CORPORATE MERGERS AND ACQUISITIONS IN CANADA

Richard W. Bird†*

Introduction

General Trends in Corporate Mergers and Acquisitions

Corporate trends in Canada closely parallel those in the United States. The increase in merger activity and the building of conglomerates in both countries has been one of the most significant developments in corporation law and finance in the last decade. Neither horizontal nor vertical integration is often cited as the reason for the increased activity, but rather a trend towards diversification has developed.[1] As in the United States, the new large firms are complex, multi-product, and inter-industry. Their structure resembles a closed-end mutual fund with the distinguishing characteristic of being actively involved in the management of their holdings.

Not much is known about mergers in Canada.[2] For information, heavy reliance appears to be placed on American studies. Even statistical information regarding the number of mergers and acquisitions taking place in Canada is lacking.[3] However, some distinct characteristics have emerged. For example, the number of foreign owned and controlled corporations responsible for merger activity in Canada is disproportionately high.[4] It also appears that given the size of the Canadian market and the cost of technological improvements, serious consideration must be given to encouraging more merger activity so as to make Canadian industries more efficient and therefore more competitive both at home and abroad.[5]

The industry is small compared to the United States. Only 48 Canadian-based industrial firms would rank in the United States list of its 500 largest corporations.[6] With smaller size, Canadian

---

† Richard W. Bird, B.B.A., B.C.L. (U.N.B.), LL.M. (Columbia), of the Faculty of Law, University of New Brunswick.

* This paper was submitted in partial fulfillment of the requirements for the degree of Master of Laws, Columbia University, 1968.

1 *The Financial Post*, Jan. 13, 1968, at p. 33, col. 1.

2 *Task Force on the Structure of Canadian Industry, Foreign Ownership and the Structure of Canadian Industry* (1968), at p. 146.

3 *Ibid.*

4 *Ibid.*

5 *Ibid.*, at p. 154 *et seq.*

6 See *Fortune*, June 15, 1968, at p. 186 and *The Financial Post*, July 20, 1968, at p. 11, col. 1.

companies generally have fewer shareholders. Some companies do not make the list of Canada's 100 largest companies because, being privately owned, they are not required to publish financial information, and reliable estimates of their size are therefore unavailable. Most notable are wholly owned subsidiaries of other foreign corporations, e.g., General Motors of Canada Ltd., Chrysler Canada Ltd., American Motors (Canada) Ltd., Canadian International Paper Co., and Canadian Johns-Manville Co.[7] If the parties involved so desire, a relatively large merger or acquisition may go unnoticed in Canada. The disclosure of the Weston empire in 1967 was a major revelation to Canadians.[8] By sales volume, George Weston Ltd. ranks fifth in the list of Canada's manufacturing, resource and utility companies.[9]

The trend is exemplified by the acquisition of John Labatt Ltd., a major Canadian brewery, by Joseph Schlitz Brewing Co. of Milwaukee, Wisconsin, in 1964.[10] In February, 1968, Labatt's acquired Ogilvie Flour Mills Co., a major Canadian milling company, by issuing cumulative, redeemable, convertible preferred shares and some cash in exchange for Ogilvie common shares. The two formerly Canadian-owned companies, Labatt's and Ogilvie, ranked 63rd and 48th respectively. Combined sales boost Labatt's position to 27th in Canada's list. Creeping foreign control and diversification have dominated corporation finance in the 1960's in Canada.

The general trend has raised important policy issues that have yet to be finally resolved in Canada. Only a token attempt has been made to decrease the extent of foreign ownership and control, and even the wisdom of this has been seriously questioned. Furthermore, as corporation laws have become increasingly more flexible, a vacuum in legislation necessary for public protection and confidence has been created which securities regulation has been slow to fill in Canada.

In sum, apart from questions of foreign ownership and control, mergers and acquisitions from a business and economic viewpoint follow American patterns. Smaller firms and markets have made Canadian industry susceptible to the domination of American research and technology, with which it has not been able to compete.

Types of Mergers and Acquisitions

Traditionally, analysis of the legal aspects of corporate mergers and acquisitions in Canada has focused on the several procedures

---

7 *The Financial Post*, July 20, 1968, at p. 11, col. 1.

8 *The Financial Post*, Dec. 10, 1966, at p. 1, col. 2.

9 *The Financial Post*, July 20, 1968, at p. 11, col. 6.

10 W. L. Gordon, *A Choice for Canada* (1966), at p. 86.

used to fuse one company with another. They include: a sale of assets, a sale of shares, and a statutory amalgamation. The latter is sometimes referred to as a statutory merger[11] and, if the fusion results in the formation of an entirely new corporation, as a statutory consolidation.

(a) Purchase and Sale of Assets

A sale of assets involves the sale by one corporation of substantially all its assets to another in return for cash or securities and sometimes a combination of both of them. Usually the vendor is then liquidated, distributing the cash or securities to its shareholders. Where securities are given in exchange and the vendor company is liquidated, the shareholders of the vendor become shareholders in the purchasing company. Legally, the vendor company need not be liquidated. The cash could be reinvested in a new enterprise or, if securities are involved, remain as a holding company, provided its objects of incorporation so permit.

(b) Purchase and Sale of Shares

For many purposes, legally it makes little difference whether a company is buying one share or all the shares of another company. Again the consideration given may be cash or securities or both of them. This time, however, the vendor-shareholders obtain the consideration without the necessity of liquidation proceedings. The acquired company becomes a subsidiary of the purchaser. By then liquidating the subsidiary, results can be achieved which are identical to those of a purchase and sale of assets. But again, liquidation is not essential. In fact, much may depend on whether the acquiring company purchased all or only a part of the shares of the other company. It may be that the acquiring company only wants control of the other company in which case, purchase of 50 per cent of shares may be all that is desirable. Liquidation may not be feasible.

