large number of private parent corporations), the gains of the unequal sharing rule are divided unevenly between those who hold majority positions and minority shareholders. In such a market, the risks of opportunistic redistribution may not be entirely diversifiable. A rule of unequal redistribution may allow for *greater* variability in the returns of minority shareholders by allowing an opportunistic shifting of enterprise values to the hands of the controllers. Nevertheless, this may be anticipated and factored into the price of the minority shares.

However, as indicated above, if redistribution generates significant associated transaction costs or diminutions in enterprise value, an appraisal right with more extended protection may conduce to a lower cost of capital. Such protection may be supplied by an appraisal right that is designed to protect both pre-transaction market value and hidden values that are latent in the enterprise at the time of the fundamental change and discoverable only on the basis of inside information. This redefined valuation objective would tend to make opportunistic predations effected by managers or majority shareholders less profitable, reducing the incidence of such transactions and the associated dead weight social losses.

This valuation procedure introduces its own set of difficulties and costs, which are explored at greater length below. For now suffice it to say that procedural, evidentiary, and conceptual difficulties attend the determination of hidden values. Objective evidence of hidden values will be hard to come by. These values will be discoverable only (if at all) in a careful search of the books and other documents of the company, and then only—particularly in respect of a large public company—with great effort and expense. Sometimes the inside information will only be known

to the insiders themselves and not subject to documentary or other discovery.

The difficulties of calculating hidden values might well suggest that the costs of so doing exceed the benefits. However, difficulties of calculating hidden values might also be used to argue in favour of a full gain-sharing principle. If the danger of opportunistic redistribution and associated economic costs is large, and it is difficult for a court to differentiate between transaction synergies and hidden values, it may be easy for the majority engineering the transaction to successfully characterize hidden values as transaction synergies. A rule allowing for the recovery of transaction synergies by the dissenter would render this strategy of little avail and would thus operate as a strong disincentive to opportunistic plundering of hidden values.¹⁰² As has already been suggested, this may have the unfortunate property of discouraging productive fundamental changes where the realization of the gain depends on, or is more likely under a rule allowing for, unequal distribution of the gains of the transaction. Thus, the argument in favour of a full-sharing rule is strongest where the marginal discouragement of a particular variety of fundamental change caused by a sharing rule is small.¹⁰³

As in the case of a rule protecting hidden values, a full gain-sharing rule generates *additional* transaction costs on an appraisal (as compared to a pre-transaction market value rule) associated with calculation of transaction synergies. These costs may be far from trivial.¹⁰⁴ However, to the extent that the dangers of opportunistic capturing of values are reduced, the costs of monitoring against opportunism will also be reduced; further, the transaction costs associated with unproductive fundamental changes will be avoided. The costs introduced by adverse selection will also be mitigated.

The strength of the argument will vary depending on the type of transaction involved. Pure going-private transactions present the strongest case for a full gain-sharing rule. The dangers of opportunism are greatest while the likely benefits foregone are the least, although calculating synergies (as well as hidden values) may present some difficulties.¹⁰⁵

The argument for full gain-sharing can be extended to parent-sub-sidiary amalgamations in which the parent is a private company. Here,

¹⁰² Ideally, the answer to an underinclusive recovery is to refine the accounting process to make the recovery more exact; that is, to design valuation procedures that distinguish between hidden values and transaction synergies. The assumption in the text is that this is not possible. If so, the next best solution to remedying the problem may therefore be an *overinclusive* recovery. Of course, as the text following indicates, this may generate new problems.

¹⁰³ See Easterbrook & Fischel, *supra*, note 64. The authors acknowledge that: "In *many* cases the apportionment of the gain makes little difference to the success of the transaction . . . in some *marginal* cases apportionment is the decisive factor" (*ibid.* at 708-09 [emphasis added]).

¹⁰⁴ See Part V, *infra*.

¹⁰⁵ This did not deter the court in *Re Ripley International Ltd.*, *infra*, note 217, from refusing permission to proceed with a statutory arrangement where the minority shareholders did not receive a prorata share of anticipated taxation benefits from the transaction.

the dangers of opportunism and the difficulties of detecting it remain great. Although the benefits that potentially result from such transactions are numerous, a full gain-sharing rule may not seriously impair the incentives to undertake them. While it is true that the returns to majority shareholders for undertaking the change will be less under a full gain-sharing rule than under a non-sharing rule, *any* positive return is arguably a *sufficient* incentive. Unlike sales of control blocks or takeover bids, effecting a parent-subsidary amalgamation cannot deprive the controllers of psychological benefits associated with relinquishing control, and a rule of unequal distribution of benefits may therefore be unnecessary to generate incentives to undertake the change. Whatever the transaction costs of the amalgamation, as long as these costs are shared *pro rata* between parent and subsidiary, moving to a gain-sharing rule should not deter many gain-generating amalgamations.¹⁰⁶

In parent-subsidary amalgamations where the parent corporation is a public company, the dangers that the transaction will be undertaken for opportunistic rather than sound business reasons is lessened. Moreover, it will be easier for minority shareholders to detect opportunism *ex post*, strengthening the deterrent effect of a liability rule for non-disclosure. Thus, the case for a full gain-sharing rule is weakened.

A gain-sharing rule may nevertheless be justifiable on the basis that the costs of assessing hidden values and transaction synergies (one of the key objections to a full gain-sharing rule) may be entirely avoided through recourse to what might be called an *appraised shareholder right of re-entry*. This right would enable a cashed-out shareholder to insist that a public parent company effecting a freeze out of minority shareholders in a subsidiary pay a dissentient shareholder in the currency of the parent's own *participating* securities.¹⁰⁷ The appraisal would serve

¹⁰⁶ Easterbrook & Fischel, *supra*, note 64, suggest that a prorata apportionment of the gain as between majority and minority favours the minority since the majority remain in the enterprise and take the risk of the gains materializing or not while the minority take their money and run. However, as long as the gain is evaluated by taking into account the risk of the prospective cash flows (building risk into the discount rate, as would normally be done) this argument fails. For example, assume that the probability distribution of the gains from the transaction is a 25 percent chance of a \$1000 loss, a 50 percent chance of a \$1000 gain, and a 25 percent chance of a \$3000 gain. The expected value of the gain is \$1000. Assume that the majority holding is 60 percent, and the minority holding 40 percent, and that the risk discounted value of the gain is \$800 (normally, the "beta" of the *project* would yield the appropriate discounting factor; a reasonable approximation is the beta of the *firm*). Therefore the minority would be entitled, on a full gain-sharing basis, to \$320 of the anticipated gain. Even though the majority actually experiences the risk of the project and the minority does not, the minority receives only what they would be willing to pay for a 40 percent interest in the risky project, and are not therefore overcompensated.

Easterbrook and Fischel further argue that majority shareholders are not compensated for the opportunity cost of the time spent planning the transaction under a full gain-sharing rule. However, if the transaction is substantially planned and engineered by managers without substantial shareholdings, this argument fails as well.

¹⁰⁷ At present, appraisal payouts must be in cash. See *Canadian Gas and Energy Fund Ltd. v. Sceptre Resources Ltd.* (1985), 29 B.L.R. 178 (Alta. Q.B.).

the function of fixing the ratio of conversion of the subsidiary's securities into participating securities of the parent. If the ratio is fixed on the basis of the relative market values of the parent's and subsidiary's shares *prior* to *any* public announcement of the transaction,¹⁰⁸ this will ensure that the dissentient minority shareholder captures his or her full *pro rata* share of any hidden values as well as any synergies generated by the transaction because of the participating character of the securities received. This appraised right of re-entry depends on readily ascertainable values and would not therefore give rise to difficult or expensive litigation or uncertainty of adjudication. The same result might be accomplished by paying the dissentient shareholder sufficient cash to purchase an equivalent number of the parent's participating securities. One potential advantage of making the payment in securities rather than cash, however, is the avoidance of a short-run cash drain that might imperil the fundamental change.¹⁰⁹

G. *The Appraisal Right and Other Fundamental Changes*

There are a great variety of fundamental changes with an equally great variety of purposes. As with freeze outs, these fundamental changes may generate economic gains or be, in whole or in part, instances of opportunistic redistribution. As in all other cases, the value of the appraisal right will depend on the relative importance of opportunism, the number and magnitude of profitable transactions foregone because of the existence of an appraisal right with a given valuation objective, and the relative transaction costs generated by the right.

Two situations where the dangers of opportunism will be particularly pressing are alterations to the terms of outstanding securities or other constitutional amendments and reincorporation in another jurisdiction. In either of these cases, majority shareholders may be able to shift values away from minority shareholders to themselves. For example, although an amendment to the articles of incorporation to cancel arrearages of dividends on preferred shares may be essential to resurrect a failing company by enabling it to secure new financing, the amendment may be intended only to secure an advantage for the common shareholders at the expense of the preferreds. The non-payment of dividends leading up to the cancellation of arrearages may indeed be part of a scheme designed precisely to shift value from the preferreds to the commons. Similarly, a reincorporation in another jurisdiction may achieve financial benefits but may also substantially alter the balance of majority and minority rights in a manner favourable to the majority.¹¹⁰

¹⁰⁸ This is the formula suggested by Brudney & Chirelstein, *supra*, note 93. For a critical comment see S.M. Lorne, "A Reappraisal of Fair Shares in Controlled Mergers" (1978) 126 U. Penn. L. Rev. 955.

¹⁰⁹ This may not be a serious problem in any case. See *infra*, Part V.B.7.

¹¹⁰ The corporate law of the jurisdiction in which the company is incorporated will be instrumental in defining the relationship between majority and minority shareholders. A change of juris-

Even if shareholders are not forcibly evicted from the company, an appraisal right protecting only pre-transaction market values may again be an insufficient protection for minority shareholders. The ability of the controllers to effect changes that diminish the value of the minority holdings may amount to a *de facto* freeze out, forcing minority shareholders to claim the appraisal right merely to preserve the prior *market value* of their investments. This would result in the capturing by majority shareholders of hidden values.

Employing a valuation objective that includes hidden values—or perhaps even transaction synergies—would not likely discourage productive fundamental changes of this nature. Although alterations to the terms of outstanding securities and reincorporation in another jurisdiction may produce very real economic benefits, the realization of these benefits does not appear to be crucially dependant upon an unequal distribution of benefits as between shareholders.

A distinction may be drawn in this respect between control transactions such as unitary and two-step takeovers and sales of control blocks of stock and the types of fundamental change identified above. In respect of the former, the auction mechanism by which productive transfers of control occur is facilitated by the unequal distribution of benefits accompanying the change of control. However, in respect of amendments to the articles or a change of corporate jurisdiction (which could amount to precisely the same thing) equal sharing of benefits may not significantly vitiate the incentives to undertake the change. Thus, as with going-private transactions, a case can be made for an appraisal right protecting hidden values or extending beyond this to a full gain-sharing rule.

H. Valuation Objective and Corporation Type

It has been suggested that the need for an appraisal right and the optimal form of valuation principle will depend upon the tradeoff between the facilitation of productive fundamental changes and discouragement of opportunism. This will vary between different types of

diction may be one means by which the majority can alter the bargain between shareholders. See, for example, W.L. Cary, "Federalism and Corporate Law: Reflections Upon Delaware" (1974) 83 Yale L.J. 663; E.L. Folk, "State Statutes: Their Role in Prescribing Norms of Management Conduct" (1976) 31 Bus. Law. 1031; M.A. Eisenberg, *The Structure of the Corporation: A Legal Analysis* (Boston: Little, Brown, 1976) at 319. Happily, empirical investigations of the results of jurisdictional moves indicate that, on average, minority shareholders are no worse off, and in most cases better off, as a result of the move. See P. Dodd & R. Leftwich, "The Market for Corporate Charters: Unhealthy Competition versus Federal Regulation" (1980) 53 J. Bus. 259; B.D. Baysinger & R.K. Butler Jr., "The Role of Corporate Law in the Theory of the Firm" (1985) 28 J.L. & Econ. 179; R. Romano, "Law as a Product: Some Pieces of the Incorporation Puzzle" (1985) 1 J. Law., Econ., & Org. 225. See also R.K. Winter Jr., "State Law, Shareholder Protection, and the Theory of the Corporation" (1977) 6 J. Legal Stud. 251; D.R. Fischel, "The 'Race to the Bottom' Revisited: Reflections on Recent Developments in Delaware's Corporation Law" (1982) 76 N.W.U.L. Rev. 913. Some jurisdictional moves may nevertheless be undertaken for opportunistic reasons, and the appraisal right might serve as protection against such opportunism.

fundamental changes. The value of the appraisal right—and again, the optimal valuation principle—may also depend on the type of corporation, further complicating the search for a single statutory standard form of appraisal right.

A number of factors are likely to determine the degree of opportunism engaged in by public companies. Public companies with deep public markets will usually be large issuers that expect to continually re-enter the market in search of fresh infusions of equity capital. These corporations are most subject to the discipline of the market, in addition to being more likely targets of administrative scrutiny, and for these reasons are less likely to engage in opportunistic behaviour. Although this market discipline may be absent in going-private transactions, large public corporations are the least likely to go private, whether the controlling shareholder (if there is one) is itself a public corporation, a private corporation, or an individual. Further, markets for managers will operate to restrain managerial opportunism.¹¹¹

On the other hand, the transactions and financing costs of taking over large public companies will tend to be great, blunting to a degree the efficacy of the takeover mechanism as a disciplinary tool. Moreover, the degree of opportunism engaged in by the firm's managers is likely to increase as the portion of the firm owned by the managers declines.¹¹² As a general matter, the larger the corporation, the smaller the degree of management ownership. Also, where share ownership is highly dispersed, the collective action or free rider problem associated with the protection of shareholder rights will be exacerbated, diminishing the degree of direct oversight by shareholders.¹¹³

As one moves to smaller public companies whose shares are more thinly traded, the degree of administrative and regulatory oversight may slacken. Interest in these stocks is more likely to be episodic and the degree of public scrutiny correspondingly less. Thus, the market is less likely than in the case of public corporations with deep markets to have a constant flow of evaluative information. This may well result in a tendency for the prices of thinly traded companies to experience short run fluctuations away from the equilibrium or intrinsic value.¹¹⁴ It may be that greater opportunities exist for the diversion of corporate assets or share price manipulation. Such corporations are also more likely to have concentrated share holdings, although the impact of concentration is not entirely unambiguous. Shareholders with large interests may be in a position to instigate actions favouring one constituency of shareholders

¹¹¹ Fama, *supra*, note 33. A distinction should be drawn, however, between opportunism by owner managers and non-owner managers: the former are less likely to worry about discipline from the market for managers.

¹¹² See Jensen & Meckling, *supra*, note 71. However, compare G.J. Stigler & C. Friedland, "The Literature of Economics: The Case of Berle and Means" (1983) 26 J. Law. & Econ. 237.

¹¹³ See *infra*, Part VI.A.1.

¹¹⁴ See *infra*, Part VIII.E.

over another (or the majority at the expense of the minority), leading to higher levels of opportunism. However, shareholders with significant interests have a greater incentive to monitor management performance, overcoming to a degree the collective action problem characteristic of corporations with widely dispersed ownership. Thus, while there is some reason to believe that anticipated agency costs may be higher in respect of public corporations trading in thin rather than deep markets, it is difficult without reliable evidence to draw any firm conclusions that might justify a different form of appraisal right.

Private companies, which are structurally very different from public companies, present quite different problems. Such corporations will have a small number of shareholders, restrictions on the transferability of shares, and a very limited market for the company's securities.¹¹⁵ The shareholders, directors and officers will often be the same people. Shareholders of private companies will tend to have the same relationship and expectations as partners. These shareholders will almost uniformly expect to share equally in any gains experienced by the corporation, whatever the source.

At the same time, disputes between shareholders, as well as opportunistic attempts to engage in diversion of earnings or corporate assets, are not uncommon. In addition, as indicated in the earlier discussion of the bail-out rationale, fundamental changes in private corporations that diminish enterprise value may frequently be undertaken for opportunistic reasons. Thus, it becomes difficult to distinguish between the bail-out and anti-discrimination rationales for the appraisal right. These differences suggest that a more generous evaluation principle is appropriate for private corporations; indeed, a strong case is made out in *all* circumstances for the awarding of full participation in transaction synergies and hidden values, allowing the applicant shareholder to receive pre-transaction value where it is to his or her advantage to do so.¹¹⁶

Yet another problem looms in the design of an effective statutory appraisal right—workability. Before considering the question of the differences between the appraisal right and other remedial techniques addressed to the problems noted here, the practice and procedure of the appraisal right in Canada will be explored.

¹¹⁵ In Ontario's *Securities Act*, *supra*, note 16 at s. 1(1)(31), a private company is defined as "a company in whose constating document, i. the right to transfer its shares is restricted, ii. the number of its shareholders, exclusive of persons who are in its employment and exclusive of persons who, having been formerly in the employment of the company, were, while in that employment, and have continued after termination of that employment to be, shareholders of the company, is limited to not more than fifty, two or more persons who are the joint registered owners of one or more shares being counted as one shareholder, and iii. any invitation to the public to subscribe for its securities is prohibited." See also *CBCA*, *supra*, note 1 at ss. 2(6)-(8); *OBCA*, *supra*, note 2 at ss. 1(1)(27), 1(6).

¹¹⁶ See *infra*, Part V.D.

V. PRACTICE AND PROCEDURE OF THE APPRAISAL RIGHT IN CANADA: CAN THE APPRAISAL RIGHT BE MADE WORKABLE?

A. *A Catalogue of Potential Problems*

Thus far, I have identified some reasons why shareholders might value an appraisal right. However, whether or not a security with an appraisal right is an efficient financial contract also depends on other factors. These include whether an appraisal right can in practice be designed to meet the theoretical needs of shareholders, and the extent of the cost of exercise of the appraisal right to shareholders and to the company.

"The company" must be recognized as a proxy for all those whose claims on the enterprise may be affected by the payout of appraisal claims. For the most part, these will be those shareholders who choose not to exercise the appraisal right on any given fundamental change since the statutory solvency tests that govern the appraisal provision forbid appraisal payouts if the solvency of the enterprise (and hence the tickets held by fixed claimants) would be jeopardized by the payments.¹¹⁷ *Ex ante*, it may not be clear to an individual shareholder whether the appraisal right will represent a benefit (if exercised) or a cost (should the shareholder remain in the company). Therefore, the shareholder will want to know both the prospective benefits and the prospective costs.

The shortcomings of the appraisal right include at least the following.¹¹⁸ First, there is a tax cost. Cashing out of the enterprise via the appraisal route will give rise to a taxable event, the burden of which might have been reduced or avoided altogether by going along with the fundamental change in the form proposed. Second, most cashed-out investors will reinvest their funds. This reinvestment will result in brokerage costs that would not have been incurred had the investment continued in the enterprise. Third, in the delay between dissenting from the resolution adopting the fundamental change and the cash payout, the shareholder may earn less than his or her investment, increasing the cost of the appraisal right relative to other alternatives (that is, going along with the transaction or cashing out in the market). Fourth, the procedural hurdles whereby the shareholder claims his or her appraisal right are often technical and treacherous for the shareholder, who may, by making any number of technical errors, lose his or her appraisal entitlement. Fifth, exercising the appraisal right is costly to the shareholder, who will likely have to hire experts to give valuations of the shares and the pay a lawyer to pursue the claim. Some or all of these costs may be

¹¹⁷ In fact, creditors and other fixed claimants bear at least part of the cost—the payout may jeopardize the future solvency of the corporation and hence increase the risk of non-payment to these constituents. See *infra*, note 156 and accompanying text.