(c) Statutory Amalgamations

Where it is intended that the shareholders of all[12] the companies involved in the transaction shall be shareholders in the surviving company, an alternative route is to proceed under a statutory enactment which amalgamates all the companies involved. This procedure is slightly less complex and often has several other advantages.[13]

11 See *e.g.*, N.Y. Bus. Corp. Law, s. 901.

12 In all procedures, more than two companies may legally be involved in the transaction.

13 *Infra*, at p. 42.

(d) Mergers and Consolidations v. Acquisitions

The term "merger" is popularly used to denote a fusion of companies of relatively equal size and importance[14] where most, if not all, of the shareholders of the constituent corporations continue in the surviving corporation. If instead of a surviving corporation there is a new corporation, the fusion is called a "consolidation". "If, on the other hand, a relatively small firm is being absorbed into a larger one, an 'acquisition', or in the terminology of the Accounting Bulletin [No. 48 (1957)] a 'purchase', is said to have been made."[15] Procedural analysis ignores this distinction and somewhat surprisingly, in the past matters of substance have been governed by procedure.

In many cases the distinction between mergers and consolidations and acquisitions could and should be made. If, for example, the shareholders of one or more of the companies involved ultimately receive cash and no longer have any interest in the business, the transaction is properly called an acquisition. But if those shareholders receive shares and have a substantial interest in the surviving or new corporation, the transaction is a merger or consolidation. Where the consideration is mixed, *e.g.*, cash and securities, or the constituent firms are not of relative equal size, the distinction may be difficult to make. Nevertheless, because such a distinction may be the only one of real validity for many purposes, *e.g.*, in deciding whether a shareholder should have appraisal rights or what the tax consequences of the transaction should be, it may be very useful to exert some effort to make it.

Consider three examples involving a sale of assets for shares. If the purchaser, when compared to the vendor, is relatively large, the issuance of new shares will probably not affect control. The nature of the investment of the purchaser's shareholders will not have changed greatly. This is in contradistinction to the shareholders of the vendor. The transaction may properly be called a purchase and sale of assets.

Suppose the companies are of relatively equal size. Here the nature of the investments of the shareholders of each company may change substantially and control will probably be shared. *De facto*, the transaction is a merger.

In the extreme case, if the purchaser, when compared to the vendor, is relatively small, the issuance of shares for the assets of the vendor could conceivably transfer control to the vendor.[16] In

14 Baker & Cary, *Cases and Materials on Corporations* (3rd ed., 1959) at p. 1435.

15 *Ibid.*

16 See *Farris v. Glen Alden Corporation* (1958), 393 Pa. 440, 143 A. 2d 25.

effect, the shareholders of the vendor have "purchased" the purchaser. However, Canadian corporation law is not this refined.

Choice of Procedure

Any one of the procedures outlined above can be used to effect a merger or acquisition. There are, however, important peripheral differences attached to each procedure. Some, such as taxation, can be so important as to dictate the procedure finally selected.

The differences are both conceptual and historical. For many purposes, a sale of assets is a corporate transaction while a sale of shares is an individual property transaction. Each has its own attendant consequences. The difficulty is to determine the extent to which mergers and acquisitions are governed by these analogous concepts from which the basic procedures were derived. Various aspects of both blend to form the statutory amalgamation thus further complicating basic notions.

Numerous requirements and consequences have historical origins. Several specifically relate back to the doctrine of *ultra vires*, e.g., authorization of a sale of assets and authorization of the purchase of shares in another company.

Given these differences in procedures and results, how do we decide the best procedure in any given situation? Some may be eliminated on business grounds, *e.g.*, it may be desirable to obtain 100 per cent control thus making a purchase of shares less feasible. In other cases, authorization may be difficult at the shareholder level; with some procedures, it is possible for minority shareholders to block the entire transaction. As though these corporate problems were not enough, Canada's constitutional division of corporate powers imposes possible limitations on various kinds of mergers, and then there are the problems of taxation, accountancy, anti-trust, and securities regulation. The selection of a particular procedure can only be made after a thorough analysis of these peripheral consequences.

Mergers and Acquisitions—an Historical Overview

The Doctrine of Ultra Vires *at Common Law*

In mid-nineteenth century England the corporation was an independent legal entity created by the state, with powers limited to those necessary to undertake the purpose for which it had been incorporated. The purpose, or corporate objects, of the undertaking was defined in a deed of settlement. This was a document substituted for an act of Parliament and akin to a partnership agreement. It established the basis of the contractual relations between the corporation, its shareholders, and the state.

Corporate power was limited to that necessary to attain corporate objectives for several reasons. Parliament replaced the royal charters of the previous century with special act incorporations to prevent a recurrence of the monopolies of the South Sea Bubble Era.[17] By restricting corporate objectives by statute, acts not in furtherance of those objects could be struck down as being *ultra vires* the corporation. And if desired, the corporate franchise could be withdrawn. Thus, hopefully, the evils of corporate monopolies would not recur.

The doctrine also was intended to protect shareholders and creditors. By restricting corporate powers to those incidental to the objects expressed in the deed of settlement, each shareholder knew to what purpose his investment was put. If he intended to invest in a railway in Wales, the directors were not to use corporate funds to buy coffee beans in Brazil. Creditors were similarly concerned.

At first the doctrine applied only to companies incorporated by special Acts of Parliament, but it was soon extended to companies incorporated by deeds of settlement. They too derived their ultimate authority from Parliament. Incorporations by memorandum of agreements were under similar restrictions. Here lay the basic impediments to corporate mergers and acquisitions.

Mergers and acquisitions tend toward concentration of wealth and economic power and sometimes monopoly. They also change the nature of the underlying investments; sometimes radically. In sum, mergers and acquisitions parallel the types of activity that the doctrine of *ultra vires* was aimed against. At common law, it was clear that under the type of corporate objects clauses envisaged by Parliament, mergers and acquisitions were *ultra vires* the company.

A sale of all the assets of the company was *ultra vires* on the theory that such a sale would be an abandonment of the undertaking.[18] Put another way, the sale would constitute a termination of the very reason why the company was incorporated.

---

17 "The first and second decades of the eighteenth century were marked by an almost frenetic boom in company flotations which led to the famous South Sea Bubble. Most company promoters were not particularly fussy about whether they obtained charters (an expensive and dilatory process) and those who felt it desirable to give their projects this hallmark of respectability found it simpler and cheaper to acquire charters from moribund companies which were able to do a brisk trade therein. An insurance company acquired the charters of the Mines Royal and Mineral and Battery Works, and a company which proposed to lend money on land in Ireland and a banking partnership in turn acquired the charter of the Sword Blade Company which had been formed to manufacture hollow sword blades": Gower, *Modern Company Law* (2nd ed., 1957), at p. 27.

18 See *Simpson v. Westminster Palace Hotel Co.* (1860), 8 H.L.C. 712, at p. 717, 11 E.R. 608, at p. 610.

For one company to purchase the undertaking of another was also *ultra vires*. In *Re Era Assurance Society, Anchor Case*[19] one insurance company could not purchase another insurance company's undertaking "without some special power in the deed of settlement to authorize such a transaction".[20] Under the deed the directors were only empowered to effect assurances in the ordinary course which included obtaining a medical certificate and a careful inquiry in each case; and the shareholders trusted to the discretion of the directors to be exercised upon the information so obtained.

> The shareholders who elected the directors to exercise a special discretion of this kind on every occasion could not have meant to authorize the board to accept a mass of policies on lives of which they could know nothing beyond the fact that they had been accepted by another company. If such a transaction were valid, the shareholders would be subjected to liabilities which they never contracted to undertake. Still less did they authorize the directors to take upon themselves all the debts of another company.[21]

Similar restrictions prohibited one company from purchasing shares of another company. Limited by the objects of incorporation, a company could only exercise its powers for the purpose of doing something *bona fide* connected with those objects and in the ordinary course of business adapted to their attainment. The purchase of shares was considered an embarkment in a totally different business.[22] There was also the concern that such a purchase would in effect make every shareholder a partner or shareholder in the other partnership or body.[23]

There is, however, authority that a merger or acquisition would be valid at common law if ratified by every shareholder.[24] If incorporation is viewed as a contract, this position has merit. Such ratification would, in effect, amount to a change of the "contract" of incorporation. On the other hand, one must consider the position of the state and third parties. It is clear that where a company was incorporated by a special Act of Parliament, even unanimous consent could not validate an otherwise *ultra vires* act. If Parliament

---

19 (1860), 2 J. & H. 400, at p. 404, 70 E.R. 1113, at p. 1115 (Ch.).

20 *Ibid.*

21 *Ibid.*

22 *Joint Stock Discount Co. v. Brown* (1866), L.R. 3 Eq. 139, at p. 151, accord *In re Barned's Banking Company*, (1867) L.R. 3 Ch. App. 105, at p. 112.

23 *Ex. p. British Nation Life Assurance Association* (1878), 8 Ch.D. 679, at p. 704; this problem is more acute in partnership than in corporate law.

24 See *Simpson v. Westminister Palace Hotel Co., Supra*, footnote 18; *Peterson and Canwood Cooperative Assn.* v. *Cook*, [1923] 1 W.W.R. 1212, at p. 1215 (Sask., K.B.).

thought it wise to limit corporate powers, no majority, however large, could sanction the mis-application of funds.[25] It appears this latter view prevails in Canada.[26]

In sum, mergers and acquisitions were *ultra vires* at early common law. The purchase and sale of assets and the purchase of shares violated the ordinary course of business rules relating to directors. In mid-nineteenth century, there were no general statutory amalgamation provisions.

Mergers and Acquisitions in the Post-Industrial Revolution

"Ultra vires was the expression of a social policy which failed."[27] Technological development and business expansion necessitated greater corporate freedom than that allowed by the doctrine of *ultra vires*. "Courts, from having been astute to assure limitation of corporations in the early part of the 19th century, became almost equally astute to find ways of eluding galling and frequently obsolete restrictions. Either the right of any person to assert that a corporation had acted beyond its power was cut off in some fashion (usually by erection of a judicial theory that he 'was estopped' from raising the point), or the corporate powers were construed as including power to do all acts 'incidental' to the main purpose. Of the incidents of an enterprise there is no end."[28]

A sale of assets was upheld as an incident to the corporate power to buy and sell property. In *Wilson v. Miers*[29] the directors were authorized to buy, sell, and charter ships. Pursuant to this power, they purported to sell the company's entire fleet. The contract was upheld under the general authority given to the directors to sell their ships. "The authority extended to sell some ships, and, if some, there is no rule of law limiting it to less than [the entire fleet], or to a part only."[30] Earlier cases involving a sale of the undertaking were distinguished on the ground that the sums received could be re-

---

25 *Bagshaw v. The Eastern Union Railway Company* (1849), 7 Hare 114, at p. 129, 68 E.R. 46, at p. 52 (Ch.).

26 Beck, *An Analysis of Foss v. Harbottle*, in Zeigel, *Studies in Canadian Company Law* (1967), at p. 563. See also Gower, *Modern Company Law* (2nd ed., 1957), at pp. 78-95.

27 Baker and Cary, *Cases and Materials on Corporations* (3rd ed., 1959), at p. 358.

28 A. A. Berle, Jr., *Historical Inheritance of American Corporations* in *Cases and Materials on Corporations* (3rd ed., Baker and Cary, 1959), at pp. 1 and 5.

29 (1861), 10 C.B. (N.S.) 348, 142 E.R. 486 (C.P.).