¹¹⁸ See generally Manning, *supra*, note 10; Vorenburg, *supra*, note 10; Brudney, *supra*, note 75; J.E. Magnet, "Shareholders' Appraisal Rights in Canada" (1979) 11 *Ott. L. Rev.* 100.

irrecoverable in the appraisal proceeding. Sixth, claiming the appraisal right generates uncertainties associated with valuation that are not present if the shareholder accepts the terms of the proposed transaction or sells in the market. Uncertainty is a cost to risk-averse shareholders, making the appraisal procedure relatively unattractive. Finally, the appraisal right is an unpredictable expense to the corporation that may deter or abort productive fundamental changes.

B. *The Canadian Experience*

The *CBCA* appraisal provisions have been more successful at meeting some of these criticisms than others. On balance, the Canadian experience raises some serious questions about the value of the appraisal right to shareholders, at least in its current form.

1. Tax cost

Election of the appraisal option by a dissenting shareholder may trigger a taxable event for that shareholder. The fundamental change dissented from may or may not also result in a taxable event for a non-dissenting shareholder. It is clear that the decision of whether to elect the appraisal right will be coloured by the *relative* tax treatment accorded dissenting and non-dissenting shareholders. In determining whether it is appropriate under the *Income Tax Act* to provide the same or differential tax treatment to dissenters and non-dissenters (and whether, if the *Act* fails to make the appropriate distinctions, a court should take the differential tax treatment into account in appraising the value of the shares), a number of potential problems must be considered. The first is that *less favourable* tax treatment for dissenters may create an artificial disincentive to claiming the appraisal right, eroding the protection the right affords shareholders under either the bail-out or anti-discrimination rationales for the right. The second is that *preferential* treatment of dissenters may result in shareholders claiming the appraisal right only for tax reasons, a clearly wasteful and unproductive use of social resources. The third problem will arise only where the *Income Tax Act* fails to embody the theoretically appropriate distinctions (if any) between the tax treatment accorded dissenters and non-dissenters. In such a case, the court may wish to adjust the award of fair value in view of the relative tax consequences in order to achieve the appropriate *after tax* award of fair value. As noted below, not all the benchmarks for the taxation of dissenters make it equally easy for a court to make the necessary adjustments to achieve a satisfactory after-tax outcome.

In this section, I will suggest that, irrespective of the rationale and circumstances under which the right is claimed, the appropriate tax treatment of dissenters should be the same as that accorded non-dissenters.

In the context of a freezeout, there are at least three possible

benchmarks for fixing the the tax treatment accorded to dissenters. The first is that of remaining in the enterprise as if the transaction dissented from had never occurred. The second is that accorded non-dissenting shareholders who accept the form and amount of consideration offered under the terms of the transaction. The third is that of selling the shares in the market. These will be dealt with in turn.

Had the transaction never occurred, no taxable event would have arisen. To the extent that any tax is levied on the appraised amount, the shareholder is worse off by comparison. However, it is easy to overstate the amount by which the shareholder is disadvantaged. Very few (if any) shareholders will buy with the expectation of holding the shares indefinitely. In the normal course of events, the shares would have been disposed of at some future date, and on that date a taxable event would have arisen. Thus, the main component of what the shareholder has lost as a result of the premature termination of interest is not the full amount of the tax exigible on the appraised amount, but that amount less the present value of the expected tax costs on future disposition. The shorter the taxpayer's anticipated horizon to disposition at the date of the freeze out, the smaller the loss associated with the unanticipated cashout and the smaller the value of the appraisal right as protection against this loss. Especially where taxation of the proceeds of disposition results in a tax loss on the appraisal, the taxpayer may also suffer disadvantage as a result of losing control over the timing of the taxable event (for example, by losing the ability to push tax losses forward into a year in which offsetting taxable gains are expected).

This benchmark appears to be an inappropriate one in any case. It makes an implicit but important assumption; that the appraisal right is designed at least in part to protect shareholders against the tax consequences of unanticipated termination of the investment. To a shareholder holding a diversified portfolio of securities, the risk of such an event and its resulting financial consequences can be reduced to a minimum. Further, the shareholder's ability to orchestrate his or her financial affairs so as to minimize the effect of unanticipated termination cannot be replicated by the corporation. Any anticipated residual effect on the risk-adjusted financial return from holding the shares can be factored into the price paid for the shares.

Moreover, should the *Income Tax Act* fail to accord dissenters tax treatment in accord with this benchmark, the court may wish to adjust the award of fair value to yield an after-tax result similar to that experienced by the shareholder had he or she not cashed out of the company. It may be difficult or impossible for a court to determine the particular dissenter's anticipated horizon to disposition had the freezeout not occurred in order to accomplish this good.

Finally, and perhaps most importantly, according dissenters superior tax treatment to that given non-dissenters will result in an incentive to claim the appraisal right purely for tax motives.

If it is inappropriate to accord dissenters more favourable treatment than non-dissenters, it is also inappropriate to accord them *less* favourable treatment. According the dissenters inferior treatment will allow management to freeze shareholders out of the corporation at less than the true value of the shares, confident that few shareholders will elect the appraisal option.

Thus, the second benchmark is a more suitable standard. That is, dissenters should receive the same tax treatment that non-dissenting shareholders will receive under the terms of the transaction. This will remove the tax system as a consideration either for or against electing the appraisal option, allowing the decision to be made solely on the basis of the anti-discrimination and bail-out rationales canvassed earlier. For this same reason, the third benchmark—that of a sale in the market—will be unsuitable unless non-dissenters receive the same tax treatment.

The situation is more complicated in cases not involving shareholder freezeouts, under either the bail-out or anti-discrimination rationales. In this situation, two possible benchmarks present themselves for the taxation of the proceeds of disposition arising from the appraisal. The first is remaining in the enterprise, which will almost always be a non-taxable event either because there will be no taxable disposition of the interests of non-dissenters or because of the rollover accorded shareholders on corporate reorganizations.¹¹⁹ The second benchmark is a sale of the shares in the market, which will usually result in treatment of the proceeds of disposition as a capital gain.¹²⁰

The first benchmark suffers from a computational difficulty. If those who cash out are to truly receive the same tax treatment accorded to non-dissenters, then there should be exigible tax on the award equal to the present value of the future tax liability that would have resulted on a sale of the shares in the ordinary course of events. A more easily administered alternative, is available however. Where the dissenter uses the proceeds of disposition to purchase replacement shares of another corporation, then, on the assumption that these shares have the same horizon to taxable disposition as those they replace, granting the taxpayer a tax-free rollover on the proceeds of disposition resulting from the appraisal will yield the same tax treatment for dissenters as non-dissenters.¹²¹ This benchmark renders the tax system neutral as between electing to “go

¹¹⁹ *Income Tax Act*, *supra*, note 78 at s. 86.

¹²⁰ *Ibid.* at s. 39. Although recent changes to the *Income Tax Act* make capital gains non-taxable, this is subject to a lifetime exemption limit. Thus, capital gains treatment may result in immediate tax consequences where the exemption has already been exhausted and a future tax burden where the exemption has not yet been fully used up (see *ibid.* at s. 58(1)). Capital gains treatment is only equivalent to a non-taxable event in the case of a shareholder with no reasonable prospect of exhausting his or her lifetime exemption.

¹²¹ There is already precedent in the *Income Tax Act* for such a tax-free rollover where property is destroyed or expropriated and replacement property is purchased within a specified period of time (*supra*, note 78 at s. 44). It is arguable that s. 44 *currently* applies to a forcible termination of a shareholding interest. An amendment to the *Act* would put the matter beyond doubt.

along" with the transaction (and, in this case, remaining a shareholder) and electing the appraisal option.

Unfortunately, the latter solution is not perfect. Some shareholders who already had plans to sell their shares in the market will take advantage of the fortuitous event of a transaction triggering the appraisal right to use the right as a means of achieving a portfolio adjustment without tax cost. This will result both in an unwarranted tax expenditure by the government and a socially unproductive expenditure of resources in determining fair value for these dissenters.¹²² The second tax benchmark (selling the shares in the market) will avoid this problem but will generate a disincentive to claiming the appraisal right as compared to remaining in the corporation, reducing the efficacy of the right.¹²³ Thus, although the choice between the two tax benchmarks is not completely uncontroversial, it would appear that the better benchmark in non-freezeout cases is the same as that in cases involving freezeouts; that is, treatment identical to non-dissenters. This will involve the tax treatment indicated above.

Current tax treatment of the proceeds of disposition resulting from an appraisal is not entirely satisfactory in all freezeout situations. A strict reading of the *Income Tax Act* suggests that *any* purchase of shares by the corporation, whether pursuant to the terms of a freezeout transaction or as a result of an appraisal, will result in the same tax treatment—the ideal result.¹²⁴ However, Revenue Canada has issued tax rulings in the context of freeze out amalgamations which accord capital gains treat-

¹²² The marginal cost may not be great where other shareholders claim the right for legitimate (that is, non-tax) reasons since the claims of all dissenters are joined together (that is, there is only one adjudication of fair value). See, for example, *CBCA*, *supra*, note 1 at s. 184(21).

¹²³ This is the clearest where the appraisal right is claimed in order to prevent discrimination. In such cases, the transaction may be a *de facto* freezeout: that is, engineered on terms that leave the shareholder no realistic alternative but to claim the appraisal right to protect his or her investment. Should dissenters be taxed less favourably than non-dissenters, this will widen the opportunity available to management to discriminate. Where the right is claimed under the bail-out rationale, it might seem more appropriate to use the market value standard since the appraisal right is a direct substitute for a sale in the market. However, even in these cases, the efficacy of the right would be impaired by failing to accord dissenters the same treatment as non-dissenters since the unequal treatment would create an artificial incentive not to claim the right, denuding the protection afforded shareholders against unwise (or opportunistic) fundamental changes diminishing enterprise value.

¹²⁴ Where a corporation redeems, acquires or cancels any of its shares by any means, this may give rise to a deemed dividend to its shareholders. See *ITA*, *supra*, note 78 at s. 84(3). The repurchase may also generate a capital gain or loss as well, to the extent to which the proceeds of disposition exceed the adjusted cost base, less the amount of the deemed dividend (*ITA*, s. 54(h)(x) provides that the proceeds of disposition are reduced by the amount of the deemed dividend). These rules, on their face, apply equally to a repurchase pursuant to the terms of a freezeout transaction or by means of an appraisal. If the freezeout is effected by means of converting existing shareholdings into redeemable preferred shares on an amalgamation and immediately redeeming them, the situation is unaltered; the initial conversion is subject to a tax-free rollover, and the subsequent redemption yields the results indicated above (*ITA*, s. 86(1)). Essentially the same result is achieved if a freezeout occurs by means of a sale of assets followed by a winding-up and liquidation of the corporation (*ITA*, ss. 54(h)(x), 84(2)).

ment to dissenters; this is more favourable than the treatment accorded non-dissenters.¹²⁵ As noted, this simply encourages election of the appraisal alternative in order to achieve the resulting tax advantage and results in a socially unproductive use of resources in effecting appraised cashouts. Nothing in the *Act* compels such treatment, and it would be better to accord to dissenters the same deemed dividend treatment accorded to non-dissenters.¹²⁶

A strict application of the *Act* in accordance with the above reading (that is, deemed dividend treatment for dissenters) will result in inappropriate tax treatment in non-freezeout situations since dissenters will bear a larger tax burden than non-dissenters. It would be more appropriate to amend the *Act* to give dissenters capital gains treatment with the option of utilizing a tax-free rollover where substitute shares are purchased with the proceeds of disposition.¹²⁷

2. Brokerage cost

It has sometimes been suggested, on the assumption that the dissentient shareholder will reinvest the proceeds arising from the appraisal, that brokerage fees or other reinvestment costs be added to the appraised value of the shares. As with added tax burden, it must be recognized that the added cost at most includes the value of current brokerage costs less the present value of the brokerage costs that would have been incurred on a future sale in the ordinary course of events.¹²⁸ As in the case

¹²⁵ Although there is no reported tax ruling, the author has knowledge of one recent tax ruling to this effect, and an informal conversation with an employee of Revenue Canada confirms that this is the tax treatment that the department views as appropriate in the case of amalgamations.

Until recently, extending capital gains treatment to dissenting shareholders in a freezeout transaction resulted in roughly the same treatment of dissenting and non-dissenting shareholders since the taxation of deemed dividends and capital gains was approximately the same in a wide range of situations. The recent amendment to the *Income Tax Act* exempting capital gains from taxation (subject to lifetime limits) substantially alters this position (see *supra*, note 120).

¹²⁶ The department bases its position on the theory that the corporation resulting from the amalgamation is a different entity in law than either of the pre-amalgamation corporate entities. Thus, the purchase of shares in the pre-amalgamation corporation by the post-amalgamation entity is, in law, equivalent to a purchase of shares by a third party. The argument fails to withstand analysis on both policy and technical grounds. The policy considerations have already been made clear. In respect of the latter, the appraisal provisions appear to contemplate a *lis* as between the shareholder and the *pre*-amalgamation corporation. For example, in the *CBCA*, *supra*, note 1 at s. 184, the provision allows a shareholder to dissent in respect of shares of a "corporation," and s. 184(1) clearly identifies the "corporation" as the pre-amalgamation entity. Whether or not the amalgamated entity is different in law from the pre-amalgamation entities, the cause of action that arises from enlisting the appraisal right is one in respect of the pre-amalgamation entity, and the tax treatment of the cashout should reflect this reality.

¹²⁷ Where the shareholder does not purchase substitute shares, treating the disposition as an event giving rise to a capital gain *may* result in a greater tax liability for the dissenter than the non-dissenter (see *supra*, note 120). This has the salutary effect of ensuring that the appraisal right is not claimed solely for tax reasons. Since the dissenter has the option of purchasing substitute securities and receiving a tax-free rollover, there is no disincentive to claiming the right.

¹²⁸ This does not necessarily imply that the date of resale be fixed in the mind of the buyer at

of tax costs, the objective should be to ensure equal treatment of dissenters and non-dissenters in order to eliminate any artificial incentive to claiming (or not claiming) the appraisal right.

It is also appropriate to draw a distinction between freezeout and non-freezeout transactions. In respect of the former, it would not be appropriate to make an allowance for reinvestment costs. Both dissenters and non-dissenters are forcibly cashed out; thus, claiming the appraisal right results in no additional reinvestment burden for dissenters.

In respect of non-freezeout transactions, equal treatment of dissenters and non-dissenters will involve adding the difference between present reinvestment costs and the present value of normally anticipated future reinvestment costs to the appraised value of the shares. This will necessarily involve an element of imprecision; for example, should the court assume that the seller will purchase substitute securities from a discount of a full-service broker? Will the seller be entitled to a volume discount? These questions are relatively easy compared to that of determining the seller's horizon to disposition in the normal course of events in order to compute the present value of future brokerage costs. Adding these questions, particularly the last, to the agenda of issues canvassed in order to determine fair value will result in considerable additional adjudication expense, perhaps overwhelming the benefits to be achieved. As well, adding reinvestment costs to the appraised amount will generate an incentive to claim the right purely as a means of avoiding reinvestment costs.

The first of these problems may be avoided by awarding reinvestment costs according to a pre-determined schedule, computed and revised from time to time on the basis of industry averages, and awarding a constant fraction of these costs determined by computing a mean present value of future reinvestment costs (based on a mean shareholder horizon to disposition in the normal course of events). Unfortunately, this exacerbates the second problem. A non-particularized assessment of brokerage costs will tempt those with a short horizon to disposition to employ the appraisal right as a cheap method of effecting a portfolio adjustment. No ideal solution is available, but the schedule method may be a satisfactory compromise.

Pending the adoption of a legislative (or regulatory) solution of this character, it might be better, as a general matter, to leave the shareholder to cover the brokerage costs generated by the reinvestment of the proceeds of the appraisal, albeit at some cost to the efficacy of the appraisal right in those situations where the shareholder has the option of remaining in the enterprise or seeking an appraisal. This suggestion appears to replicate current practice. Canadian courts have not (at least explicitly) taken brokerage or other reinvestment costs into account in assessing fair value under the statutes.

the time of purchase. An anticipated brokerage cost, as in the case of an anticipated tax cost, may be calculated probabilistically, taking into account the *probable* time of disposition and reinvestment.

3. Delay cost

The appraisal provision of the *CBCA* allows the court in its discretion to award “a reasonable rate of interest on the amount payable to each dissenting shareholder from the date the action approved by the resolution is effective until the date of payment.”¹²⁹ This provision avoids a complete sterilization of the dissenter’s investment during the period between dissent and ultimate cashout. However, the shareholder who dissents loses all his or her rights as a shareholder, including the right to receive dividends, generally within about one month from the date when the resolution adopting the fundamental change is approved by shareholders.¹³⁰ The date when the action approved by the resolution is effective could conceivably be much later than the date at which the dissenting shareholder’s capital loses its earning power. Thus, the provision ought to be amended to allow the shareholder to start earning interest as soon as the shareholder loses his or her entitlement to dividends.

The issue of interest may also arise where an appraised cashout occurs under either the compulsory acquisition¹³¹ or oppression¹³² provisions of the statute. In the former case, the *CBCA* allowance for interest appears to be adequate in allowing the shareholder a “reasonable rate of interest” from approximately the time at which he or she loses his rights as a shareholder.¹³³

In respect of the oppression remedy (where an appraisal is awarded), the *CBCA* makes no express provision for interest,¹³⁴ but cases decided under similar oppression legislation in British Columbia have awarded interest from the date when the oppressive conduct arose.¹³⁵ It

¹²⁹ *CBCA*, *supra*, note 1 at s. 184(25).

¹³⁰ Section 184(11) of the *CBCA*, *ibid.*, suspends the shareholder’s rights upon sending the notice required by s. 184(7) within twenty days of receipt of the corporate notice of the resolution approving the change, which must be sent within ten days of the adoption of the resolution. (*ibid.* at s. 184(6)). In the normal course of events (absent delay by the corporation in sending its required notice, which extends the shareholder’s response time), the shareholder will lose his or her rights as a shareholder within thirty days of the adoption of the resolution.

¹³¹ *Ibid.* at s. 199.

¹³² *Ibid.* at s. 234.

¹³³ The *CBCA* allows for a “reasonable rate of interest from the date [the shareholder] sends or delivers his share certificates . . .” (*ibid.* at s. 199(17)). This date appears to roughly correspond with the time when the shareholder loses his or her interest in the company (*ibid.* at ss. 199(5)-(8)). See, for example, *Re Whitehorse Copper Mines Ltd.*, *supra*, note 98.

¹³⁴ However, the *CBCA*, *ibid.*, at s. 234(3)(j), provides for “an order compensating an aggrieved party” and appears therefore to allow for an award of interest on the appraised value. See also note 135.