30 (1861), 10 C.B. (N.S.) 348, at p. 364, 142 E.R. 486, at p. 493 (C.P.)

invested and the business continued. This position has been followed in Canada.[31]

The distinction between a sale of assets pursuant to a general power to buy and sell property and a sale of the undertaking is uncertain. While the tendency has been to restrict the latter and uphold contracts under the former, the concept of a sale of the undertaking has never been completely abandoned. Several companies acts in Canada confer incidental and ancillary powers similar to the following:

> A company shall possess as incidental and ancillary to the powers set out in the letters patent or supplementary letters patent power to . . .
>
> (m) sell or dispose of the undertaking of the company or any part thereof for such consideration as the company may think fit . . . if authorized so to do by the vote of a majority in number of shareholders present or represented by proxy, at a general meeting duly called for considering the matter, and holding not less than two-thirds of the issued capital stock of the company;
>
> (o) sell, improve, manage, develop, exchange, lease, dispose of, turn to account or otherwise deal with all or any part of the property and rights of the company.[32]

Masten, J. A., expressed the following opinion of the distinction:

> I would suggest that unless the party attacking the transaction satisfies the Court that the proposed sale is for a purpose which is not within the scope of promoting or carrying on the objects of the company as defined in their constating instruments (but is, for example, directed towards the winding-up of the company) then clause (o) applies; while (m) comes into play only when some branch of the company's charter activities is to be abandoned.[33]

While in most jurisdictions[34] the matter is now mainly of historical interest because of changes in wording of the various provisions, in some the problem still remains.[35]

---

31 *Hovey v. Whiting* (1886), 14 S.C.R. 515 (Board of directors have the power to make an assignment of all the assets of a company); *Brown v. Moore* (1921), 62 S.C.R. 487 (Power to sell the lands and property implied in the nature of the business, it not being established the company was disposing of its whole undertaking); *Ritchie v. Vermillion Mining Co.*, (1902), 4 O.L.R. 588 (Sale by company of all its mines not ultra vires because there was nothing to prevent the business being continued by purchasing other mines); and see also, *Ellis v. Norwich Broom and Brush Co.* (1906), 8 O.W.N. 25.

32 See *Herrmann v. Canadian Nickel Co. Ltd.* (1929), 64 O.L.R. 190, at pp. 193-4.

33 *Ibid.*, at p. 194.

34 *e.g.*, The Corporations Act, R.S.O., 1960, c. 71, ss. 22 (l) (m) and (n).

35 *e.g.*, The Companies Act, R.S.P.E.I., 1951, c. 26, ss. 13 (m) and (q).

The incidental doctrine was also used as a means of circumventing the prohibition against the purchase of shares. The purchase of shares was a valid exercise of a general investment power[36] as well as being valid under a general power to dispose of property for such consideration as the directors thought proper.[37]

Since the basic legal problem was to be found in the limitations in the corporate objects, the practice developed to draft very broad objectives and include every conceivable power that the corporation might at some time wish to pursue. The list has become formidable. Specifically, to alleviate the problems relating to corporate mergers and acquisitions, the memorandum of association often included as corporate objects: the power to buy and sell property; to acquire the undertaking of another company; to dispose of its own undertaking, particularly for shares in another company; and to hold shares or securities of any other company. *Prima facie*, at least, they appeared to solve the *ultra vires* problem—if they were valid corporate objects.

While the practice of transmuting corporate powers to corporate objectives has been criticized, the legality of the basic notion never appears to have been questioned.[38] At most, the courts limited the scope of ancillary powers by application of the *ejusdem generis* rule to the scope of the main objects.[39] Individually, they were not immune from attack.

Most important was the striking down of the power to sell the undertaking as a corporate object.

> Under the Companies Act, 1862, the incorporation of a company is effected by the registration of a memorandum of association which is to state the 'objects for which the proposed company is to be established'. To my mind that means the objects which the corporation during its corporate life is to pursue, the purposes by whose fulfilment it is to seek to earn profit . . . [These words] . . . have, in my opinion, no relation to acts to be done after the corporate life has come to an end.
> Sale of even all the property at a particular moment may be, but sale of the whole undertaking and division of the proceeds cannot be, a corporate object.[40]

The other provisions fared better. The power to purchase an undertaking was upheld and often a company was incorporated for this specific purpose.[41] Also upheld was the power to purchase

36 *In re Barned's Banking Company* (1867), L.R. 3 Ch. App. 105.

37 H. A. Street, *The Doctrine of Ultra Vires* (1930), at p. 74.

38 See *Bell Houses Ltd. v. City Walls Property Ltd.*, [1966] 2 All E.R. 674.

39 Gower, *Modern Company Law* (2nd ed., 1957), at p. 84.

40 *Bisgood v. Henderson's Transvaal Est. Ltd.*, [1908] 1 Ch. 743, at pp. 757 and 761 (C.A.).

41 *Ernest v. Nicholls* (1857), 6 H.L.C. 401, 10 E.R. 1351.

shares in another company.[42] "There is not, either by the common or statute law, anything to prohibit one trading corporation from taking or accepting shares in another trading corporation. There may, of course, be circumstances which prohibit or render it improper for a company to do so, having regard to its own constitution as defined by its memorandum and articles."[43]

In sum, the courts and the bar circumvented the doctrine of *ultra vires*. Obviously it had "outlived its usefulness".[44] Mergers and acquisitions which were formerly prohibited were now possible.

Enactment of Ancillary and Incidental Powers

The formidable list of ancillary and incidental powers formerly found in corporate charters is now conferred by statute in most jurisdictions[45], unless the incorporating charter otherwise expressly excludes any of them. The purpose of this statutory enactment is two-fold. It eliminates the necessity of drafting prolix corporate objects and it finally resolves the disputes over the validity of corporate powers as corporate objects. A summary of the powers relating to mergers and acquisitions will be found in Table A.