¹³⁵ *Diligenti v. RWMD Operations Kelowna Ltd. (No. 2)* (1977), 4 B.C.L.R. 134 (S.C.) at 173; *Re Johnston and West Fraser Timber Co. Ltd.* (1982), 133 D.L.R. (3d) 77 (B.C.S.C.) at 94, *rev’d* on other grounds (1982), 19 B.L.R. 193 (B.C.C.A.). Both awards were made under the British Columbia *Court Order Interest Act*, R.S.B.C. 1979, c. 76. Similar legislation in Ontario and other provinces would likely permit a similar result. See, for example, Ontario *Courts of Justice Act*, 1984, S.O. 1984, c. 11, ss. 137-139.

appears that a similar result could be achieved under the *CBCA*.¹³⁶

Of course, more than merely the issue of timing arises. Equally important is the rate of interest that should be paid on the appraised value of the shares prior to the date of payment. Claiming the appraisal right transforms the shareholder's status from that of residual taker to one of fixed claimant, thus substantially reducing risk. Thus, *prima facie* it is appropriate to award a rate of interest approximating that paid by the corporation to its unsecured creditors. In the main, it is probably fair to say that the courts have awarded something less than this.¹³⁷

It may be that this rate of interest should be even higher than that demanded by the corporation's unsecured creditors, however, because the claimant shareholder also faces a risk associated with the uncertainty surrounding the determination of fair value. A fuller discussion of this matter is withheld pending a consideration of those procedural and other factors that help create this uncertainty and the means whereby it could be reduced.¹³⁸

Thus, both the basic statutory appraisal provision and the current practice of courts in awarding interest could stand some improvement although it is probably safe to say that the problem of delay cost is not a serious one under the *CBCA* and cognate statutes given the statutory allowance of *some* interest to dissenting shareholders pending payment.

4. Procedural hurdles

Experience with the somewhat Byzantine procedural provisions of the *CBCA* has not been altogether happy. The statute requires a litany of notices, counter-notices, and deadlines, and the shareholder who fails to comply strictly with these provisions may be disentitled from exercising his or her appraisal right. The labyrinthine provisions vastly increase the possibility of fatal technical slips.¹³⁹

¹³⁶ See *supra*, notes 134-35. But see *Re Bird Precision Bellows Ltd.*, [1934] 3 All E.R. 444, [1984] Ch. 419, aff'd [1985] 3 All E.R. 523 (C.A.) (refusing to award interest in respect of an appraisal under the English oppression provision).

¹³⁷ In the oppression context, see *Diligenti v. RWMD Operations Kelowna Ltd. (No. 2)*, *supra*, note 135 at 173 (awarding 8 percent interest in 1976); *Re Johnston and West Fraser Timber Co. Ltd.*, *supra*, note 135 at 94. In the compulsory acquisition context, see, for example, *Re Whitehorse Copper Mines Ltd.*, *supra*, note 98; *Cyprus Anvil Mining Corp. v. Dickson*, *supra*, note 98 (both cases awarding interest "at the rate of interest paid on moneys which are paid into court"); *Canadian Gas & Energy Ltd. v. Septre Resources Ltd.*, *supra*, note 107 (awarding a rate of 13.5 percent interest). In respect of freezeout amalgamations, see *Re Domglas Inc.; Domglas Inc. v. Jarislawsky* (1980), 13 B.L.R. 135 (Que. C.S.), aff'd (1982), 138 D.L.R. (3d) 521, 22 B.L.R. 121 (Que. C.A.) (awarding 13 percent interest); *LoCicero v. B.A.C.M. Industries Ltd.*, 28 B.L.R. 172 (Man. Q.B.) (awarding interest at the prime rate).

¹³⁸ See *infra*, Part V.B.6.

¹³⁹ See *CBCA*, *supra*, note 1 at ss. 184(5)-(8), (12), (14), (15). These procedures seem needlessly complex and beg for simplification. Failure of the shareholder to observe a single deadline may be fatal to the assertion of his or her claim, while failure of the corporation to observe a deadline merely extends the period during which the shareholder's counter-responses must be made.

The procedures in the compulsory acquisition provision are considerably less complex, but in

The drafters appear to have aimed at creating a quasi-inquisitorial procedure for determining "fair value." The court is empowered, on application of the corporation or the shareholder, to "fix a fair value for the shares"¹⁴⁰ and "may in its discretion appoint one or more appraisers to assist the court to fix a fair value for the shares."¹⁴¹ The statute does not indicate who bears the burden of proof in determining the fair value. Nor does it provide for pleadings or discovery or indicate who is to bear the cost of the court-appointed appraiser.¹⁴² In fact, the procedure for appointing an appraiser has seldom been used.¹⁴³ In most cases, the parties have enlisted the aid of their own expert witnesses, sometimes calling a dizzying number.¹⁴⁴ Thus, the reality is that the question of determining fair value has been decided in a substantially adversarial manner, but in some cases without the benefit of procedures such as pleadings or discovery or even a clear idea of the party on whom the burden of proof is placed. Without some or all of these procedural advantages, it is difficult or impossible (at least where hidden values or transaction synergies are in question) for the applicant to obtain the crucial information needed to challenge the company's offered price. The information will be in the possession of the company and otherwise unavailable to the dissenter.

The courts have not been entirely unresponsive to these procedural difficulties. In *Neonex International Ltd. v. Kolasa*,¹⁴⁵ Bouck J. converted the dissenter's application¹⁴⁶ to determine fair value into an "action" in order to give the claimant the benefit of pleadings and discovery. In order that the company bear the burden of proof, the court ordered

some respects equally unforgiving, in that a failure to meet the statutory deadlines may disentitle the shareholder from claiming an appraisal (although admittedly the result of so doing is only to consign the shareholder to receive the price offered by the corporation on the initial takeover—a price accepted by at least 90 percent of disinterested shareholders and thus probably fair) (*ibid.* at s. 199). No procedures are specified for a court-ordered appraisal under the oppression remedy (*ibid.* at s. 234).

¹⁴⁰ *Ibid.* at s. 184(20).

¹⁴¹ *Ibid.* at s. 184(21).

¹⁴² The appraisal procedure in the compulsory acquisition provision, *ibid.* at s. 199, is very similar in empowering the court to "fix a fair value for the shares of a dissenting offeree" and in authorizing the court to "appoint one or more appraisers to assist the court to fix a fair value . . ." (*ibid.* at ss. 199(14)-(15)). There are no provisions regarding pleadings, discovery, or the final award of costs. No procedures at all—for valuation or otherwise—are specified in the oppression section, although the court has powers to give an order "requiring the trial of any issue," which allows for a trial of the valuation issue (*ibid.* at s. 234(3)(n)).

¹⁴³ A number of cases decided under the British Columbia compulsory acquisition legislation have appointed expert appraisers to assist the court. See, for example, *Re Wall & Redekop Corp.* (1974), 50 D.L.R. (3d) 733, [1975] 1 W.W.R. 621 (B.C.S.C.); *Re VCS Holdings Ltd. and Helliwell* (1978), [1978] 5 W.W.R. 559, 5 B.L.R. 265 (B.C.S.C.).

¹⁴⁴ See, for example, *Re Whitehorse Copper Mines Ltd.*, *supra* note 98; *Cyprus Anvil Mining Corp. v. Dickson*, *supra*, note 98 (both compulsory acquisition cases).

¹⁴⁵ (1978), [1978] 2 W.W.R. 593, 84 D.L.R. (3d) 446, 3 B.L.R. 1 (B.C.S.C.) [hereinafter cited to D.L.R.].

¹⁴⁶ The application arose in the context of a freezeout amalgamation under s. 184 of the *CBCA*, *supra*, note 1.

the company to stand as plaintiff and the applicant as defendant in the reconstituted action.¹⁴⁷ Bouck J. is not alone in attempting to fashion extra-statutory procedures better suited for the determination of fair value and less slanted in favour of the corporation.¹⁴⁸

¹⁴⁷ *Neonex International Ltd. v. Kolasa*, *supra*, note 145. Bouck J. commented at 454 that:

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 a complaint due to the complex nature of the operations of New Neonex. Many practical problems come to mind if the respondents' suggestion is followed. For example, who would pay the cost of the appraiser during the course of such an inquiry? Costs are a creature of statute and not the common law. An appraiser could take months or years conducting an investigation. Generally speaking, the rules and procedure of this court only allow an award of costs at the conclusion of a proceeding. They cannot be advanced part way through to help finance the other side's claim or defence.

From whom would the appraiser take his instructions? Not from the Court, because it must remain impartial if it is to perform its proper function. If the court did appoint an appraiser, where does the onus of proof lie? Whose witness is the appraiser? What happens if his evidence is shown to be erroneous? What other evidence would the court then have to reach a decision?

Our procedure, our rules of evidence, and our adversary system cannot adjust to the kind of inquiry [with court appointed appraisers] recommended by the respondents. Although it may be tempting to embark upon a hearing of this nature and see if it can be done, I believe the wisest course is to stick to what has been tried and tested in the past. In the long run it will be less expensive.

¹⁴⁸ In an application under the *CBCA*, *supra*, note 1 at s. 184 in *Robertson v. Canadian Cannery Ltd.* (1978), 4 B.L.R. 290, the Ont. H.C. directed a trial of the issue of fair value, complete with pleadings, discovery, and production, with the company as plaintiff. Steele J. held that "I do not believe . . . that in an action such as this where the duty is upon the Court to determine what the fair value is, that there is any real onus of proof on either party because the Court must come to a conclusion itself" (*ibid.* at 292-93). Nevertheless, he held that "[t]he Act casts upon the directors an obligation to fix a fair value of the shares and to show by accompanying statements how it was determined. I read this provision as casting upon the directors an obligation in the first instance to justify the fair value . . ." (*ibid.* at 292). The court appears, therefore, to have at least cast a tactical burden of persuasion on the company. The compulsory acquisition provision contains no such provision requiring the company to determine a fair value for the purposes of making an offer to the dissident—since the takeover bid is itself an offer. *Quaere* if the result would therefore be different.

See also *Re Domglas Inc.; Domglas Inc. v. Jarislowsky*, *supra*, note 137 (following *Robertson* and not specifically allocating the burden of proof); *Denischuk and Bonn Energy Corp.* (1983), 29 Sask. R. 156 (Q.B.) (holding that the corporation should assume carriage of the application and adduce primary evidence of the shares' fair value); *Les Investissements Mont-Soleil Inc. v. National Drug Ltd.* (1982), 22 B.L.R. 139 (Que. C.S.) (not allocating the burden of proof but holding that both parties should make it their goal to assist the court in calculating fair value).

Alberta's newly passed legislation has made a step towards rationalization of the procedures by providing that, in connection with a dissent application, "the court may give directions for . . . the trial of issues and interlocutory matters, including pleadings and examination for discovery" (*ABCA*, *supra*, note 2 at s. 184(12)(b)).

Until recently, the compulsory acquisition provisions cast a heavy onus on the dissenter to show that the price paid in the initial takeover to the 90 percent (or more) of accepting shareholders was unfair. The reasoning of the leading English case, *Re Hoare & Co. Ltd.* (1933), 150 L.T. 374, [1933] All E.R. 105 (Ch.D.) was adopted by Canadian courts even where differences in the Canadian legislation might have suggested a different result: *Re Dad's Cookie Co. (B.C.) Ltd.* (1969), 69 W.W.R. 641, 7 D.L.R. (3d) 243 (B.C.S.C.); *Re Canadian Allied Property Investments Ltd.* (1977), 3 B.C.L.R. 366, 78 D.L.R. (3d) 132 (S.C.), *aff'd* (sub-nom. *Gregory v. Canadian Allied Property Investments*

Other courts have shown a willingness to interpret the statutory procedures in a manner most favourable to the dissenting shareholder. In *Jepson v. The Canadian Salt Company Ltd.*¹⁴⁹ the dissenting shareholder appeared to have clearly failed to comply with the statute in a number of respects that might have proved fatal to his appraisal application with a less sympathetic judge. The court in each instance interpreted the statute in the dissident's favour, at least once in a manner that can only be described as strained.¹⁵⁰

A true inquisitorial type of procedure would likely be superior to an adversarial one in determining fair value. The costs of enlisting the aid of a single appraiser will almost certainly be less than the costs generated by the armies of evaluators often called in aid by the parties to establish their case for fair value. Where transaction synergies or hidden values are in question, an adversarial proceeding has the additional effect of disadvantaging the dissenter who must obtain information controlled by the corporation. At first blush, liberal discovery procedures allowing the shareholder access to inside information appear to be an answer to this problem. However, liberal discovery generates fresh difficulties. The information to which shareholders would gain access might be of a highly sensitive nature, and its disclosure could irrevocably harm the company's

Ltd.) *supra*, note 78 (both decided under B.C. legislation); *Re Whitehorse Copper Mines Ltd.*, *supra*, note 98 (decided under the *CBCA* at s. 199). But in *Cyprus Anvil Mining Corp. v. Dickson*, *supra*, note 98, McEachern C.J.S.C. reversed the position he had earlier taken in *Whitehorse* and purported to follow the approach of Steele J. in *Robertson*. However, the result appears to be a divided burden of proof, with the court imposing an "onus upon any party to adduce evidence establishing, by a balance of probabilities, the correctness of any contention upon which he relies" (*ibid.* at 197).

There are good reasons for imposing a high standard of proof on dissenters on compulsory acquisitions. See *supra*, Part VI.E.2. But see also J.P. Chertkow, "Compulsory Acquisition of Shares Under Section 199 of the Canada Business Corporations Act and *Re Whitehorse Copper Mines Ltd.: An Offer You Can Refuse*" (1982-83) 7 *Can. Bus. L.J.* 154.

In the compulsory acquisition context, see also *Jefferson v. Omnitrone Investments Ltd.* (1979), 18 B.C.L.R. 188 (S.C.) which, while putting an onus on the dissenter to show unfairness of price, also submitted the valuation issue to trial with a "full right of discovery of documents and examinations for discovery relating to the question of price" (*ibid.* at 192). But see the English rule in *Re Everite Locknuts, Ltd.* (1945), [1945] Ch. 220; *Re Press Caps Ltd.* (1949), [1949] Ch. 434 (C.A.).¹⁴⁹ (1979), 7 B.L.R. 181 (Alta. S.C.).

¹⁵⁰ The court held that an informal letter indicating the shareholder's dissent was adequate notice under *CBCA*, *supra*, note 1 at s. 184, and also that a demand for payment that failed to indicate the number of shares held by the applicant (as required to make the notice valid by s. 184(7)) was nevertheless proper because it referred to an earlier letter in which the number was given. The applicants also failed to tender their shares within the statutory time limit; the court held that certain representations by the company had induced them not to, raising an estoppel. Finally, the application for a court determination of fair value appeared to have been outside of the statutory period. The court appeared almost deliberately to misread the provision to bring the applicant within its purview. See also *Manning v. Harris Steel Group Inc.* (1984), 59 B.C.L.R. 1 (B.C.C.A.) (technical violations of procedural provisions of B.C. statute held not fatal to shareholder's application in the interests of furthering the policy of the appraisal provision); *Roytor & Co. v. Skye Resources Ltd.* (Ont. S.C.) [unreported] (shareholder dissent held not out of time); *Re Brant Investments Ltd. and Keeprite Inc.*, *supra*, note 10 (commenting on the difficulties caused the shareholder by the shortness of time to make up his or her mind to claim the appraisal right).

competitive interests. It may be necessary for management to harbour the information and protect it from general disclosure. Liberal discovery would work against this interest, especially given that it would not be difficult for a competitor to take up a small shareholding in the company against the day when the appraisal right may be triggered and the opportunity to discover inside information arise. By contrast, an inquisitorial proceeding might be combined with liberal investigatorial powers and *in camera* hearings (excluding shareholder applicants). This would allow for the revelation of possibly sensitive inside information bearing on price and improve the accuracy of the appraisal without harming the competitive interests of the corporation, but would necessarily disentitle the applicant from participating in the determination of fair value. It would be highly advantageous to have the valuation undertaken by an expert tribunal or valuator rather than a court. The question of valuation is a highly technical matter, and despite the noblest efforts of judges, one which they are not likely to perform particularly well.¹⁵¹ Expert valuers might be culled from the ranks of the business community including investment analysts, chartered accountants, and financial economists.

The question of valuation ought to be referred to the expert tribunal whether or not a question of calculating hidden values or synergies arises. The determination of a pre-transaction value is not without its own difficulties given that either exogenous events (such as movements in the market or changes in economic conditions) or the terms of the transaction dissented from may have affected the market price after the announcement of the proposed change.¹⁵²

Whatever procedure is ultimately adopted, it is at least clear that the present procedures are caught in a legal limbo between an inquisitorial and an adversarial procedure, with the advantages of neither.

5. Expense of exercise

There are two principal cost concerns: the shareholder who wishes to claim the appraisal right and cash out of the company ought not face costs that would inhibit him or her from doing so and destroy the efficacy of the right;¹⁵³ and the costs rule ought not invite minority shareholders to abuse the appraisal right for its nuisance value.

Under existing practice, courts have tended to be generous to claimants when awarding costs but nonetheless often follow the usual rule that

¹⁵¹ See *infra*, part VIII.

¹⁵² This problem will arise in any case where the announcement of the fundamental change and the valuation date are remote in time, as is almost always (in varying degrees) the case. Abstracting away from the effects on price noted above will involve techniques beyond the competence of courts. See *infra*, Part VII, and see Fischel, *supra*, note 10 at 893-94.

¹⁵³ The costs of an appraisal can be considerable. See, for example, *Re Whitehorse Copper Mines Ltd.*, *supra*, note 98 (a compulsory acquisition in which a total of eight expert witnesses were called); *Re Johnston and West Fraser Timber Co. Ltd.*, *supra*, note 135 (an oppression case where the petitioner ultimately bore all his own costs associated with the determination of a fair price).

costs follow the relative success of each party in establishing a claim in respect to "fair value."¹⁵⁴ Under such a rule, the uncertainty that inevitably attends the determination of fair value and the magnitude of the potential costs may conspire to deter a normally risk-averse shareholder from claiming the appraisal right if any other alternative is available.¹⁵⁵ Having the company bear the costs of the appraisal shifts the burden of the costs to the body of shareholders who remain in the company¹⁵⁶ and removes costs as an obstacle to the exercise of the right.

This does not, however, entirely answer the second concern. With an unconditional indemnity as to costs, shareholders may be tempted to exploit the appraisal right for its nuisance value. By exercising the right, the shareholders could threaten to impose the cost of an appraisal on the company. They may be able to secure a payout that exceeds the real value of the shareholdings only because it is cheaper for the company to agree to cash them out at the excessive price than to proceed to a valuation.

A suitable compromise may be to impose the costs of valuation on

¹⁵⁴ See, for example, *LoCicero v. B.A.C.M. Industries Ltd.*, *supra*, note 137 (costs awarded to applicant where cashout price was closer to his suggested figure for "fair value"); *Re Johnston and West Fraser Timber Co. Ltd.*, *ibid.* (no award of costs because of divided success at valuation hearing); *Re Whitehorse Copper Mines Ltd.*, *ibid.* (costs of appraisal on compulsory acquisition awarded to applicants); *Re Diligent and RWMD Operations Kelowna Ltd. (No. 2)*, *supra*, note 135 (costs of appraisal pursuant to oppression application divided between parties following relative success at hearing); *Re Domglas Inc.; Domglas Inc. v. Jarislowsky*, *supra*, note 137 (awarding costs of appraisal on freezeout amalgamation to applicant where appraised value of \$36 substantially exceeded company's offer of \$20). But see *Canadian Gas & Energy Fund Ltd. v. Sceptre Resources Ltd.*, *supra*, note 107 (awarding the claimant party and party costs on a compulsory acquisition appraisal even though the value awarded did not greatly exceed the offered price).

¹⁵⁵ If the typology of reported cases is at least somewhat related to the underlying population of disputes (although see G.L. Priest & B. Klein, "The Selection of Disputes for Litigation" (1984) 13 J. Leg. Stud. 1), one would have expected a good deal more cases in situations where the appraisal right was being voluntarily resorted to (that is, in cases other than freezeout or compulsory acquisition situations). That very few cases have arisen in such situations may be telling in respect of the current costs rules (it may also be a consequence of the many other infirmities of the appraisal right). Indeed, at present, the appraisal right appears to be a realistic alternative only for well-heeled shareholders with large holdings.

¹⁵⁶ The appraisal and oppression provisions forbid payment to shareholders following an order to purchase if the corporation would thereby be rendered insolvent on *either* a current liabilities *or* a net assets basis. Thus, the ostensible burden of the appraisal payouts falls on shareholders. However, creditors and other fixed claimants (such as employees) may also bear part of the cost if the probability of the firm being able to meet its fixed charges is reduced by the appraisal payouts, increasing fixed claimant risk (*CBCA*, *supra*, note 1 at ss. 184(26), 234(6)). See *OBCA*, *supra*, note 2 at ss. 184(28), 247(6). There is no such solvency test in the compulsory acquisition provisions in the *CBCA* at s. 199 and *OBCA* at s. 187. These provisions provide no guidance in a case where the appraisal payouts threaten to render the corporation insolvent. Equally inexplicable is the omission of a solvency test in respect of the *OBCA* provision allowing a shareholder to "put" his or her shares to the corporation upon the acquisition by a single shareholder of 90 percent or more of the shares of a class (*OBCA* s. 188). It is conceivable that the shareholder may be able to trump the interests of creditors and employees, who would thereby end up paying the full cost of the cashout. This is an obviously inappropriate result.

the company subject to a discretion of the court to "order otherwise" if the applicant claims the appraisal right, bargains for a settlement, or proffers a valuation in bad faith.¹⁵⁷ A similar technique to balance the two concerns is to allow the court discretion to find that the appraisal right shall not be available to some or all shareholders in respect of any given transaction.¹⁵⁸ There is no reason why a court might not be given both levels of discretion. The importance of the costs issue cannot be overstated: effective costs provisions are essential for effective shareholder remedies.

6. Adjudication risk

As noted above, invocation of the appraisal right under current procedures and cost rules is attended by a considerable amount of uncertainty,¹⁵⁹ arguably tending to deter a normally risk-averse shareholder from claiming the right. It is also arguable, however, that the risk of adjudication is entirely diversifiable. If so, investors holding diversified portfolios should be indifferent to an increase in such risk.¹⁶⁰

In practice, however, the shareholder may not view adjudication risk with such equanimity. Claiming the appraisal right is an infrequent

¹⁵⁷ See *OBCA*, *supra*, note 2 at s. 105(6). See also *Wallersteiner v. Moir (No.2)* (1975), [1975] 1 All E.R. 849 (C.A.) (the court has an equitable jurisdiction to order the company to indemnify the plaintiff for costs in a derivative action, provided the plaintiff was acting in good faith and it was reasonable and prudent in the company's interest for the plaintiff to bring the action); *Turner v. Mailhot* (1985), 28 B.L.R. 222 (Ont. H.C.) (the *CBCA* provides a statutory footing for a similar court-ordered indemnification in similar circumstances). See generally Iacobucci, Pilkington & Pritchard, *supra*, note 13 at 175.

¹⁵⁸ The Ontario legislation gives the court a discretion to declare that the appraisal right "will not arise upon the taking of the proposed action" (*OBCA*, *ibid.* at s. 184(29)). It is not clear if the court may declare that this is the case in respect of a specific transaction but applying to *all* appraisal claimants, in respect of a specific transaction and *specific* claimants, or both. Probably the former was intended because the provision, for which there is no counterpart in the *CBCA*, was evidently included in the *OBCA* to avoid a possible multiplicity of triggering events in respect of complex fundamental changes.

¹⁵⁹ The adversarial technique for determining fair value probably adds to the uncertainty facing the claimant by increasing the range of potential values that a court might find to represent fair value. See, for example, the differences in valuation advanced by experts called for either party in *Diligenti v. RWMD Operations Kelowna Ltd. (No. 2)*, *supra*, note 135 where the court ultimately averaged the figures put forward by the experts for each side. See *Re Johnston and West Fraser Timber Co. Ltd.*, *ibid.*, where the court at 86 commented that:

[A]ll four experts expressed divergent or conflicting opinions as to market value. Different assumptions were advanced by each expert which, depending on the one accepted, had a profound effect on the resulting market value. The assumptions reflect the subjective experience and opinions of the particular expert propounding their acceptance. . . . One gained the impression that one could readily commence such a study with a preconceived market value in mind and, by the application of selected assumptions, readily provide calculations which supported the preconceived result.

See also the heroic efforts of McEachern C.J.S.C. in *Re Whitehorse Copper Mines Ltd.*, *supra*, note 98 and *Cyprus Anvil Mining Corp. v. Dickson*, *supra*, note 98 in determining the fair value of thinly traded public companies.

¹⁶⁰ See *supra*, Part III.A.1.

event. Deciding whether or not to claim the right might, as a psychological matter, be subject to a consideration of the total risk of the appraisal. The prudent course would be to treat the risk of adjudication as a cost to the shareholder.

The uncertainty associated with the process of fixing a fair value would be reduced if those suggestions pertaining to procedures and costs were adopted. Uncertainty may further be reduced if, as suggested below, greater reliance is placed on pre-transaction market price as the basic tool for valuing a dissenter's shares.¹⁶¹

While the degree to which adjudication risk may affect a shareholder's decision of whether or not to claim the appraisal right cannot be quantified, the presence of this risk indicates that courts should err on the side of generosity in awarding pre-payment interest to the appraisal claimant. Thus, the standard considered earlier (the rate of interest paid to the corporation's unsecured creditors) may in fact be too conservative; a rate perhaps one or two percentage points higher might be more appropriate.

7. Cost to the company: the chilling effect on fundamental changes

One of the more vigorously debated points in the literature on appraisal rights is whether or not the appraisal right is likely to be costly for the company (aside from the potential competitive cost noted above) and the related point of what effect this will have on the undertaking of fundamental changes.¹⁶²

Manning suggests that "[f]rom the perspective of the company, these statutes can be a frightful nuisance, drain, and burden." He argues that a "sudden and largely unpredictable drain is imposed upon the corporation's cash position" at a time when "the enterprise is more apt to be in need of a blood transfusion than a leeching."¹⁶³ He further suggests that if there are sufficient dissenters, the transaction may be entirely aborted.

Manning's argument has been met by Eisenberg with equal vigour on two fronts. First, there "may be a short-run need for a cash input, but it is seldom material."¹⁶⁴ Second, to the extent that the number of dissenters grows or threatens to grow, this will exert a salutary effect upon

¹⁶¹ See *infra*, Part VIII.

¹⁶² Earlier, it was suggested that a valuation rule yielding participation in hidden values or synergies of the transaction may tend to discourage productive fundamental changes and hence generate economic losses. This must be separated from a concern that the cash drain generated by widespread exercise of the appraisal right may abort the fundamental change. In the former case, the concern is with the question of structuring *appropriate incentives* to undertake productive fundamental changes. In the latter case, the concern is primarily one of the effect of the payouts on working capital and the resulting illiquidity and increased financial risk.

¹⁶³ Manning, *supra*, note 10 at 234.

¹⁶⁴ Eisenberg, *supra*, note 38 at 73.

management by inducing them to attempt to secure the best deal possible for the shareholders.¹⁶⁵

In the author's view, the Eisenberg arguments carry greater force. The author knows of no case involving a large public company where the number of dissenters was so great as to threaten the fundamental change. Should such a case arise, any fundamental change that succeeded in attracting so many dissenters is not likely to be the sort of beneficial fundamental change that there is great concern about saving.¹⁶⁶ Given the general apathy of shareholders, a vigorous dissent expressed through the widespread exercise of the appraisal right is likely to be symptomatic of a deep-seated infirmity in the fundamental change. As has already been suggested,¹⁶⁷ the value of the appraisal right lies precisely in its potential to deter value-decreasing transactions, while permitting value-increasing transactions to go forward.

C. Summary

However theoretically attractive the appraisal right is, unless it can be made to work in practice, it cannot fulfil its potential function. Some relatively acute practical difficulties presently diminish the effectiveness of the appraisal right.

It is clear that amendments can be made to the procedural and costs provisions of the *CBCA* and cognate statutes that would improve the efficacy of the appraisal right. These changes would have the effect of reducing the delays and uncertainties as well as the costs of the appraisal right. Changes might also be made in the federal taxation legislation. A minor amendment is indicated in the provision allowing for payment of interest on the dissenter's shares. The awarding by the courts of a somewhat more generous interest rate paid on appraised value prior to actual payment is suggested. These improvements would make the appraisal right more attractive as a remedial option.

VI. THE APPRAISAL RIGHT AND OTHER REMEDIAL TECHNIQUES: DOES THE APPRAISAL RIGHT HAVE A UNIQUE ROLE TO PLAY?

One final issue that will be canvassed before suggesting the optimal form of the valuation objective accompanying the statutory appraisal right is the question of what *special* role the appraisal right can play in furthering the anti-discrimination and bail-out rationales. If other market or legal devices can perform the same function or perform it more efficaciously than the appraisal right, there is little need for this appraisal

¹⁶⁵ *Ibid.* at 83-84. It would appear that E.L. Folk was the first to suggest this point as a rationale for the appraisal right in "De Facto Mergers in Delaware: *Hariton v. Arco Electronics, Inc.*" (1963) 49 Va. L. Rev. 1261.

¹⁶⁶ See *supra*, note 109 and accompanying text.

¹⁶⁷ See *supra*, Part III.D.

right. It is suggested that the appraisal right may service these interests in a way which is not entirely duplicated by other remedial techniques.

A. *The Appraisal Right as Cure for or Prevention of Discrimination*

1. The alternatives

The utility of a shareholder appraisal right depends to a considerable degree on the utility and scope of *other* remedies available to prevent an opportunistic redistribution of enterprise values. These other techniques include subjecting the transaction to a test for business purpose or for fairness; requiring prior administrative or court approval; requiring management to submit to shareholders a valuation of terminated shares; putting in place a liability rule of mandated "full disclosure" in favour of shareholders; applying a liability for trading on inside information; or requiring a majority of the minority approval whether by means of a class or intra-class vote. In order to determine the role of the appraisal right in preventing or curing the harms caused by opportunism, the *potential* shortcomings of each of these techniques is examined as well as the potentially unique role that might be played by an appraisal right.

Since a large part of the difficulty in drawing a line between productive and unproductive fundamental changes consists in separating those transactions with a genuine business motive from those that have a purely or partly redistributive motive, the minority shareholder's first line of defence might be to subject the transaction to a test for a legitimate "business purpose." Such a requirement has not often been explicitly resorted to in Canada although the presence or absence of some demonstrable business motive will undoubtedly colour a court's attitude to the transaction if challenged.¹⁶⁸

A requirement to make out a business purpose may well eliminate those transactions that manifestly lack any business purpose. But, as in other contexts, subjecting fundamental changes to a business purpose test will not entirely protect minority shareholders against redistributive predation. An opportunistic redistribution may easily be engrafted upon a transaction with a legitimate business purpose to lend it an air of propriety. Alternatively, a transaction yielding real economic gains may be

¹⁶⁸ It would be misleading to suggest that the courts have *never* insisted on a valid business motive. A number of cases have imposed such a requirement in the context of two-step freezeouts under the compulsory acquisition legislation. See the English case of *Re Bugle Press Ltd.* (1960), [1961] Ch. 270, [1960] 3 All E.R. 641 (C.A.); *Blue Metal Industries Ltd. v. Dille* (1969), [1970] A.C. 827 at 849 (P.C.); and in Canada, *Rathie v. Montreal Trust Co.* (1953), [1953] 2 S.C.R. 204. At least one court has interpreted the arrangement provision in a like fashion. See *Re Standard Manufacturing Company and Baird* (1984), 5 D.L.R. (4th) 697 (Nfld. S.C.), holding that the arrangement provisions cannot be used to effect an eviction without some benefit accruing to the company. The *Standard* case echoes earlier cases involving attempted evictions of minority shareholders by means of amendments to the company's constitution. See, e.g., *Brown v. British Abrasive Wheel Co., Ltd.* (1919), [1919] 1 Ch. 290; *Dafen Tinplate Co., Ltd. v. Llanelly Steel Co. (1907) Ltd.* (1920), [1920] 2 Ch. 124, 89 L.J. Ch. 346.

structured in a manner that is unnecessary to attain the increase in value in order to disenfranchise the minority. Although courts and securities regulators are no longer as deferential to majority rule as they once were, nor as slow to review the *bona fides* and the business purpose of corporate fundamental changes,¹⁶⁹ it seems clear that the courts' natural reticence to sit as a review panel on business judgments renders a business purpose test a leaky sieve in preventing opportunistic redistribution.

A business purpose test, in addition to being *under*-inclusive, may in some situations be *over*-inclusive. Where a court is called upon to review the business purpose of a transaction, there is the danger that a court anxious to preserve minority shareholder rights will strike down those transactions whose business purpose cannot—either because of complexity, uncertainty of attainment, or the danger of jeopardizing sensitive information—be adequately communicated to the court. In either case, the difficulty with a business purpose test arises from the questionable institutional competence of the courts to stand as a review tribunal in questions of business judgment.¹⁷⁰

Moreover, a strategy of reliance upon the invocation by disgruntled minority shareholders of fiduciary duties or the oppression remedy to prevent opportunistic transactions runs into the problem of collective action and free riders. An assertion of lack of business purpose presents a complex factual issue to a court. Trial of the issue is an expensive and time-consuming affair attended by much uncertainty. Few minority shareholders holding small stakes in the company (many of whom have a purely transient interest) will stand to gain sufficiently to make a suit worthwhile. Further, where the plaintiff is unable to secure contribution towards costs from other shareholders—but all shareholders stand to gain equally from success—each minority shareholder has a strong incentive to let someone else sue. Although costs rules in the federal and Ontario legislation now allow a shareholder to seek an indemnity from the corporation in a derivative action, “costs follow the event” is still the rule of usual application without right of contribution from other shareholders or the benefit of an indemnity from the corporation.¹⁷¹ A similar collective action problem plagues a requirement that insiders demonstrate the “fairness” of the price paid to evicted minority shareholders.¹⁷²

¹⁶⁹ See MacIntosh, *supra*, note 35.

¹⁷⁰ Cf. Borden, *supra*, note 78.

¹⁷¹ It is unclear whether a shareholder may seek indemnity with respect to an oppression action. See, for example, *CBCA*, *supra*, note 1 at s. 233, especially s. 233(d) (court powers in a derivative action), and s. 234(3) (court powers in an oppression application).

¹⁷² Courts in Great Britain and in Canada have required that the proposed fundamental change be fair in a number of contexts requiring court approval for the change. These include reductions of capital and statutory arrangements. These putative fairness tests have tended sometimes to mean little more than ensuring that all relevant procedures have been complied with and that all required majorities have been obtained, although the Canadian courts have at times been very active in policing the fairness of statutory arrangements. Increasingly, the courts have interpreted the statutory oppression remedy as imposing a general requirement of fairness; the result of

The collective action problem, however, is not entirely insurmountable. One way to reduce its impact is by empowering a publicly funded administrative agency to function as an oversight body administering to shareholder rights much as an indenture trustee serves the interests of bondholders. The federal and Ontario statutes, for example, now give standing to administrative officials to undertake actions alleging oppression,¹⁷³ and a recent case suggests that the action may be undertaken in the form of a class action on behalf of minority shareholders.¹⁷⁴ Further, the Ontario Securities Commission and its counterparts in other provinces exercise a powerful oversight function in respect of the activities of all publicly traded corporations, and the administrations of the administrators are not infrequently set in motion by private complaint.

Despite these openings for administrative intervention, the federal incorporation legislation (which has set the pattern for legislation in Ontario and five other Canadian provinces) was designed to be primarily "self-enforcing" by means of private action.¹⁷⁵ Indeed, the Canadian experience under the former Letters Patent regimes indicates that administrative involvement in corporate fundamental transactions as a matter of course is impractical owing to the inevitably limited resources of the designated oversight bodies and the overwhelming number of transactions presented for approval.¹⁷⁶

However, administrative oversight need not be structured as a mandatory administrative sanction in order to be effective. Where oppressive conduct is alleged, a minority shareholder has the opportunity to consult administrative officials with a view to the latter undertaking an action on his or her behalf or on behalf of all minority shareholders.¹⁷⁷ This *ad hoc* administrative intervention may be an effective way of overcoming the collective action problem. It is reasonable to expect that this mechanism will be increasingly resorted to in Ontario and other provinces with similar administrative oversight bodies in the future.

finding a lack of fairness could be either liability or the enjoining of the transaction. Thus, a generalized fairness doctrine seems already on the horizon. See MacIntosh, *supra*, note 35. The issues of fairness and business purpose are closely intertwined; the absence of a legitimate business purpose may suggest an absence of fairness by implicating opportunistic motives. A general requirement of fairness is plagued by the same question of judicial competence as that of business purpose.

¹⁷³ *CBCA*, *supra*, note 1 at ss. 231, 234; *OBCA*, *supra*, note 2 at s. 247. Under the *CBCA* the administrative official (the "Director") may also commence a derivative action in favour of the corporation (*CBCA* s. 231). The *OBCA* may permit the same result although the statute is not quite so explicit (*OBCA* s. 244). See also Ontario *Securities Act*, *supra*, note 16 at s. 132 (permitting the Commission to commence a derivative action in favour of the corporation in the case of insider trading). Both the *CBCA* and the *OBCA* permit administrative officials to intervene in a variety of other circumstances. See, for example, *CBCA* ss. 119, 131, 138, 148, 151, 161, 185.1, 204, 197, 198, 206, 222, 236. The *OBCA* contains similar provisions.

¹⁷⁴ See *Sparling v. Royal Trustco Ltd.* (1984), 24 B.L.R. 145 (Ont. C.A.).

¹⁷⁵ Dickerson Report, *supra*, note 3 at paras. 13, 14, 496.

¹⁷⁶ See, e.g., Ontario, *Interim Report of the Select Committee on Company Law* (Chair: A.F. Lawrence) at para. 1.1.7. [hereinafter Lawrence Report].

¹⁷⁷ See *Sparling v. Royal Trustco Ltd.*, *supra*, note 174.