They permit mergers and acquisitions by purchase and sale of assets, purchase of shares, and in some jurisdictions, by amalgamation.

A Special Status for Letters Patent Companies?

In six jurisdictions in Canada, companies are incorporated by letters patent. Whether the doctrine of *ultra vires* has any application to these companies is a contentious issue.[46] It is clear that prior to *Bonanza Creek Gold Mining Co. Ltd. v. R.*[47] it was generally thought that letters patent companies were subject to the doctrine.[48] In *Newhouse v. Northern Light Power and Coal Co. Ltd.*[49] a company was not able to take over the undertakings of several other companies because the charter contained no provision enabling it to do so. The transaction was therefore *ultra vires*.

---

42 *In re Barned's Banking Company* (1867), L.R. 3 Ch. App. 105; *Royal Bank of India's Case* (1869), L.R. 4 Ch. App. 252; *Canada Life Assurance Co. v. Peel Manufacturing Co.* (1869), 26 Gr. 477, at pp. 486-7.

43 *Royal Bank of India's Case* (1869), L.R. 4 Ch. App. 252, at p. 257.

44 Gower, *Modern Company Law* (2nd ed., 1957), at p. 93.

45 Newfoundland appears to be the sole exception. See The Companies Act, R.S.N., 1952, c. 168.

46 See, Mockler, *The Doctrine of Ultra Vires in Letters Patent Companies*, in Ziegel, *Studies in Canadian Company Law* (1967), at p. 231.

47 [1916] 1 A.C. 566 (P.C.).

48 Robson, *Company Law* (1916), 36 Can. Law Times 861; Mulvey, *Some Phases of Canadian Company Law* (1920), 40 Can. Law Times 832.

49 (1914), 29 W.L.R. 249.

TABLE A—CORPORATE POWERS RELATIN

Corporate Powers Canada Corporations Act s. 14 (1)	Alta. s. 19	B.C. s. 22	Man. s. 26	N s
(b) to purchase or otherwise acquire and undertake all or any of the assets, business, property, privileges, contracts, rights, obligations and liabilities of any other company or any society, firm or person carrying on any business that the company is authorized to carry on, or possessed of property suitable for the purposes of the company;	(1) (c)	(1) (c)	(1) (b)	(1
(d) to amalgamate . . . with any other company or any society, firm or person, carrying on or engaged in or about to carry on or engage in any business or transaction that the company is authorized to carry on or engage in, . . . ;				
(e) to take, or otherwise acquire and hold, shares, debentures or other securities of any other company having objects altogether or in part similar to those of the company, . . . and to sell or otherwise deal with the same;	(1) (g)	(1) (g) (subject to section 150)[1]	(1) (f)	(
(h) to promote any other company or companies for the purpose of acquiring or taking over all or any of the property and liabilities of the company, . . . ;	(1) (m)	(1) (m)	(1) (j)	(
(m) to sell or dispose of the undertaking of the company or any part thereof for such consideration as the company may think fit, and in particular for shares, debentures or securities of any other company that has objects altogether or in part similar to those of the company;	(1)	(1)	(1) (r) (subject to section 148)[4]	(1
(s) to sell, improve, manage, develop, exchange, lease, dispose of, turn to account or otherwise deal with all or any part of the property and rights of the company;	(1) (q)	(1) (q)	(1) (s) (in the ordinary course of its business)	(
(u) to distribute among the shareholders of the company in kind, specie or otherwise, any property or assets of the company including any proceeds of the sale or disposition of any property of the company and in any other company belonging to the company, or of which it may have power to dispose, if either such distribution is made for the purpose of enabling the company to surrender its charter under the provisions of this Act, or such distribution, apart from the provisions of this paragraph, would have been lawful if made in cash;	(1)	(1) (s)	(1) (w)	(
(3) Nothing in this section shall prevent the inclusion in the letters patent or supplementary letters patent of a company of other powers in addition to or in modification of the powers mentioned in subsection (1)	(2)	(3)		
(4) Any of the powers set out in subsection (1) may be withheld or limited by the letters patent or supplementary letters patent of the company.			(2)	

FOOTNOTES:

1 Section 150 (1) reads: "Notwithstanding anything contained in its memorandum, no public company shall take or acquire by purchase or otherwise any shares in any other corporation unless expressly authorized in each such case by an ordinary resolution of the company. A general meeting of the company may by ordinary resolution confer a general authority to take or acquire shares, but such authority shall expire at the next general meeting of the company, unless it is continued by ordinary resolution passed thereat, whether previous notice thereof has been given or not."

2 A special resolution in Nova Scotia requires approval by shareholders representing at least three-fourths of the shares.

3 See the first sentence of section 150 (1) of British Columbia, supra.

ƝG TO MERGERS AND ACQUISITIONS

N.B. s. 14	N.S. s. 24	Ont. s. 22	P.E.I. s. 13	Que. s. 29	Sask. s. 30	Uniform Act s. 25
(1) (b)	(3) (b)	(1) (b)	(1) (b)	29	(d)	(1) (b)
			(1) (d)		(f)	
(1) (e)	(3) (g) (with the sanction of a special resolution)[2]	(1) (e)	(1) (e)	(m) (invest the available funds of the company in any manner which it may consider to be in its interests)	(h) (Subject to section 151)[3]	(1) (e)
(1) (h)	(3) (e)	(1) (h)	(1) (h)		(m)	(1) (i)
(1) (m)	(3) (f) (with the sanction of a special resolution)[2]	(1) (m) (if authorized so to do by a special resolution)[5]	(1) (m) (if authorized by a vote of the shareholders holding not less than ⅔ of the shares)	(h)	(1)	(1) (q) (if authorized to do so by a special resolution)[6]
(1) (s)		(1) (n) (in the ordinary course of its business)	(1) (q)	29	(q)	(1) (r) in the ordinary course of its business)
(1) (u)	(3) (h)	(1) (r)[7]	(1) (s)	(q)	(s)	(1) (v)
(3)	(4)		(2)	29	(3)	
(2)		(2)			(1)	(2)

4 Section 148 reads: "No corporation shall sell, lease, exchange or otherwise dispose of the undertaking as an entirety of the corporation, or a substantial part thereof, unless authorized so to do by special resolution." A special resolution in Manitoba requires approval by shareholders representing at least two-thirds of the shares.