In going-private transactions (and perhaps other fundamental changes), another strategy for preventing the exploitation of material insider information is requiring full disclosure of any material information bearing on price. The *OBCA* and Ontario Securities Commission require, in addition to the shareholder approvals noted below, that an "independent" valuation of forcibly terminated participating shares be prepared in connection with any going-private transaction and that a summary of the valuation be sent to shareholders.¹⁷⁸ Even aside from the collective action problem that exists if the valuation or summary sent to shareholders is deficient, this protective device may also be deficient in an important respect. It is somewhat doubtful that any valuer appointed and instructed by management may be relied upon to uncover any hidden values that management or the majority shareholders are anxious should remain a source of private gain. Any firm that is hired by management and that hopes or expects to receive further work from the corporation or to be hired by other corporate managers inevitably finds itself in a position where the greatest rewards may arise from pessimistic assessments of value that coincidentally mirror those publicly expressed by management.

Under the federal and Ontario legislation, insider trading attracts criminal and civil sanctions. However, rules forbidding insider trading (or mandating a corporate valuation in the interests of preventing insider trading) are plagued by difficulties of discovery in the best of circumstances. These difficulties are exacerbated in the case of pure going-private transactions. Shareholders will frequently be unable to acquire the information necessary to ground the liability. Exposure of a misstatement respecting values at the time of going private, or of the exploitation of inside information, necessarily involves uncovering objective information that reflect on the accuracy of the information given shareholders. Where the company continues as a public entity, subsequent performance or corporate events may furnish the required information. However, once the company has gone private, there is by definition no market price available to give clues as to captured hidden values. Coincidentally, public disclosure obligations cease, drying up the flow of readily available information.¹⁷⁹

Further, in respect of many fundamental changes, such as an amendment to the articles of incorporation to alter the terms of outstanding securities, the legislation forbidding insider trading will not usually apply. The Ontario legislation, for example, enjoins only insider trading

¹⁷⁸ *OBCA*, *supra*, note 2 at ss. 189(2)-(3); Ontario Securities Commission Policy 9.1.

¹⁷⁹ The newly expanded rules for examination on discovery alleviate the problem to some degree. See *Rules of Civil Procedure*, O. Reg. 560/84 (as amended). Rule 30.02(1) requires that any relevant documents in the possession, control, or power of a party must be disclosed on discovery. Rule 30.02(4) allows a court to order that such disclosure obligation shall extend to subsidiary, controlled, or affiliated corporations of a corporate party to the action. In addition, rule 31.06 permits liberal discovery (including cross-examination) of any person examined on discovery.

in connection with the *sale* or *purchase* of a security.¹⁸⁰

Rules mandating disclosure of information known to insiders or acquirors bearing on the value of the target company suffer from the same infirmities that plague insider-trading liability.¹⁸¹ Procedural requirements designed to ensure that shareholders assent to the fundamental change are another possible protective mechanism. In addition to the approval of a *majority* of shareholders, the federal and Ontario legislation typically require approval by any affected *class* of shareholders on the undertaking of a fundamental change.¹⁸² This may be insufficient protection where interested insiders control sufficient shares to determine the result of any class vote. The protection afforded minority shareholders is substantially enhanced where company-wide and class votes are taken so as to exclude those shareholders in a position of conflict of interest—that is, where required approvals must be given by a “majority of the minority.” In Ontario, both by legislation and administrative fiat, going-private transactions must receive the approval of a majority of the disinterested minority of all affected classes before a going-private transaction may proceed.¹⁸³

These approvals, while highly suggestive of the fairness of the transaction, are nonetheless not *foolproof* guarantees. Management’s control over the proxy machinery and ability to control information reaching shareholders, coupled with shareholder apathy, may result in class majority of the minority approvals even where the transaction affects minority shareholders adversely.

Finally, in the case of going-private transactions, the disciplinary mechanisms of the market restraining purely redistributive action slacken or disappear. A company that is going private will have few worries about the action adversely affecting its cost of capital since the company will not be seeking further public funding so long as it continues to remain a private company.¹⁸⁴

¹⁸⁰ Ontario *Securities Act*, *supra*, note 16 at s. 131. See also s. 75 (criminal liability).

¹⁸¹ See, for example, Ontario *Securities Act*, *supra*, note 16 at ss. 74-75; *Regulation Made Under the Securities Act*, R.R.O. 1980, Reg. 910 (as amended), at ss. 163-75, and Forms 32-34; Ontario Securities Commission Policy 9.1. See also *In The Matter of Canada Cement LaFarge Limited and Standard Industries*, (1980) Bulletin of Ontario Securities Comm. 400.

¹⁸² See, for example, *CBCA*, *supra*, note 1 at ss. 170, 177, 183, 203, 204. *Cf. OBCA*, *supra*, note 2 at ss. 169, 175, 181, 183, 189.

¹⁸³ *OBCA*, *ibid.* at s. 189; Ontario Securities Commission Policy 9.1. The requisite supra-majority depends on whether or not the consideration is payable wholly or partly in non-cash consideration and whether or not the offered cash consideration is at least as great as the prepared valuation (*OBCA* s. 189(4); Policy 9.1 II.B). The stock exchanges also insist on majority of the minority voting approval in some situations involving fundamental changes. See generally MacIntosh, *supra*, note 35.

¹⁸⁴ This review of various shareholder protective devices is not an endorsement of all or any of these protections. Rather, it is merely an inventory of some of the reasons why these protections will not be complete guarantees against opportunistic conduct of managers or shareholders for the purpose of determining what unique role the appraisal right might serve.

2. The appraisal right

Adoption of an appraisal proceeding may confer benefits on both the company and dissenting shareholders by virtue of being a *relatively* cheap dispute resolution mechanism. Although the appraisal right has been criticized as being slow, uncertain, and costly,¹⁸⁵ it may be advantageous to both majority and minority shareholders if it is cheap relative to other available relief. While liability entitlements arising under common law or statutory fiduciary or oppression rules require a complex and expensive adjudication of right, the appraisal right is a strict liability entitlement that arises *as of right* merely on the happening of stated occurrences.¹⁸⁶ Although trial of the issue of "fair price" has often proved difficult and expensive,¹⁸⁷ by reducing the arena of conflict to this single issue the appraisal procedure leads to a reduction in the joint company-shareholder expenses of dispute resolution. In many cases, the result of the determination of right under a relevant liability rule (for example, fiduciary duties or the oppression remedy) offers no greater protection; the courts simply order the buyout of minority shares at an appraised value.¹⁸⁸ Thus, in many cases the appraisal right leads to comparable relief. It also often avoids the problems associated with minority holdouts that attend the conferral of powers of veto on minority shareholders (either individually or as a group).¹⁸⁹

The strict liability character of the appraisal entitlement is important in relation to more than merely the issues of costs and relief. Where an adjudication of entitlement involves trial of complex issues of law and fact—as in the case of allegations of breach of fiduciary duty or of oppression—a great amount of uncertainty is introduced in the determination of right. Uncertainty is a cost to risk-averse plaintiffs—the greater the uncertainty surrounding the outcome, the less likely it is that a minority shareholder will be willing to sue to defend his or her rights. Resort to the appraisal right restricts the ambit of uncertainty to the issue of cashout price and eliminates any uncertainty associated with entitlement (provided the minefield of procedural requirements is crossed without a fatal accident). All other things being equal, this renders the appraisal right a comparatively attractive entitlement.

¹⁸⁵ See *supra*, note 28 and following text.

¹⁸⁶ At least in respect of the basic s. 184 appraisal entitlement. A somewhat different role is reserved for an appraisal pursuant to an oppression application (See *infra*, Part VIII.D).

¹⁸⁷ See *infra*, Part VIII.

¹⁸⁸ See, for example, *Re Mason and Intercity Properties Limited* (1984) 2 A.C.W.S. (2d) 524 (Ont. S.C.) aff'd (1984), 34 A.C.W.S. (2d) 366 (Ont. Div. Ct); *Miller v. F. Mendel Holdings Ltd.* (1984), 26 B.L.R. 85 (Sask. Q.B.); *Mason v. M.O.W. Holdings Ltd.* (1983), 23 Man. R. (2d) 260 (Q.B.); *Johnston, Sales, McKay and Dragon Investment Ltd. v. West Fraser Timber Co. Ltd.* (1981), 29 B.C.L.R. 379 (S.C.), rev'd (1982), 37 B.C.L.R. 360, 140 D.L.R. (3d) 574 (C.A.); *Diligenti v. RWMD Operations Kelowna Ltd.* (1976), 1 B.C.L.R. 36 (S.C.). In these cases the shareholder would have been quite happy to have secured the remedy without going to the expense, difficulty, and risk of showing oppression.

¹⁸⁹ See *supra*, note 10.

Moreover, the appraisal right is an individualized entitlement. Class and majority of the minority requirements protect respectively discrete and fluid *bodies* of minority shareholders in the company. The appraisal right, by contrast, protects *individual* shareholders by allowing any shareholder to exercise his or her appraisal entitlement regardless of the opinion of *any* other shareholder respecting the fairness or propriety of the transaction.

The individualization of the entitlement answers to an extent the problem of collective action; it does not, however, entirely overcome it. A free-rider problem arises insofar as the court hearing to determine fair price joins and binds all dissenting shareholders.¹⁹⁰ Hence the valuation hearing confers joint benefits¹⁹¹ but, at least in the *CBCA* and most cognate statutes, without a right of contribution from other shareholders or payment of costs by the company.¹⁹² This problem might be remedied, along the lines suggested earlier, by redesigning the costs provisions so that the company routinely pays part or all of the costs of the appraisal.¹⁹³

B. *The Appraisal Right and the Bail-out Rationale?*

In addition to those advantages already noted, the appraisal right has perhaps an even more special role to play where it is claimed under the bail-out rationale. In many situations where the shareholder claims the right under this rationale, the essence of the protection conferred will be against unwise business decisions. The decision dissented from will not typically attract liability under relevant fiduciary or fiduciary-like norms (like the oppression remedy) or for breach of the duty of care and skill. Similarly, where the reason for claiming the right under the bail-out rationale is *opportunistic* risk shifting that diminishes enterprise value, it will frequently be difficult to convince a court that a simple shift in the risk of the enterprise constitutes oppressive conduct.¹⁹⁴ The appraisal right thus confers protection that is not duplicated by the techniques explored above in relation to problems of discrimination.¹⁹⁵

¹⁹⁰ A court hearing need not arise unless the company and one or more dissentients fail to agree on a cashout price; however, the price offered to all such dissentients of any given class or a series must be the same (*CBCA*, *supra*, note 1 at s. 184(19)).

¹⁹¹ The appraisal right may also confer joint benefits if sufficient shareholders dissent, threatening to cause such a cash drain on the corporation that the fundamental change is abandoned. The author knows of no case where this has occurred.

¹⁹² This problem has been overcome in the Alberta legislation by having the company pay the costs of the appraisal proceeding. *ABCA*, *supra*, note 2 at s. 184(11)(b) provides that "[a] dissenting shareholder. . . except in special circumstances shall not be required to pay the costs of the application or appraisal." It is not entirely clear what license this gives minority shareholders to hire expert witnesses, at the cost of the company, to contest the company's asserted fair price.

¹⁹³ See *ibid.* and Part V.B.5, *supra*.

¹⁹⁴ Although see *Re Mason and Intercity Properties Limited*, *supra*, note 188.

¹⁹⁵ This does not by itself mean that this protection has any value; only that, if the protection is otherwise valued, the appraisal remedy is one of a very few ways of conferring this protection.

VII. A MENU APPROACH TO A NON-MANDATORY STATUTORY APPRAISAL RIGHT

Before evaluating the impact of appraisal rationale, transaction type, and corporation type on the selection of a statutory appraisal right, it is appropriate to consider another fundamental question: Should the statutory appraisal right be mandatory or merely presumptive in character? The choice between these two alternatives reflects the choice between the two principal functions of corporate law.

In this section, it is suggested that the case for a mandatory statutory appraisal right is weak. However, a case is made for a non-mandatory (or "permissive") statutory appraisal right or a number of appraisal rights with alternative valuation objectives. These might be selected at will by any company for incorporation into the company's constitutional documents, with the option of declining to have any appraisal right at all.

A. A Mandatory or Permissive Appraisal Right?

In one aspect, corporate law is "enabling"; that is, it supplies a type of standard form contract with terms that the parties in the greater number of corporations would in any case agree to in an environment where transactions costs were zero or negligible. Wearing its enabling mantle, corporate law supplies rules that are presumptive rather than prescriptive in character. The motivating reason for rules of this character is the reduction of the transaction costs of financial contracting; the statutory standard form renders it unnecessary to specifically contract to a given outcome. Under this rationale, there is no reason to prevent those involved in a corporation from contracting to other rules where they consider it appropriate to do so. The enabling function of corporate law seeks to assist in the process of private ordering.

In another aspect corporate law is "regulatory," supplying minimum standards of performance or otherwise regulating the conduct of the affairs of the corporation. Regulatory law by its nature gives rise to mandatory rules. It is necessarily based on the presumption that private ordering—market contracting—is failing to produce an entirely efficient financial contract.¹⁹⁶

¹⁹⁶ Of course, transaction costs may inhibit the process of bargaining to the same financial contract as we would see in a zero transaction costs environment. This is also an instance of market failure. However, the type of market failure that is sufficient to ground mandatory rules is generally some failure of the activities of the corporation, or the nature of its legal relationship with its security holders, to be reflected in its cost of capital. Even in the case of "last period problems," where those exiting the market (for example, by retirement or cessation of business) "take the money and run" without fear of market reprisals, presumptive rules allowing for contracting out (supplemented by anti-fraud rules) are adequate as long as these problems are anticipated by the market.

It may sometimes be possible to justify mandatory rules under the enabling function. Mandating a restricted number of standard form financial contracts the aggregate market costs of pricing securities. It is obviously expensive to determine and price each feature of the rather complex finan-

It is difficult to make out a strong case for regulatory rules with respect to public companies with widely traded securities. The evidence is fairly strong that markets for the securities of such companies operate with a high degree of efficiency.¹⁹⁷ Although there are undeniably

cial contract between shareholder and corporation that is embodied in lengthy documents such as the articles, by-laws, and other constitutional documents of the corporation. If the degree of variance in these financial contracts is reduced, securities may be priced at reduced cost, securing (other things being equal) a net social gain. Of course, other things do not remain entirely equal; there is loss resulting from restricting the scope of possible financial contracting. The case in favour of mandatory provisions under the enabling function thus depends on the relative magnitude of these efficiency gains and losses. It may well be that the argument has the greatest force in the case of thinly-traded public companies where the marginal reduction of information and pricing costs associated with mandating specific features of the company-shareholder contract might tend to be the greatest. Where, however, (as in the appraisal right) it is unclear what the most efficient form of contract is, it would be imprudent to mandate any specific form of appraisal right in the interests of a reduction of information costs.

¹⁹⁷ An elementary finance textbook that reviews the theory and evidence in a highly readable form is Brealey & Myers, *supra*, note 18 at 254-75. See also Lorie, Dodd & Kimpton, *supra*, note 76; Malkiel, *supra*, note 76. For a more technical analysis see Tinic & West, *supra*, note 18. The classic review, although necessarily dated, is Fama, *supra*, note 76. These investigations, focusing on the American market, have tended to confirm the efficiency of securities markets in respect to information as to past price movements ("weak form" efficiency), publicly-available information which may impact on securities prices ("semi-strong form" efficiency), but not in respect to insider information ("strong form" efficiency).

The evidence is considerably less well developed in respect of Canadian markets. It would appear, however, that stock price movements exhibit a similar random character. See C.H. Rorke *et al.*, "The Random Walk Hypothesis in the Canadian Equity Market" (1976) 8 J. Bus. Admin. 23.

The evidence is mixed in respect of the efficiency of Canadian securities markets as to publicly available information. The following studies suggest semi-strong form efficiency. J.P. Williamson, "Performance of Canadian Mutual Funds, 1961-70" (1971) 36:3 Bus. Q. 94; D. Grant, "Investment Performance of Canadian Mutual Funds; 1960-1974" (1976) 8 J. Bus. Admin. 1; A.L. Calvert & J. Lefoll, "The CAPM Under Inflation and the Performance of Canadian Mutual Funds" (1980) 12 J. Bus. Admin. 107; A.L., Calvert & J. Lefoll, "Performance and Systematic Risk Stability of Canadian Mutual Funds Under Inflation" (1981) 8 J. Bus. Fin. & Acc. 279; W.M. Lawson, "Market Efficiency: The Trading of Professionals on the Toronto Stock Exchange" (1980) 12 J. Bus. Admin. 41. Some studies appear to show inefficiencies: G. Charest, "Returns to Dividend Changing Stocks on the Toronto Stock Exchange" (1980) 12 J. Bus. Admin. 1; G. Charest, "Returns to Splitting Stocks on the Toronto Stock Exchange" (1980) 12 J. Bus. Admin. 19. Other studies apparently showing inefficiencies are collected in J.P. Williamson, "Canadian Capital Markets" in Consumer and Corporate Affairs Canada, *Proposals for a Securities Market Law for Canada*, vol. 3 (1979) 1. However, it should be noted that the conclusions in these earlier works are based on the observed relationship between risk and return and therefore depend critically on an accurate measurement of risk. Relatively recent developments suggest that there are serious statistical biases in the measurement of risk in thinly-traded stocks—which of course dominate in Canadian capital markets—that were not taken into account. Thus, these studies must now be regarded as of questionable validity. See E. Dimson, "Risk Measurement when Shares are Subject to Infrequent Trading" (1979) 7 J. Fin. Econ. 179; Fowler, *et al.*, *supra*, note 26; R. Roll, "A Possible Explanation of the Small Firm Effect" (1981) 36 J. Fin. 879.

As in the United States, Canadian markets have not been found to be efficient as to inside information. See Fowler *et al.*, *supra*, note 45; Fowler & Rorke, *supra*, note 45; Baesal & Stein, *supra*, note 45.

Canadian markets appear to be less transactionally efficient than American markets. See Tinic & West, *supra*, note 44.

“agency costs” associated with public corporations, these costs are anticipated by the market and reflected in the firm’s cost of capital and the wages paid its managers. The price a shareholder pays for a security in a widely held public company is the market’s best estimate of the intrinsic worth of the security based on all publicly available information and incorporating an anticipation of future contingencies that may disadvantage minority shareholders, such as freezeouts and discriminatory alterations of the articles. Thus, the financial contract that this type of firm offers shareholders is reflected in its cost of capital.¹⁹⁸ This supplies a potent incentive for the firm to design a contract that will result in an optimal cost of capital for the firm. Thus, there is little need for a mandatory appraisal right.

In the context of private corporations, strong arguments can again be made against a regime of regulatory, as opposed to enabling, rules. Many private companies are in effect “incorporated partnerships” with a small number of participants. The constitutional or other documents that together constitute the financial contract of the parties, can be, and usually is, highly tailored to meet the specific needs of these participants. Regulatory rules become less necessary to the extent that the parties regulate their own relationship with specific contractual provisions. In fact, given the heterogeneity of interests to be protected in a private corporation and the relatively large variance in the type of financial contract struck, mandatory rules will unduly inhibit the process of contracting to achieve the accommodation of specific preferences. It would appear that presumptive rather than mandatory rules are indicated.

The dominant form of corporate enterprise in Canada is the public company whose shares trade in thin markets. Such companies appear at first sight to present the strongest case in favour of mandatory rules. It has already been suggested that there may be some reason to believe that agency costs will be higher in respect of such corporations. Moreover, most of the evidence of the efficiency of the stock markets has been developed in the context of public companies trading in deep markets.¹⁹⁹ Even if agency costs are higher in thinly traded public companies, however, there is no *a priori* reason to believe, nor is there reliable evidence suggesting, that the market inappropriately discounts any added risks of investing in such companies.²⁰⁰ The available evidence tends rather to suggest that Canadian markets are efficient in the semi-strong form despite the number of thinly traded companies.²⁰¹ Thus, there are still potent incentives for thinly traded companies to select a form of financial contract that will minimize its cost of capital. It is likely that investors in such corporations demand and receive a risk premium for investing in an

¹⁹⁸ See *ibid.* and Jensen & Meckling, *supra*, note 71.

¹⁹⁹ See *supra*, note 197.

²⁰⁰ *Ibid.*

²⁰¹ *Ibid.*

enterprise with a higher risk of discrimination against minority shareholders. Thus, as a general rule, permissive or enabling rules are appropriate in the context of Canadian capital markets.

B. The Optimal Form of the Statutory Valuation Principle and the Indeterminacy of Pure Theory

It has been suggested that the two main functions served by an appraisal right are under the bail-out and anti-discrimination rationales. A close examination of the different rationales for the appraisal right suggests that the valuation objective might well vary depending on the rationale under which the appraisal right is claimed.

If, for example, a dissentient shareholder enlists the protection of the appraisal right in a situation where there has been, or is alleged to have been, substantive discrimination between shareholders, the optimal valuation objective *may* include an assessment of hidden values captured by some shareholders to the exclusion of others or an assessment of the transaction synergies.

If, on the other hand, the reason for claiming the right is to avoid the consequences of an unwise fundamental change, the more appropriate valuation objective is to value the dissentient's shares on a pre-fundamental change basis in order to provide protection from the effect or anticipated effect of the change on the enterprise.²⁰²

The optimal valuation objective may also vary depending on the type of transaction under consideration. For example, as indicated above, going-private transactions present far greater dangers of opportunistic redistribution than two-step takeovers, and fewer opportunities for generating economic gains. Therefore, these transactions present a stronger case than other types of fundamental changes for a full gain-sharing rule. Finally, the appropriate valuation principle may depend on the type of corporation.

Obviously, taking all of these factors into account at once might yield an extremely complex and unwieldy form of statutory appraisal right. Even more than this, it would appear that the question of what constitutes an optimal statutory appraisal form cannot be determined from pure theory alone. The answer will depend on several matters that are fundamentally empirical: the degree of opportunism in the marketplace; the extent to which legal and market constraints operate to prevent opportunism; the extent to which a rule of unequal sharing is necessary to encourage productive fundamental changes; the magnitude of negotiating, monitoring, enforcement, and other transaction costs

²⁰² The distinction between awarding a post- and a pre-fundamental change value is not a distinction between looking backward and looking forward. Valuation is always looking forward, projecting a stream of enterprise earnings and applying an appropriate discount rate. The crucial difference between the two methods is the selection of the notional enterprise of which the dissentient shareholder is taken to be a part; that is, the pre- or post-fundamental change enterprise.

under each rule. Variation in any of these parameters may produce widely differing results.

These are matters about which little hard (or at least systematic) empirical evidence exists. However, there is an important source of indirect evidence about the relative weights of these factors; private ordering arrangements in the marketplace. If appraisal rights are an efficient feature of the shareholder's financial contract, we would expect to see them introduced in an attempt to reduce the cost of capital. By the same mechanism, we might gain some insights into the optimal form of the discrimination principle and hence the appropriate method of valuing dissentient shares on an appraisal. Other insights may be gained from the empirical investigations of economists.

C. *The Evidence from the Market*

The record from the market is less than it might be. At common law, the rule in *Trevor v. Whitworth*²⁰³ made it impossible for a corporation to repurchase its issued shares. This foreclosed the opportunity of offering appraisal rights. At the same time that this prohibition was lifted in Canada, mandatory appraisal rights were enacted in many Canadian jurisdictions. Thus, there is little opportunity to observe the market-generated contract.

This does not mean, however, that there is no market record at all to consult. The federal legislation and cognate statutes allow for contracting out of the appraisal requirement in some situations. Further, although the statutory appraisal rights are otherwise mandatory, it is possible for a corporation to offer appraisal rights where not mandated by statute.

The difficulty is that no systematic evidence exists to indicate the frequency of contracting out, nor as to how often appraisal rights are voluntarily given where not mandated. Anecdotal evidence suggests, at least, that contracting out is not an infrequent event. Such evidence also indicates that corporations sometimes offer appraisal rights where not mandated by statute.²⁰⁴ However, the implications of the latter type of event are not entirely clear; such occurrences may be a response to purely market forces, or an attempt to conform to perceived *legal* norms, which may or may not be efficient.²⁰⁵

²⁰³ (1887), 12 App. Cas. 409 (H.L.).

²⁰⁴ See, for example, *Stevens v. Home Oil Co. Ltd.* (1980), 123 D.L.R. (3d) 297, 28 A.R. 331 (Q.B.) (transaction made conditional upon majority of the minority approval although not required by statute).

²⁰⁵ One might look also to bond covenants to see if appraisal rights are a common feature of trust indentures. Since debt holders are protected in the main by contract rather than by statute, the debt relationship may yield clues as to the optimal form of shareholder financial contract. Although bondholder votes are frequently required in respect of recapitalizations or changes in the terms of outstanding bonds, appraisal rights in favour of dissentient bondholders are rarely if ever observed.

This evidence must be used with extreme caution, however. Debt holders, in contrast to share-

It may be significant that the rule in *Trevor v. Whitworth* persisted for as long as it did without change. If there is some tendency in the common law towards efficiency,²⁰⁶ and appraisal rights are an efficient feature of a shareholder's financial contract, one would anticipate a much shorter life for the rule in *Trevor* than was in fact the case.²⁰⁷

Other evidence suggests that in most cases the optimal valuation objective for the appraisal right will be pre-transaction market value. Empirical investigations of such phenomena as going-private transactions, mergers, takeover bids, jurisdictional moves, spin-offs, and sell-offs confirm that on average these transactions generate real economic gains and are not merely instances of redistribution effected by opportunistic insiders.²⁰⁸ While not all individual transactions generate gains, and

holders, are not residual claimants, and, as a result, the value of an appraisal right in favour of bondholders may differ from the value to shareholders. Further, the nature of bondholder-shareholder conflicts of interest, while in some ways similar to shareholder-shareholder conflicts, may be sufficiently different to render direct comparisons misleading. Equally importantly, bond covenants are typically enforced by the indenture trustee, surmounting the collection action problem. Many of these bond covenants protect bondholders against change in the risk of the investment and indirectly influence the firm's investment decisions, perhaps rendering the appraisal right a superfluous protection. See, for example, Smith & Warner, *supra*, note 20; A. Barnea, R.A. Haugen & L.W. Senbet, *Agency Problems and Financial Contracting* (Englewood Cliffs: Prentice Hall, 1985).

Thus, the absence of appraisal rights in bond covenants is at best merely *suggestive* evidence, and far from conclusive of the absence of an efficiency rationale to the shareholder appraisal right.

²⁰⁶ G.L. Priest, "The Common Law Process and the Selection of Efficient Rules" (1977) 6 J. Leg. Stud. 65; P.H. Rubin, "Why is the Common Law Efficient?" (1977) 6 J. Leg. Stud. 205; R. Posner, "A Reply to Some Recent Criticisms of the Efficiency Theory of the Common Law" (1981) 9 Hofstra L. Rev. 775. See, however, Priest & Klein, *supra*, note 155 throwing some doubt on the efficiency theory.

²⁰⁷ The Ontario legislation of 1882 did in fact allow for share repurchase, but only with approval of a company-wide supra-majority. *An Act to Confer Additional Powers upon Joint Stock Companies*, 45 Vict., c. 17, s. 9. This provision was soon merged with the provisions allowing for a reduction of capital, which could only be effected with *both* shareholder supra-majority approval and supplementary letters patent. The repurchase provision reappeared in truncated form in 1900 in *An Act to Amend The Ontario Companies Act*, 63 Vict., c. 23, s. 2. This *Act* allowed the repurchase of preference shares, again only upon approval of a supra-majority of shareholders and with supplementary letters patent, in addition to a determination by the Provincial Secretary that the repurchase was "bona fide in character." This provision was in turn merged with the reduction of capital provision in the statute. Thus, while share repurchase continued to be possible in the Ontario (as it was in the federal) legislation, this was so only through the reduction of capital provisions with demanding mandatory shareholder protections. Thus, share repurchase was not possible as a normal incident of corporate management. The *CBCA* and cognate statutes presently allow share repurchase limited only by solvency tests (*CBCA*, *supra*, note 1 at ss. 32-33; *OBCA*, *supra*, note 2 at ss. 30-31).

Those who use the efficiency theory to buttress the argument in favour of the efficiency of the appraisal right bear the burden of explaining why American corporate law generally permitted appraisal rights while Commonwealth law did not. See Fischel, *supra*, note 10 at 881-82.

²⁰⁸ See, for example, DeAngelo, DeAngelo & Rice, *supra*, note 78 (going private transactions); Romano, *supra*, note 110 (changes in jurisdiction); P. Dodd, "Merger Proposals, Management Discretion, and Stockholder Wealth" (1980) 8 J. Fin. Econ. 105 (mergers); Eckbo, *supra*, note 73 (mergers); Jensen & Ruback, *supra*, note 73 (changes in corporate control); K. Schipper & A. Smith, "Effects of Recontracting on Shareholder Wealth: The Case of Voluntary Spin-offs" (1983) 12 J. Fin. Econ. 437 (spin-offs); A. Klein, "Voluntary Divestitures: Motives and Consequences" (Ph.D. dissertation, U. of Chicago, 1983) [unpublished] (sell-offs and spin-offs).

some (like “shark repellent” charter amendments) appear to generate losses more frequently than gains,²⁰⁹ there is little in the finance literature to suggest that appropriation of hidden values is the key impetus behind a wide variety of fundamental changes. Of perhaps even greater interest, these same empirical investigations suggest that minority shareholders frequently participate in the synergies or other gains generated by these transactions by virtue of the terms offered them in the transaction.²¹⁰ To the extent that this is true, a valuation objective that includes a calculation of transaction synergies (whether out of a concern to protect appropriation of hidden values, from notions of what constitutes fair treatment of minority shareholders, or otherwise) may be entirely unnecessary or even lead to double counting of transaction synergies in favour of dissenting shareholders. If the latter is true, the appraisal right will only serve as an invitation to opportunism for minority shareholders, who will find it worth their while to dissent only to capture a greater portion of the gains. This in turn will reduce the probability that productive fundamental changes will occur.²¹¹

D. The Menu Approach

What evidence there is from the market does not, therefore, strongly confirm the value of the appraisal right.²¹² Neither does the market suggest a valuation objective more favourable than pre-transaction market value if the appraisal right is an efficient shareholder protection. However, a statutory appraisal right might be capable of curing some of the deficiencies that stand in the way of an effective market-generated appraisal right or one with a valuation objective extending to hidden values or transaction synergies. In an unregulated market, appraisal rights might fail to develop only because the costs of exercise, as well as the difficulties of drafting and valuation, may overwhelm any benefits achieved by the right. Drafting a valuation rule is a difficult task that is

²⁰⁹ See *supra*, notes 80 and 82.

²¹⁰ See *supra*, note 208.

²¹¹ The evidence also suggests that in some transactions (like negotiated mergers) one party to the transaction may capture all the gains which arise; indeed, in a competitive market for corporate acquisitions, one would expect all the gains to go to the “acquired” firm (whether pursuant to a negotiated acquisition or not). See Jensen & Ruback, *supra*, note 73. In these transactions especially, awarding dissenting shareholders an appraised “fair value” that includes an assessment of transaction synergies will only encourage withholding of approval by individual shareholders in an attempt to secure a higher payoff. Such an award would be difficult to justify under either the bailout or anti-discrimination rationales. See also K. Schipper & R. Thompson, “The Impact of Merger-Related Regulations on the Shareholders of Acquiring Firms” (1985) 23 J. Acct. Res. 184; K. Schipper & R. Thompson, “The Impact of Merger-Related Regulations Using Exact Distributions of Test Statistics” (1985) 23 J. Acct. Res. 408.

²¹² This might be so for a number of reasons: where, for example, the degree of opportunistic behaviour engaged in by shareholding majorities is not great, where other legal remedies (or the market) are an adequate answer to problems of opportunism, where the costs of the appraisal right (to shareholders and to the company) overwhelm any gains which arise, or where there is some combination of these or other factors.

very often not something with which public accountants or corporate lawyers feel comfortable. Establishing procedures for carrying out the valuation may be both cumbersome and expensive. The benefits of contracting to an appropriate appraisal right and providing suitable mechanisms to secure effective implementation may not justify the effort.

These infirmities could be overcome by the provision of a number of "off-the-rack" statutory standard forms with streamlined, low-cost procedure and reliable, expert valuation. Providing more than one statutory standard form may serve a wider range of interests than is presently served by the unitary and mandatory statutory appraisal right. In addition, it may achieve, by lowering the costs of the appraisal procedure, what private ordering is unable to do. At the very least, presenting the option of selecting from amongst a number of statutory standard forms can do little *harm*. If the appraisal right has little or no value (or is actually harmful), a corporation may simply stipulate in its constitutional documents that no appraisal right will be available.

These statutory standard forms might be cast as follows. Where a claim is made under the basic appraisal provision in respect of all public corporations and all types of fundamental transactions, and without considering the rationale under which the right is claimed, the appraisal valuation should yield only a pre-transaction market price exclusive of any hidden values or transaction synergies. However, this statutory right should be permissive in character. An alternative menu of valuation options should be made available for adoption if desired. One option would include in the appraised fair value any hidden values arising from the transaction.²¹³ Another would include hidden values and a *pro rata* share of transaction synergies; only this valuation principle seeks to ensure full substantive equality of treatment. Any corporation would have the option of selecting any (or none) of the statutory valuation procedures or any other valuation procedure in respect of any type of fundamental change. The costs of so doing would be minimal since the statutory procedure would specify the valuation objective and procedure, and the preferred rule would only need to be incorporated by reference into the corporation's constitution.

Where the baseline valuation technique selected by the corporation departs from a pre-fundamental change value, an additional election could be made in the corporation's constitutional documents, permitting shareholders to select a valuation based on pre-fundamental change value. This would protect against discrimination while preserving the ability of shareholders to elect the bail-out alternative.

Thus, in every case, an appraisal procedure could be tailored to the transaction and corporation type, permitting the valuation objective to vary depending on the rationale under which the right is claimed.

²¹³ Thus, the valuation tribunal would be called upon to ferret out and evaluate any inside information bearing on security value as opposed to merely assessing publicly available information.

Where a case of oppression is made out, the court ought to be given discretion to apply whatever valuation objective it chooses based on the factors enumerated above, unless the parties have foreclosed the issue by appropriate private ordering arrangements. This recognizes the fact that parties cannot be expected to draft complete contingent contracts determining the outcome in every possible event of discrimination, even where the statutory standard form makes contracting cheaper and easier. The oppression provision should therefore be seen as supplying a *residual* category of appraisal event.

With respect to private companies, all of the valuation objectives available to public companies should be equally available. However, given the probable expectations of shareholders in most private corporations, the "default" rule (that which applies if the articles are entirely silent on the question of appraisal rights) would be a valuation yielding full substantive equality of treatment for all transactions, irrespective of the rationale under which the right is claimed and whether it is claimed under the basic appraisal or oppression provision. Because of the likelihood of unwise or opportunistic fundamental changes that have the effect of diminishing enterprise value, shareholders should presumptively be given the ability to elect pre-transaction market value. Again, the basic statutory appraisal provision would be permissive in character, allowing for contracting out.

Thus, the question of the appraisal right's efficiency and of the optimal form of valuation principle would be left, in most cases, in the market itself. The statutory provision would serve an *enabling* function, assisting private ordering by reducing the transaction costs of arriving at a specific contractual outcome.

VIII. CURRENT VALUATION PRACTICE IN CANADA

A. *General: Valuation Objective*

The *CBCA* extends an appraisal right to shareholders irrespective of whether or not there is a public market for the company's shares. No distinction is made in the valuation objective as between public companies with deep markets, public companies with thin markets, and private companies. Nor is any distinction in valuation objective made between different types of fundamental changes or different reasons for claiming the appraisal right.

The statute as enacted in 1975 entitled the dissenting shareholder to fair value, excluding any value reasonably attributable to the anticipated adoption of the resolution affirming the fundamental change.²¹⁴ The statute was amended in 1978 to entitle the shareholder to fair value "determined as of the close of business on the day before the resolution was

²¹⁴ S.C. 1974-75, c. 33, s. 184(3).

adopted or the order was made.”²¹⁵

As originally enacted, the statute was responsive to one of the most potent reasons for having an appraisal right in the public corporations context—the inadequacy of the market exit option where stock prices adjust too quickly for shareholders to avoid the market’s unfavourable verdict on the proposed fundamental change. The 1978 amendment results in a failure of the appraisal right to wash out the drop in price from the appraised value.²¹⁶

Interestingly, the change was made with a view to benefitting shareholders by enabling them to participate in any anticipated value generated by the transaction.²¹⁷ Unfortunately, the amendment fails to recognize that the valuation objective may vary depending on the rationale under which the appraisal right is claimed.²¹⁸ Neither the statute as originally drafted nor the amendment gives the court the flexibility it needs to respond to this factor. Since the provision is mandatory, there is no option of contracting around the specific valuation objective to yield the desired form of protection.²¹⁹

²¹⁵ S.C. 1978-79, c. 9, s. 60(2).

²¹⁶ That is, assuming that the valuation date necessarily determines the valuation objective to be used—an assumption that the drafters of the statute appear to have implicitly adopted but one that does not necessarily follow as a matter of logic. See *infra*, notes 241-42 and accompanying text.

²¹⁷ The change appears to have been a response to a rash of freezeout amalgamations and the failure of the statute as originally drafted to allow the forcibly cashed-out minority to participate in the anticipated gains of the transaction. See, for example, comments of Bouck J. on point in *Neonex International Ltd. v. Kolasa*, *supra*, note 145. See also *LoCicero v. B.A.C.M. Industries Ltd.*, *supra*, note 154 (decided under a statute identical to the *CBCA* as originally drafted, and refusing to add anticipated tax savings to appraised value). The amendment essentially restored the provision of the Draft Bill of the Dickerson Committee, which would have provided that fair value be “determined as of the day before the resolution was adopted by the shareholders of the corporation” (see *supra*, note 3 at cl. 14.17(3)). In contrast to the basic appraisal right under s. 184 of the *CBCA*, *supra*, note 1, the compulsory acquisition provision (s. 199) does not indicate a valuation date. Two western cases have reached different conclusions as to whether transaction synergies are to be included in the valuation. See *Canadian Gas & Energy Fund Ltd. v. Sceptre Resources Ltd.*, *supra*, note 107 (holding that the value of a dissenter’s shares should reflect the value of the *pre*-transactional entity, thereby excluding transaction synergies); *Cyprus Anvil Mining Corporation v. Dickson* (1982), 40 B.C.L.R. 180, 20 B.L.R. 21 (B.C.S.C.) (holding that the fair value of the dissenter’s shares should be based on the value of the corporation’s properties when combined with the operations of the acquiror, and hence including transaction synergies). See also *Re Ripley International Ltd.*, (1977), 1 B.L.R. 269 (Ont. H.C.) (denial of approval for statutory arrangement because of the failure of the scheme to allow the cashed-out minority to participate in anticipated tax savings); *Re Mason and Intercity Properties Limited*, *supra*, note 188 (an oppression case in which an appraised buyout of the petitioner’s shares was ordered “at a fair value” but “with nothing added for denial of opportunity to participate in future growth” because the petitioner was found to be “to some degree the author of the awkward predicament in which she finds herself”; *ibid.* at 11). See also *infra*, note 229 and accompanying text, and *OBCA*, *supra*, note 2 at s. 189(2)(a) (apparently excluding transaction synergies from the valuation required for a going-private transaction).