5 A special resolution in Ontario requires approval by shareholders representing at least two-thirds of the shares.

6 A special resolution in the Uniform Act requires approval by shareholders representing at least two-thirds of the shares.

7 Section 22 (1) (r) reads: "to distribute among the shareholders of the company in money, kind, specie or otherwise as may be resolved, by way of dividend, bonus or in any other manner deemed advisable, any property of the company, but no such distribution shall decrease the capital of the company unless made in accordance with this Act;".

However, Viscount Haldane's startling decision in *Bonanza Creek*[50] became a landmark in the law of letters patent companies.

> In the case of a company created by charter the doctrine of *ultra vires* has no real application in the absence of statutory restriction added to what is written in the charter. Such a company has the capacity of a natural person to acquire powers and rights . . .[51]

The decision would appear to overrule *Newhouse v. Northern Light Power and Coal Co. Ltd.*[52] and eliminate the necessity of the enactment of ancillary powers in these jurisdictions. Their enactment, however, has had a restricting rather than an expanding effect. The inescapable inference from such enactments is that the company was granted no power to dispose otherwise of its property.[53] It would thus appear that all companies incorporated in Canada are in much the same position.[54]

Authorization and Procedure

Sale of Assets

The aim of the legislators in enacting ancillary powers permitting a sale of the undertaking was mainly to overcome the limitations imposed by the doctrine of *ultra vires*. It was also to eliminate the repetition of such powers in the incorporating documents.

It would appear probable that the wording corresponds closely to that which was in common use in corporate charters at the time of their enactment. In its simplest form, the ancillary power to sell the undertaking reads:

> A company may . . . sell or dispose of the undertaking of the company or any part thereof for such consideration as the company may think fit, and in particular for shares, debentures or securities of any other company that has objects altogether or in part similar to those of the company;[55]

Because of its limited aims, there was no need to provide for any procedure or special authorization. In fact, the contrary was probably intended. Subject to special statutory restrictions, and, in the case of companies incorporated by memorandum of association, to provisions in the articles, the affairs of a company are managed

50 [1916] 1 A.C. 566 (P.C.).

51 *Ibid.*, at pp. 583-4.

52 (1914), 29 W.W.R. 249.

53 *Stanishewski v. Tkachuk*, [1955] O.R. 667, at p. 683 (Ont., Sup. Ct.).

54 See Mockler, *The Doctrine of Ultra Vires in Letters Patent Companies*, in Ziegel, *Studies in Canadian Company Law* (1967), at p. 231.

55 Canada Corporations Act, R.S.C., 1952, c. 53, s. 14 (l) (m).

by the board of directors.[56] Generally, incidental and ancillary powers conferred on a company are intended to be exercisable by the board. *A fortiori*, in the absence of a contrary provision, the board of directors may sell the undertaking.[57]

Some theorists[58] doubt the wisdom of selling the undertaking pursuant to an authorization solely from the board of directors. While some of their reasons are not clear, their doubts are not without some merit. First, there is an interrelationship between the ancillary power and other statutory provisions, *e.g.*, an amalgamation or reconstruction which requires special authorization. This will be discussed later.[59]

Secondly, the transaction may be between companies with interlocking directors. Should the attainment of a disinterested quorum be impossible, the matter must be taken to the shareholders for ratification.[60] This is part of the more general problem of contracts with interested directors. It hardly necessitates shareholder approval in all cases.[61] Where shareholder approval is required for this reason, approval by a majority will suffice.[62]

Finally, notwithstanding abundant authority to the contrary,[63] there is some authority that directors are appointed to carry on an undertaking and, therefore, a sale by them of the undertaking, bringing the company to the point where there would be nothing left to do but to wind it up, is not within their power.[64] Put another way, it is sometimes thought that the powers of the board of directors to manage the affairs of the company are limited by implication to those matters which relate to the company as a going concern. The difficulty with this theory is that if the directors do not have the authority then the shareholders must have it; however, shareholder power must be expressly provided for.

---

56 *e.g.*, Canada Corporations Act, R.S.C., 1952, c. 53, s. 84 (1).

57 *Wilson v. Miers, Supra*, footnote 29; *Automatic Self-Cleansing Filter Syndicate Co., Ltd. v. Cuninghame*, [1906] 2 Ch. 34 (C.A.); *Hovey v. Whiting* (1886), 14 S.C.R. 515; *Brown v. Moore* (1921), 62 S.C.R. 487; *Ellis v. Norwich Broom and Brush Co.* (1906), 8 O.W.N. 25.

58 Fraser and Stewart, *Company Law of Canada* (5th ed., 1962), at p. 121; English, *Corporate Acquisitions—General Considerations*, in Ziegel, *Studies in Canadian Company Law* (1967), at pp. 605-6.

59 *Infra*, at p. 32.

60 *North-West Transportation Co. v. Beatty* (1887), 12 A.C. 589 (P.C.); *Garvie v. Axmith* (1962), 31 D.L.R. (2d) 65 (Ont., Sup. Ct.).

61 See English, *Corporate Acquisitions—General Considerations*, in Ziegel, *Studies in Canadian Company Law* (1967), at pp. 605-6.

62 *Garvie v. Axmith* (1962), 31 D.L.R. (2d) 65 (Ont., Sup. Ct.).