²¹⁸ See Parts III and IV, *supra*.

²¹⁹ The availability of the appraisal right is not made subject to the articles or by-laws or to a unanimous shareholder agreement as are other provisions in the statute. See, e.g., *CBCA*, *supra*, note 1 at ss. 97, 98, 133. Nevertheless, at least one court has held that where a private agreement specifies

If the recommendations respecting the valuation objective suggested earlier were adopted, the default rule in all cases involving public corporations would be a non-sharing rule based on pre-transaction market value. In all cases involving private corporations, the default rule would be full gain sharing (while permitting the shareholder to elect the pre-transaction alternative). However, flexibility is achieved by allowing any corporation to stipulate in its constitutional documents that a different valuation principle be used (or that there be no appraisal right at all) in some or all transactional circumstances or by enabling shareholders to elect a specific valuation objective.

B. Public Companies with Deep Markets

As noted above, one of the criticisms of the appraisal right in the context of public companies with deep markets is that "in the end [the shareholder] will be awarded the market price of the shares. He could have gotten that in the first place by the rather simpler method of calling his broker."²²⁰ The few decided cases in Canada in the context of large public companies do indicate an inclination to award market price.²²¹

When we recall the rationales underlying the appraisal right, however, it is plain that this criticism misses the point. Where the right is invoked under the bail-out rationale, awarding a current market price will prove an inadequate protection owing to the rapid adjustment of security prices to the announcement of the change. Similarly, where the right is claimed under the anti-discrimination rationale, the market price will reflect the anticipated effects of the discrimination on security prices.

However, it is unnecessary to abandon market price as an indication of value. Indeed, if the anticipated effects of the change can be isolated and removed, the market price that prevailed before the fundamental change was announced is the most reliable gauge of value for widely traded public corporations. As Fischel has suggested,²²² sophisticated econometric techniques can be used to "reconstruct" a putative market price as of the valuation date absent the effects of the proposed fundamental change by using the market price of the shares before any public announcement of the change and projecting this price forward to the val-

the procedure for valuation, that procedure pre-empts a court determination of fair value. See *MICA Management v. Lockett* (1986), (Ont. S.C.) [unreported]. However laudable the result, *quaere* if the court read the statute correctly.

²²⁰ Manning, *supra*, note 10.

²²¹ *Re Montgomery and Shell Canada Ltd.* (1980), 111 D.L.R. (3d) 116 (Sask. Q.B.) (awarding market price under s. 184 of the *CBCA*, *supra*, note 1 to a petitioner in the context of a large public company where a class of shares superior to those of the petitioner were created); *Lough v. Canadian Natural Resources Ltd.* (1983), 45 B.C.L.R. 335 (S.C.) (following *Montgomery* and awarding market price under s. 231 of the *B.C. Company Act*, *supra*, note 9 on a continuance in a new jurisdiction, again in the context of a large public company with a reasonably deep market). See also *Canadian Gas & Energy Fund Ltd. v. Sceptre Resources Ltd.*, *supra*, note 107 (using market price mainly, but not exclusively, to calculate fair value).

²²² Fischel, *supra*, note 10.

uation date.²²³

Where pre-transaction market value is the relevant valuation objective, this reconstructed price should be determinative of the cash-out price. Where the valuation objective extends to an assessment of hidden values or transaction synergies, unless there exists inside information showing the shares to be worth less than the market price,²²⁴ the reconstructed market price should serve as a baseline or minimum value to which the hidden values or transaction synergies are added.

C. Public Companies with Thin Markets

As a general matter, the observations about public companies trading in liquid markets apply to public companies trading in thin markets. However, in respect of the latter, market price cannot be relied upon as a completely reliable barometer of value. Thus, the appropriate valuation technique may involve supplementing the information supplied by the market price with a capitalization of anticipated earnings or, if there is an imminent probability of winding up, a calculation of net asset value.²²⁵

Canadian courts have tended to resort almost exclusively to the capitalization of earnings technique where the company's securities are traded in a thin market.²²⁶ These valuations invariably exceed the market price. Most courts in valuing minority shareholdings have not made any discount from a *pro rata* participation in the going-concern value of the enterprise;²²⁷ this is so even where the dissenters bought those shares at a market price that incorporated a minority discount.²²⁸ Further, in at

²²³ In *Canadian Gas & Energy Fund Ltd. v. Sceptre Resources Ltd.*, *supra*, note 107, the court used a pre-announcement date market price to assist it in determining the fair value of the dissenters' shares on a compulsory acquisition under s. 199 of the *CBCA*, *supra*, note 1. In some situations it may not be adequate protection to award a market price calculated *immediately* before the first public announcement of the fundamental change; many event studies show that the price adjustment begins before and is largely complete by the time of the first public announcement—owing, in many cases, to advance leakage of information and possibly insider trading. See, e.g., Fama *et al.*, "The Adjustment of Stock Prices to New Information" (1969) 10 *Int. Econ. Rev.* 1; Jarrell, "Stock Trading Before the Announcement of Tender Offers: Insider Trading or Market Anticipation" (1987) [unpublished]. Regression techniques are available for isolating with a fair degree of accuracy the time at which information first started to "leak" into the market; it is this price, free from the anticipated effects of the fundamental change, which should be projected forward to the valuation date in reconstructing market price.

²²⁴ The probability of this is likely to be quite small. Were the shares worth less than the market price, management would have an incentive to release the information bearing on value in order to secure approval of the fundamental change and to avoid dissent.

²²⁵ A valuation by means of the net assets technique must include an assessment of break up, sale, and distribution costs. See *obiter* comments in *Re Domglas Inc.*; *Domglas Inc. v. Jarilowsky*, *supra*, note 137; *Re Montgomery and Shell Canada Ltd.*, *supra*, note 221.

²²⁶ *Re Wall & Redekop Corp.*, *supra*, note 143 (freezeout amalgamation); *Re Whitehorse Copper Mines Ltd.*, *supra*, note 98 (compulsory acquisition); *Les Investissements Mont-Soleil Inc. v. National Drug Limited*, *supra*, note 148 (freezeout amalgamation); *LoCicero v. B.A.C.M. Industries Ltd.*, *supra*, note 137.

²²⁷ *Ibid.*

²²⁸ If minority interests are worth less than a controlling interest, this will be reflected in the

least three cases involving freezeout amalgamations, the courts have applied a 10 to 20 percent premium as compensation for forcible taking without application of a minority discount.²²⁹ Two of these cases have also allowed shareholders to participate in transaction synergies.²³⁰ In one case the court stated that the market price of the shares sets a price below which the court will not go in making an appraisal of their value.²³¹

The valuation techniques and objectives applied by the courts in valuing the shares of thinly traded public companies are flawed in a number of respects. Too little attention is paid to market price. In an efficient market, the market price of thinly traded companies may temporarily deviate from the equilibrium price, but these fluctuations should nonetheless *centre* on the equilibrium price. Thus, the market price is still a potent indication of value.

It is incorrect to add a premium for forcible taking. In some cases involving forcible taking of property (especially real estate), a premium on account of the forcible taking is appropriate where there is a significant likelihood of a sentimental or personal value in the property taken (that is, the expectation that there will be a "consumer surplus").²³² The value of an *investment* is precisely its sale value; investors do not generally hold securities because of a sentimental or personal attachment to a particular company. Even allowing for such interests in the extraordinary case, the relative rarity and probable lack of intensity of the sentimental interest and the added difficulty and cost of accounting for these attachments (particularly given their necessarily subjective nature) argue strongly in favour of ignoring such interests as a general, if not absolute, rule in share appraisals.²³³

price at which the stock trades in public markets. See, e.g., comments of Greenberg J. in *Domglas*, *supra*, note 137, at 13 B.L.R. 171.

²²⁹ *Re Domglas Inc.; Domglas Inc. v. Jarislowsky*, *supra*, note 137 (20 percent); *Les Investissements Mont-Soleil Inc. v. National Drug Limited*, *supra*, note 148 (20 percent); *LoCicero v. B.A.C.M. Industries Ltd.*, *supra*, note 137 (10 percent).

²³⁰ See *Domglas* and *Les Investissements*, *ibid.* In respect of participation in transaction synergies, see *supra*, note 217 and accompanying text.

²³¹ *Domglas*, *ibid.* See also *LoCicero v. B.A.C.M. Industries Ltd.*, *supra*, note 137.

²³² See J.L. Knetsch & T.E. Borchering, "Expropriation of Private Property and the Basis for Compensation" (1979) 29 U.T.L.J. 237. Nevertheless, enactments allowing for an expropriation of real property do not typically allow for an expropriation premium. See, e.g., *Expropriation Act*, R.S.O. 1980, c. 148; *Expropriation Act*, R.S.C. 1970, C-16 (1st Supp.). See also *Drew v. The Queen* (1961), 29 D.L.R. 114, [1961] S.C.R. 614.

²³³ In *Re Shoppers City Ltd. and M. Loeb Ltd.* (1968), [1969] 1 O.R. 449 (H.C.), Stark J. rejected a personal or sentimental attachment as a reason for blocking a compulsory acquisition. A shareholder testified that the thirteen shares he held were a Christmas present from his wife, and that he planned to give them to his three-year-old son on his twenty-first birthday. According to Stark J.: "Such a reason is no doubt a very satisfying one as far as the individual is concerned but it is not one to which, on my reading of the cases, I could properly consider" (*ibid.* at 454). The facts in this case illustrate the difficulties (and potential abuses) recognition of such interests would create. See also *Re Grierson, Oldham & Adams Ltd.* (1966), [1968] Ch. 17 at 32; *Re Mason and Intercity Properties*

As suggested earlier, if the market exacts a minority discount (and the shares were purchased subject to the market discount), a court should do the same. To do otherwise confers an unbargained-for windfall on the dissentient shareholder.²³⁴

Arguably, there is a sort of “rough justice” in awarding a *pro rata* share of capitalized earnings value and adding an eviction premium in cases involving freezeouts. If the valuation objective extends to a calculation of hidden values or transaction synergies, the imponderables of these calculations may lead to a systematic under-assessment that is thereby partly corrected. However, the valuation objective will not *always* include an assessment of hidden values or transaction synergies.²³⁵ Further, a product of the rough justice approach may be systematic *overcompensation* of appraisal claimants even where a broader valuation objective is indicated, resulting in excessive use of the appraisal right and a corresponding discouragement of fundamental changes. It is better to improve both the theoretical and practical accuracy of the accounting process by clarifying the valuation objective and fashioning procedures that are designed to make achievement of that objective possible.

D. Private Companies

Private companies present the greatest conceptual and practical difficulties for the valuation of minority shareholdings. Many small, private corporations are essentially incorporated partnerships; shareholders are often actively involved in the management of the corporation, and the shareholders’ and managers’ mutual trust and confidence is an important part of the relationship of the corporate constituents. It is commonplace that in large, public corporations management and ownership are divorced; in a small, private concern they are frequently wedded. Usually, there are strict restrictions on the transferability of shares in order to recognize and accommodate the interest of those who continue in the enterprise in selecting new “partners.”²³⁶ Even where the continuing shareholders are receptive to admitting new partners, it will often be difficult to find those willing to consign their money to an unknown enterprise run by persons who are strangers. Thus, there is no “market” for the corporation’s securities in any conventional sense and no “market” price to use as a benchmark of value.

Limited, *supra*, note 188. Nevertheless, in *In The Matter of M. Loeb Limited*, *supra*, note 10, the Ontario Securities Commission took into account the professed sentimental attachments of minority shareholders in refusing a request for an exemption from the OSC’s requirement for a majority of the minority approval in a case of a going-private transaction.

²³⁴ See *supra*, notes 226-27 and accompanying text.

²³⁵ Under the baseline valuation rule above, the court would not calculate either of these values.

²³⁶ There may, of course, be other reasons for restrictions on transfer such as securing statutory rights or exemptions accorded only to “private” companies. See, e.g., *Ontario Securities Act*, *supra*, note 16 at s. 1(1)(31).

It is therefore necessary to value the dissenter's securities by capitalizing a projected stream of enterprise earnings and to determine the dissenter's share of enterprise value on this basis. This is often an exceedingly difficult task. It may be impossible to find similar companies for the purpose of making earnings and cost of capital comparisons and projections given the differentiated nature of the businesses of small private companies.

Whether a minority discount should then be applied to the shares is also a difficult issue. The answer will almost never be as straightforward as with a publicly traded company and will tend to be highly fact-specific. A number of factors will be important. If it can be determined that the shareholder bought into the enterprise at a minority discount, receiving a *pro rata* share of going concern value might confer a windfall—whether the reason for cashing out is oppressive or opportunistic conduct of other shareholders or a disagreement about the conduct of the business. On the other hand, if the shareholder was a founding member of the company and the reason for leaving is oppressive conduct on the part of other shareholders, awarding a *pro rata* share of enterprise value might be more appropriate. The distinction between these two cases centres on the differences in shareholder expectations. In the latter situation, the shareholder explicitly or implicitly expects to remain in the company for the long haul and to benefit *pro rata* in any increase in enterprise value. Although a sale of the shares to an arm's length third party might not be possible without a minority discount, the sale would not, in the normal course of events, have occurred but for the oppressive conduct. Hence, sale value is not the relevant standard. In the former case, awarding a *pro rata* share of enterprise value would confer a windfall gain on the shareholder. The above distinctions are precisely those adopted by the English Chancery Court in *Re Bird Precision Bellows*,²³⁷ which also sensibly suggests that if the petitioner has done something to justify his or her exclusion from the company by the other shareholders, this may be a good reason for applying a minority discount.

Although the Canadian courts have generally adopted a capitalization of earnings approach in valuing the shares of private corporations,²³⁸ they have not been unanimous on the issue of a minority discount. Nor have their decisions been as successful as *Re Bird* in clarifying the relevant factors. Some courts have drawn a distinction based on whether the *actual* purchaser of the shares (pursuant to the court order to purchase) is *buying into* a minority shareholding. Where this is not the case, these

²³⁷ *Supra*, note 136.

²³⁸ See, e.g., *Kummen and Kummen v. Kummen-Shipman Ltd., Kummen and Kummen* (1983), [1983] 2 W.W.R. 577 (Man. C.A.); *Re Johnston and West Fraser Timber Co. Ltd.*, *supra*, note 135; *Re Bird Precision Bellows Ltd.*, *supra*, note 136; *Diligenti v. RWMD Operations Kelowna Ltd. (No. 2)*, *supra*, note 135. See also *Re National Building Maintenance Ltd.* (1970), [1971] 1 W.W.R. 8 (B.C. S.C.), purporting to adopt a "liquidation" measure of value but appearing to employ a capitalization of earnings approach.

courts have ruled that a minority discount is inappropriate.²³⁹ Other courts have applied a minority discount.²⁴⁰

A more satisfactory approach would be to consider the circumstances in which the shareholder bought or otherwise acquired the shares, the rationale under which the right is claimed, and, in general, any other factors that might bear on shareholder expectations.

Of course, these difficulties might be cured by explicit party stipulation or by statutory provision. In respect of the former, it is interesting that a method occasionally chosen for cash-out valuation in private corporations, where relevant arrangements have been drafted into the constitutional documents or shareholder agreements, is valuation based on book value. The dependency of book value on historical cost-accounting data virtually assures that this method will undervalue the shares of the departing shareholder. There is little doubt that book value is sometimes chosen as a valuation technique because its sheer simplicity avoids an expensive valuation and because corporate lawyers and accountants feel ill-equipped to draft or to perform valuations based on earnings capitalizations. This should not be taken as conclusive proof that book value is the optimal valuation rule; book value is clearly the favoured valuation technique. Further, as indicated earlier, one of the virtues of a statutory valuation procedure (complete with an expert valuation tribunal) is to improve upon private-ordering arrangements by supplying a reliable low-cost valuation mechanism that private-ordering arrangements could not produce because of the costs involved.

It was suggested earlier that the presumptive statutory standard

²³⁹ In *Diligenti v. RWMD Operations Kelowna Ltd. (No. 2)*, *ibid.*, the court ordered the company to purchase the petitioner's shares in an oppression action without exacting a minority discount, commenting that:

the result [of the purchase] will be that existing shareholders will simply consolidate their positions. They do not become minority shareholders as a result of the purchase—they are already, as individuals, minority shareholders; in this case they become holders of one-third of the shares instead of one-quarter. Their position in relation to each other is not changed.

(*ibid.* at 166). Other courts have adopted the reasoning in the *Diligenti* case: see *Re Abraham and Inter Wide Investments Ltd.* (1985), 51 O.R. (2d) 460 (H.C.) (an oppression case in which the company was ordered to buy out the minority shareholder complainant); *Kummen and Kummen v. Kummen-Shipman Ltd., Kummen and Kummen*, *ibid.* (oppression action in which majority shareholder was ordered to buy out the single minority shareholder). See also *Re National Building Maintenance Ltd.*, *ibid.* See also *OBCA*, *supra*, note 2 at s. 189(2)(b), and *Regulation Made Under the Securities Act*, R.R.O. 1980, Reg. 910 (as amended), s. 164(1)(c) (in each case, requiring that the independently prepared valuation for purposes of a going-private transaction not reflect a minority discount).

²⁴⁰ *Re Mason and Intercity Properties Limited*, *supra*, note 188 (an oppression case in the context of a private family corporation awarding a minority discount on the somewhat cryptically stated grounds that “[o]therwise the court would not only be correcting an intolerable situation but would be going further and confer a benefit not being enjoyed by the majority”; *ibid.* at 11); *Irwin v. D.W. Coates Enterprises Ltd.* [1985] 3 W.W.R. 765 (B.C.C.A.) (upholding the decision of an arbitrator under a buy-sell agreement to exact a minority discount); *Re Johnston and West Fraser Timber Co. Ltd.*, *supra*, note 135 (oppression).

form valuation objective ought to be one of full gain sharing for private corporations. This standard form of appraisal right might also presumptively require that no minority discount be exacted on the appraisal valuation (a result contrary to that in the public corporations context) unless otherwise ordered by the court. This would appear to best conform to the most usual expectation of shareholders in private corporations while leaving room for argument, based on the factors enumerated above, that a minority discount is appropriate. As usual, the parties would be free to alter this presumption by express provision.

E. Valuation Date

As noted above, the *CBCA* and cognate statutes instruct the court to fix fair value at the close of business on the day before the resolution approving the fundamental change is adopted.²⁴¹ It would be more appropriate to fix the valuation date at the time when the shareholder, having claimed the right, loses rights as a shareholder and is entitled only to a payment of interest on the appraised value of the shares. Since this date might vary for shareholders claiming the right,²⁴² convenience suggests that a valuation date be fixed at the end of the period during which they lose their rights as shareholders.²⁴³

F. The Effect of Insider Trading on the Existence of a Control Position on Valuation

It has sometimes been asserted that the value of the appraisal right lies in the fact that values in the stock market do not necessarily correspond with intrinsic value.²⁴⁴ Thus, R.M. Buxbaum has suggested that a good reason for eliminating the "public market" exception seen in a number of American statutes "lies in the retreat from the sanctity of a

²⁴¹ See *supra*, note 215 and accompanying text.

²⁴² See *supra*, note 130.

²⁴³ Although this might appear to suggest that transaction synergies necessarily be included in fixing fair value, this is not the case. There is no necessary connection between when the date for the valuation is fixed and whether the valuation is based on pre- or post-transaction value. For example, if the valuation date is fixed at a point one month after the approval of the transaction, a pre-transaction share value can be computed by using a pre-announcement date market value and using widely accepted statistical techniques to construct a putative share price at the valuation date. See *supra*, notes 220-24 and accompanying text. The valuation date indicated in the text is chosen so as to avoid any sterilization of the shareholder's investment between the valuation date and the time when the shareholder loses his or her rights as a shareholder.

²⁴⁴ See, e.g., Chertkow, *supra*, note 148; B.L. Welling, *Corporate Law in Canada: The Governing Principles* (Toronto: Butterworths, 1984) at 545, 554 n.338; J.E. Magnet, "Shareholders' Appraisal Rights in Canada" (1979) 11 *Ott. L. Rev.* 98 at 106; R.M. Buxbaum, "The Dissenter's Appraisal Remedy" (1976) 23 *U.C.L.A. L. Rev.* 1229 at 1247-79; M.A. Eisenberg, "The Legal Roles of Shareholders and Management in Modern Corporate Decisionmaking" (1969) 57 *Calif. L. Rev.* 1; Eisenberg, *supra*, note 38 at 81-82. Perhaps the most cogent statement of this position may be found in Note, "A Reconsideration of the Stock Market Exception to the Dissenting Shareholder's Right of Appraisal" (1976) 74 *Mich. L. Rev.* 1023.

stock exchange mechanism as a reflector of 'true' values. . . ."²⁴⁵ Those voicing this point of view usually attribute the failure of market price to reflect true values to distortions produced by insider trading, the existence of a large control position, thin trading, or simply the whimsy and caprice of the market, which responds randomly to events of uncertain purport. Indeed, the courts have tended to discount market price where there is some evidence of insider trading or the overhang of a control position, at least where the stock is thinly traded.²⁴⁶ This view is supportable only on the assumption that securities markets operate with pronounced inefficiency. As indicated above, these arguments are generally fallacious. Available evidence confirms the *efficiency*, not the *inefficiency*, of securities markets.

It is more correct to argue that market prices, while efficiently impounding publicly available information, do not reflect information that is available only to insiders. Insider information is, by definition, not publicly available and is not therefore reflected in the price established in public markets.²⁴⁷

The failure of the public price to reflect inside information is significant only where the valuation objective includes an assessment of hidden values. Even where hidden values form part of the assessment of fair value, the market price also supplies important evidence of value.

Nor is the fact of insider trading, by itself, likely to distort prices. Unless insiders are engaged in conscious market manipulation, the effect of insider trading is likely to improve rather than disturb the efficiency of the market-pricing mechanism.²⁴⁸ Since insiders possess more accurate information about intrinsic value than the market does, insider trading will push the market towards intrinsic value by sending it a signal about these hidden values.²⁴⁹ Thus, at most, the presence of insider trading should be the start of a further inquiry into whether there has in fact been *manipulation* of securities prices by means of the insider trading or, where hidden values form part of the valuation, *exploitation* of hidden

²⁴⁵ Buxbaum, *ibid.* at 1247.

²⁴⁶ *Re Whitehorse Copper Mines Ltd.*, *supra*, note 98; *Neonex International Ltd. v. Kolasa*, *supra*, note 145; *Re Wall & Redekop Corp.*, *supra*, note 143; *Re Domglas Inc.; Domglas Inc. v. Jarislowsky*, *supra*, note 137; *Les Investissements Mont-Soleil Inc. v. National Drug Ltd.*, *supra*, note 148; *Cyprus Anvil Mining Corp. v. Dickson*, *supra*, note 98. See also *Re Montgomery and Shell Canada Ltd.*, *supra*, note 221 (awarding market price where there was an active public market in the shares and no evidence of insider trading activity); *Lough v. Canadian Natural Resources Limited*, *supra*, note 221 (following *Montgomery* and using market value where active public market).

²⁴⁷ See *supra*, note 76 and accompanying text.

²⁴⁸ H.G. Manne, *Insider Trading and the Stock Market* (New York: Free Press, 1966); H.G. Manne, "Insider Trading and the Law Professors" (1970) 23 Vand. L. Rev. 547. But cf. M. Mendelson, Book Review (1969) 117 U. Pa. L. Rev. 470; J.A.C. Hetherington, "Insider Trading and the Logic of the Law" [1967] Wisc. L. Rev. 720; R.A. Schotland, "Unsafe at Any Price: A Reply to Manne" (1967) 53 Va. L. Rev. 1425.

²⁴⁹ This is not intended to constitute a normative argument in favour of insider trading, but purely a description as to the likely effects of insider trading in the absence of market manipulation.

values.²⁵⁰

The question of accounting for the effects of a control position is really the same as whether or not a minority discount is appropriate. As suggested earlier, in the case of publicly traded companies such a discount is appropriate.²⁵¹

The existence of a large control position may effect the price of the securities in public hands, but this is not evidence of a *distortion* in the price. It is clear that control shares are more valuable than non-control shares; this may reflect the ability to consume perquisites or an anticipation of being able to capture a premium price for the shares should there be a takeover or sale of control.²⁵² However, a shareholder who buys shares at a discount reflecting the existence of a control position will receive windfall compensation if a court, in valuing the securities, fails to apply a minority discount.

The existence of a control position, it is true, may substantially reduce the float of publicly traded securities and hence reduce the reliability of the market price. However, the only reason to discount market price as an indication of value in such a case would be because the float has been reduced to a point that renders the publicly traded price of questionable accuracy—and not because of the existence of a control position, *simpliciter*. In most public companies with dominant or controlling shareholders, the market float will still be quite sufficient to generate a reliable market price.²⁵³

IX. IN SEARCH OF A UNIFIED THEORY OF TRIGGERING EVENTS: A FEW PRELIMINARY THOUGHTS

Manning has forcefully suggested²⁵⁴ that those events which typically trigger the appraisal right²⁵⁵ arise from legal and constitutional con-

²⁵⁰ In an adversarial proceeding, the onus of disproving such manipulation might well be cast on those claiming the market price is a fair one, given that these parties will have monopoly access to the relevant information.

²⁵¹ Since the market is one of minority interests, using market price will automatically yield a minority discount.

²⁵² See, e.g., R.C. Lease, J.J. McConnell & W.H. Mikkelson, "The Market Value of Differential Voting Rights in Closely Held Corporations" (1984) 57 J. Bus. 443; R.C. Lease, J.J. McConnell & W.H. Mikkelson, "The Market Value of Control in Publicly Traded Corporations" (1983) 11 J. Fin. Econ. 439; H. Levy, "Economic Evaluation of Voting Power of Common Stock" (1983) 38 J. Fin. 79.

²⁵³ In *Re Montgomery and Shell Canada Ltd.*, *supra*, note 221, where the court awarded market price on an appraisal valuation, there was in fact a large control position (held by the parent of Shell Canada). Nevertheless, the court concluded that market price was an appropriate measure of value.

²⁵⁴ Manning, *supra*, note 10.

²⁵⁵ Manning had in mind American statutes with triggering events defined somewhat more narrowly than in the *CBCA* and cognate statutes, although the latter draw their inspiration and a good deal of their substance from the former. One noteworthy difference is the inclusion in Canadian statutes of changes in the primary constitutional document of the corporation as a triggering

siderations that have little to do with a unified or coherent conception of the appraisal right as a functional economic tool.²⁵⁶ If the appraisal right is regarded as protection against untoward events in the life of the enterprise potentially causing economic losses to the shareholder, then why, for example, should the signing of a potentially unfavourable collective agreement or a general decline in the stock market caused by threat of nuclear war not trigger the appraisal right?

There are unquestionably innumerable events in the life of the enterprise that may affect the value of the shareholder's investment, and the appraisal right is triggered by only a very few of these. In the main, it is substantial *structural* changes that trigger the appraisal right, such as an amalgamation, a sale of all the company's assets, or significant changes in the shareholder's financial contract with the company affected by alteration of the articles of incorporation.

The statutory selection of triggering events can easily be justified by reference to a small number of defining principles: the likely magnitude of the effect of the change on either the risk or expected return of the investment; the frequency of the event; the risks of opportunism accompanying the event; and the degree to which the company can affect the outcome of the event.

The greater the magnitude of the effect on risk or return, the more likely it is that shareholders will value the protection yielded by the appraisal right. The greater the frequency of the transaction, the greater is the nuisance and probable expense to the company of maintaining, in effect, a standing order to purchase. With greater risks of opportunistic redistribution accompanying the transaction, the value of the protection afforded shareholders by the appraisal right will be greater. Finally, to the extent that the company cannot affect the outcome of the event, the corporation may become a general insurer against business risk, an event that would seriously destabilize the company and imperil its existence.

As noted earlier, shareholders (at least those in public companies who are able to diversify their holdings) are generally unconcerned about changes in the level of *unsystematic* risk of the company and it will be changes in *systematic* or *market* risk or in security value that will attract their attention. Changes in the financial contract are infrequent, with a potentially enormous effect on the market risk or expected return of the shareholder's investment. The risks of opportunism are great. The event is wholly within the control of the company. It is not at all surprising that such changes are typically included on the list of triggering events. The same logic would explain the inclusion of a continuation of the com-

transaction for the appraisal right. Another is the inclusion in the Canadian statutes of continuance in another jurisdiction as a triggering transaction.

²⁵⁶ The constitutional argument, needless to say, has little relevance in the Canadian context. Nevertheless, Canadian appraisal provisions draw their inspiration from the American statutes with the exceptions noted *ibid.*

pany's existence in another jurisdiction; that other jurisdiction may have a very different corporate law and hence a very different "background standard form" financial contract. An amalgamation, a sale of all or substantially all of the company's assets, or a winding-up are also relatively infrequent events of potentially great significance to the corporation and the shareholder. These events may either involve a recapitalization of the enterprise that has the same result as a change in the terms of outstanding securities or substantially alter the nature of the business carried on. In each of these cases, the event is an internal one over which the corporation has control. These changes may bring into play either the bail-out or anti-discrimination rationales for the appraisal right or both of them.

External events such as a buildup of superpower tension that depress the market are entirely beyond the control of the corporation. It makes little sense for the corporation to insure equity holders against these. A security with a generalized put option, exercisable virtually at will when external events threaten the shareholder's investment, would significantly destabilize the corporation and is not likely to represent part of any efficient financial contract. Of course, the risk of opportunism associated with events beyond the control of the corporation is, by definition, nil.

Other internal events, such as the signing of a potentially unfavourable collective agreement, are within the company's control, and may significantly affect the shareholder's investment. But, in general, these will be events of both greater frequency and lesser significance. Moreover, the risks of opportunism associated with such events (at least, as between managers and shareholders or shareholders *inter se*) are likely to be far less than in significant structural or constitutional changes, and in most cases there will be no such risk at all. Thus, the statutory selection of triggering events appears to be not nearly so indefensible as Manning suggests, and indeed seems to have a workable economic logic to it.²⁵⁷

Admittedly, however, Manning's criticism is not entirely without foundation. It would be difficult and probably impractical to define a comprehensive list of those discriminatory events against which shareholders might choose to be protected by an appraisal option. It is also difficult to define the formal character of triggering events (for example, an "amalgamation," or sale of all or substantially all the corporation's assets) so as to ensure uniform treatment across events having divergent formal characteristics but substantively equivalent effects.²⁵⁸ It is there-

²⁵⁷ Cf. Eisenberg's response to Manning's criticisms, *supra*, note 38 at 73-77.

²⁵⁸ The *CBCA* and cognate statutes fail to achieve complete consistency. For example, although shareholders of a company *selling* all of its assets will get an appraisal right, shareholders of the company *buying* the assets will not, even though, as an economic event, the purchase may have as much or more effect on the buying company's shareholders as the seller's (*CBCA, supra*, note 1 at s. 184). Similarly, where a parent company amalgamates a wholly owned operating sub-

fore appropriate to vest in the court a residual discretion to order an appraisal for those instances of discrimination that are not transactions or events that the statute or parties specifically designate as triggering events.²⁵⁹ In the *CBCA* and cognate statutes, this has been achieved in connection with an application under the oppression provision by allowing the court to order²⁶⁰ that the corporation purchase the shares of the applicant at an appraised value.²⁶¹

One feature of the Ontario legislation, however, that cannot readily be explained by reference to any of the above defining principles is the unavailability of the statutory appraisal right to classes of shareholders that are not entitled to vote on the resolution approving the fundamental change.²⁶² It has been suggested here that one of the primary *raison d'être* for the appraisal right is protection against discriminatory fundamental changes initiated by shareholders or classes of shareholders exercise powers of control. The dangers of opportunistic predation are only enhanced in respect of those classes of shares that do not vote. One would therefore have thought that it is these classes to whom the ap-

subsidiary into another company, the interposition of the holding company deprives the true owners of the subsidiary (the shareholders of the parent) of the appraisal option. One mechanism for avoiding statutory appraisal rights—the effecting of what is in substance a merger by means of the issuance of a large block of shares by the target in return for the assets of the acquiror—has provoked some interesting jurisprudence and commentary in the United States. See *Farris v. Glen Alden Corp.* (1958), 393 Pa. 427, 143 A.2d 25. See *Folk*, *supra*, note 165. For a thorough review of the technical inconsistencies in the American legislation, see S.H. Schulman & A. Schenk, “Shareholders’ Voting and Appraisal Rights in Corporate Acquisition Transactions” (1983) 38 *Bus. Law.* 1529. See also Buxbaum, *supra*, note 244 for a review of the California legislation. Although it is beyond the scope of this article to review the technical inconsistencies in the *CBCA* and cognate legislation, suffice it to say that many of the technical inconsistencies noted by Schulman and Schenk are present in the Canadian legislation as well.

²⁵⁹ This discretion might be of at least two varieties: a discretion which attaches only when some form of appraisal right (whether a statutory standard form or otherwise) has been selected and is in conformity with the valuation objective chosen; or is a general residual discretionary power to order an appraisal with the valuation objective to be determined by the court. It is probably better to vest the broader discretion in the court, allowing it remedial flexibility where events arise that were not anticipated by the parties *ex ante* and in respect of which the risk has not been allocated. Unfortunately, the broader discretion introduces a danger that a court may (by accident or design) upset a prior allocation of risk by the parties should it order an appraised cashout. The seriousness of this problem depends on the courts’ sensitivity in divining the true ambit of the prior allocation of risk and the degree of willingness to resist tampering with this allocation. The *CBCA* and cognate statutes currently vest the court with a virtually unrestricted discretion to order an appraisal (see *infra*, notes 260-61).

²⁶⁰ *CBCA*, *supra*, note 1 at s. 234.

²⁶¹ *Ibid.* s. 234(3)(f). Where this has occurred, the court has usually ordered a trial of the issue of cashout price under s. 234(3)(n).

²⁶² *OBCA*, *supra*, note 2 at s. 184(1) gives the appraisal right to “a holder of shares of any class or series entitled to vote on the resolution.” By contrast, the *CBCA*, *ibid.* at s. 184(1) affords an appraisal right in respect of designated transactions to “a holder of shares of any class.” See also *OBCA* ss. 184(2), 169 and *CBCA* ss. 184(2), 170 (furnishing an appraisal right to shareholders entitled to a class vote, such vote arising where the class is affected directly or indirectly whether or not the class is otherwise entitled to vote).

appraisal right has greatest value. Should the statute continue to offer shareholders an appraisal right, logic and internal consistency suggest that the Ontario legislation should be amended to conform to the *CBCA* in offering appraisal protection to non-voting classes of shareholders.

X. CONCLUSION

The Dickerson Committee set out to design a regime of rules for fundamental changes in which the appraisal right was the Archimedean pivot. The tool was designed to supplement existing remedies and to strike an appropriate balance between majority and minority shareholders. In theory, there may well be reasons that shareholders would desire the protection afforded by the appraisal right. The protection may be against unwise business decisions that threaten to diminish security values or against the effects of discriminatory treatment of a shareholding constituency. There are also reasons, in theory, for specifying a different valuation objective, depending on the rationale under which the appraisal right is claimed. Transaction and corporation type may also influence the optimal valuation objective.

This theory cannot, however, be divorced from a host of practical considerations. The value of both the appraisal right as prevention of or cure for discriminatory action and the optimal form of valuation objective will depend on the degree to which opportunism is a problem in the marketplace. This in turn depends on the adequacy of alternative rights and remedies to which shareholders may have resort. The appraisal right must be seen as part of a larger tapestry of shareholder protections both in the law and in the marketplace. In this constellation of protections, the appraisal right may have particular advantages associated with the relative cost of its exercise and the manner in which it responds to collective action problems.

It is clear that the appraisal right generates its own costs, not the least of which is the cost of the valuation itself, especially where a calculation of hidden values or transaction synergies is involved. A generous valuation objective may also discourage the undertaking of productive fundamental changes. At least in freezeouts of public shareholders affected by a publicly traded parent, an appraised "right of re-entry" might overcome some of these problems. Pure theory alone can determine neither whether the appraisal right constitutes an efficient feature of the shareholder's financial contract nor the optimal form of valuation objective. Although there is empirical evidence suggesting that pre-transaction market value may be the optimal valuation objective, the evidence is determinative neither of this question nor in deciding whether the appraisal right under any valuation objective has any value to shareholders. Thus, the case in favour of the appraisal right has not been conclusively affirmed or disproved.

At the very least, however, it can be said that a mandatory statutory

appraisal right is likely to interfere with the process of private ordering through which an efficient financial contract is struck. A case can be made only for a presumptive appraisal right or for a menu from which the corporation may choose an appropriate appraisal right or no right at all. A presumptive right fulfills the enabling function of corporate law and serves to lower the transaction costs of financial contracting.

It can also be said with some confidence that the current statutory appraisal right suffers from procedural, cost, taxation, and other operational infirmities that render it a less attractive remedial option than it might be. The valuation process would be much improved by entrusting the task to an expert tribunal or valuator rather than (as at present) to the courts.²⁶³ What is eminently clear from the brief history of the appraisal right in Canada is that it has largely failed to fulfill the role assigned to it by the Dickerson Committee as the centrepiece of the fundamental change provisions.

²⁶³ The suggestion of entrusting commercial matters to a specialized tribunal is not entirely novel. See, e.g., the Lawrence Report, *supra*, note 176 at paras. 14.1.1-14.1.3; L.C.B. Gower, *The Principles of Modern Company Law*, 4th ed. (London: Stevens, 1979) at 718.