63 Cases cited, *supra*, footnote 57.

64 *Doyle v. Miniota Mutual Fire Insurance Co.*, [1924] 2 D.L.R. 471, at p. 478 (Man., C.A.).

On the other hand, from a policy position, shareholder approval should be required. Apart from advantages of limited liability and favourable tax considerations, the corporation provides a structure with continuity, centralization of authority, and transferability of interests. A sale of assets may be such as to substantially alter any or all of these latter corporate characteristics. Considered as a matter of policy, such a transaction raises the issue of whether it is a question of management or ownership. If the latter position is taken, authorization should be vested in the shareholders.

Four provinces follow this philosophy.[65] Their ancillary power provisions permitting the sale of the undertaking mandates a special resolution passed by the shareholders. A "special resolution" means "a resolution passed by the directors and confirmed with or without variation by at least two-thirds of the votes cast at a general meeting of the shareholders . . ."[66] Nova Scotia requires three-quarters.[67]

In Nova Scotia and Prince Edward Island the efficacy of the provisions may be illusory. We have already seen that the ancillary powers were enacted to partially abrogate the doctrine of *ultra vires*. In furtherance of this objective, it was common to expressly allow addition of other powers or modification of the statutory powers in the incorporating documents. This was intended to be permissive and not mandatory. In Nova Scotia and Prince Edward Island the ancillary powers are still subject to such additions and modifications.[68] If such provisions were construed literally, all provisions requiring shareholder approval in the ancillary powers could thus be eliminated in the corporate charter or memorandum in those provinces. In contrast, in Ontario the ancillary powers may only be limited or withheld.[69]

In sum, as a starting point, the board of directors may sell the undertaking. Some jurisdictions require shareholder approval, and there may be other reasons necessitating shareholder ratification. It is submitted that as a matter of policy, all companies Acts should require shareholder approval to sell the undertaking.[70]

A sale of the undertaking still leaves the corporate shell and the consideration received in the possession of the corporation. The corporation has the choice of winding up, continuing as a holding

---

65 Manitoba, Nova Scotia, Ontario, Prince Edward Island, and see also, Uniform Companies Act. See Table B, at p. 49, *infra*.

66 *e.g.*, The Corporations Act, R.S.O., 1960, c. 71, s. 1 (j).

67 The Companies Act, R.S.N.S., 1954, c. 41, s. 75.

68 The Companies Act, R.S.N.S., 1954, c. 41, s. 24 (4); The Companies Act, R.S.P.E.I., 1951, c. 26, s. 13 (2); See Table A, *supra*.

69 The Corporations Act, R.S.O., 1960, c. 71, s. 22 (2).

70 The Companies Act (1964), 13 Eliz. II, c. 3, s. 148 (Man.).

company, or commencing business anew. Usually its fate is predetermined by the contract of sale of the undertaking. If the consideration received is cash, the purchasing company probably will require a restrictive competition covenant which will make commencing a new and similar business impractical. The corporate objects, while amendable, may restrict other activities. In many cases winding up will be the most practical course.[71] If shares are received the purchaser will probably not want a substantial block of its shares held in one name for fear of a threat to the control of the purchaser. The purchase agreement may require the vendor to be wound up and the shares distributed to the shareholders of the vendor. To facilitate these aims, most companies may:

> . . . distribute among the shareholders of the company in kind, specie or otherwise, any property or assets of the company including any proceeds of the sale or disposal of any property of the company and in particular any shares, debentures, or other securities of or in any other company belonging to the company, or of which it may have power to dispose, if either such distribution is made for the purpose of enabling the company to surrender its charter under the provisions of this Act, or such distribution, apart from the provisions of this paragraph, would have been lawful if made in cash;[72]

The dissolution and liquidation of a company may be affected by surrender, forfeiture, expiration of the corporate charter, or by winding up. In sale of assets, any one of them may be possible. However, it is most probable that dissolution will be effected by a surrender of the charter or by a winding up of the company.

Amalgamation or Reconstruction

Earlier[73] it was indicated that there is an inter-relationship between the ancillary powers and other statutory provisions, *e.g.*, an amalgamation or reconstruction which requires special authorization. Most companies acts in Canada provide for special procedures where an arrangement or compromise between shareholders and creditors is intended.[74] The word "arrangement" is defined to include "amalgamation or reconstruction". This latter expression means:

> an arrangement pursuant to which a company (. . . called 'the transferor company') transfers or sells or proposes to transfer or sell to

71 But cf., *Dominion Cotton Mills Company Ltd. v. Amyot*, [1912] A.C. 546 (P.C.) (long term lease of all the assets of the company).

72 Canada Corporations Act, R.S.C., 1952, c. 53, s. 14 (l) (u).

73 *Supra*, at p. 30.

74 R.S.C., 1952, c. 53, ss. 126, 127; R.S.A., 1955, c. 53, ss. 139, 140; R.S.B.C., 1960, c. 67, ss. 179, 180; (1964), 13 Eliz. II, c. 3, ss. 107, 108 (Man.); R.S.N.B., 1952, c. 33, s. 47; R.S.N., 1952, c. 168, ss. 126A, 126B, 126C; R.S.N.S., 1967, c. 42, ss. 117, 118; R.S.O., 1960, c. 71, s. 95; R.S.Q., 1964, c. 271, ss. 46, 47; R.S.S., 1965, c. 131, ss. 187, 188.

any other company (. . . called 'the transferee company'), the whole or a substantial part of the business and assets of the transferor company for a consideration consisting in whole or in part of shares, debentures or other securities of the transferee company and, either, any part of such consideration is proposed to be distributed among shareholders of the transferor company of any class, or the transferor company proposes to cease carrying on the business or part of its business so sold or transferred or proposed to be sold and transferred.[75]

Broadly, the provision distinguishes mergers from acquisitions. However, the definition appears to subject only the nominal vendor to the arrangement and compromise provisions. Thus the problems of *de facto* "amalgamations or reconstructions" are neglected.[76] There are no cases dealing directly with this point in Canada. It is submitted that if the purpose of the section is to be achieved, the *de facto* merger doctrine could and should, in the proper circumstances, be applied. Thus, where nominally the company is the purchaser, if sufficient control is transferred to the vendor, it would, for purposes of the arrangements and compromises provisions, be a vendor. Alternatively, the definition of "amalgamation or reconstruction" could be read not to be exclusive and to include such transactions.

If the transaction is an "amalgamation or reconstruction", the vendor company must (1) obtain an order from a judge summoning a meeting of shareholders to consider the same; (2) obtain the approval of shareholders representing three-fourths of the shares; (3) have the arrangement or compromise sanctioned by a judge, having first given notice of such application to all dissenting shareholders; and (4) have it confirmed by supplementary letters patent.[77]

The purpose of requiring an application to be made to a judge for an order summoning a meeting of shareholders is not altogether clear. It appears to be an anachronism. Arrangements and compromises were first subject to special legislation in 1870.[78] That legislation was intended for the benefit of the company and its creditors. Summoning a meeting of creditors by judicial order was a practical solution to the vexing problem of calling a meeting of creditors with authority to bind the entire body. Later, the provisions were broadened to include arrangements and compromises between classes of shareholders, and, finally, to include amalgamations and reconstructions. The latter situations differ from the former in one important particular. There already exists a means of calling a

75 Canada Corporations Act, R.S.C., 1952, c. 53, s. 126 (4).

76 See *Farris v. Glen Alden Corporation* (1958), 393 Pa. 440, 143A 2d 25, *Supra* at p. 19.

77 *e.g.*, Canada Corporations Act, R.S.C., 1952, c. 53, s. 126.

78 The Joint Stock Companies Arrangement Act, 1870, 33 & 34 Vict., c. 104.

meeting of shareholders. Thus it is submitted that, but for the statutory provisions, a judicial summoning of a meeting would be unnecessary.

It is not surprising that courts have found the powers of the judge at the preliminary application uncertain. To say that the judge has authority to summon a meeting and to determine all matters that are fairly incidental to this purpose is not of much help.[79] His power appears to be limited to fixing the date of the meeting and its chairman and calling as many separate meetings as there are classes of shareholders in order "to secure full and frank discussion".[80] He may not determine any matter that might affect the rights of dissenting shareholders, *e.g.*, the form of notice of meeting[81], the form of proxy [82], or the disclosure of information.

Usually the preliminary application is made *ex parte*. Masten, J. A., in *Re Langley's Ltd.*[83] said that in special circumstances the judge may in his discretion require notice of the preliminary application be given to certain shareholders. It is difficult to envisage the special circumstances.

Meetings of shareholders involve numerous corporate problems including notices, proxies, voting, and information circulars. These problems are not peculiar to mergers and acquisitions and need not be discussed here. However, it should be noted that the plan must be approved by shareholders present in person or by proxy at the meeting representing three-fourths of the shares voted.[84]

The third step is to have the proposed plan sanctioned by a judge. Notice of this application must be given to all dissenting shareholders at the general meeting, unless the judge orders otherwise.[85] This application is the cornerstone of the rights of dissenting shareholders and the subject of later discussion.[86]

Finally, the plan may be confirmed by supplementary letters patent which shall then be binding on the company and shareholders.[87] It appears that the company must make this application. The use of the word "may" is indicative of the Minister's discre-

79 *Re Langley's Ltd.*, [1938] O.R. 123, at p. 128 (C.A.).

80 *Ibid.*

81 *Re Langley's Ltd.*, [1938] O.R. 123 (C.A.); contra, *Re Western Grocers Ltd.*, [1936] 2 D.L.R. 762 (Man., K.B.).

82 *In Re Dorman, Long*, [1934] Ch. 635, at p. 661; *Re Langley's Ltd.*, [1938] O.R. 123 (C.A.).

83 [1938] O.R. 123 (C.A.).

84 Canada Corporations Act, R.S.C., 1952, c. 53, s. 126 (2).

85 Canada Corporations Act, R.S.C., 1952, c. 53, s. 126 (3).

86 *Infra*, at p. 47 *et seq.*

87 Canada Corporations Act, R.S.C., 1952, c. 53, s. 126 (1).

tionary power to issue the supplementary letters patent.[88] It has been recommended[89] that the proposed supplementary letters patent be submitted to the Corporations Branch of the Department of Consumer and Corporate Affairs for preliminary approval before a meeting of shareholders is called. The Department may propose changes which the company may not be able to effect without calling another meeting of shareholders. The Department may even prohibit the amalgamation.[90]

Confirmation by supplementary letters patent is a Canadian modification of the Joint Stock Companies Arrangement Act, 1870.[91] Under that act the arrangement or compromise was binding on all creditors if the plan was sanctioned by the Court. The modification appears to have been intended to make certain that the incorporating papers correspond with the true capital structure of the company after the transaction. Often in a reorganization between shareholders and creditors, the capital structure is considerably altered. In "amalgamations and reconstructions" it is possible that no change will be required in the corporate structures. The purchasing company may have enough authorized but unissued shares to carry out the transaction, and, after distribution to the vendor's shareholders, it may be desirable to retain the corporate shell of the vendor. Supplementary letters patent would still appear to be required to bind the company and its shareholders.

Purchase of Assets

Procedurally, the purchase of an undertaking is the antithesis of the sale. However, in terms of policy, in many respects they are similar. In mergers, the important consideration is the fusion—it should not be the procedure; in acquisitions, it is the *de facto* vendor—and should not be the nominal one. Canadian legislation has not recognized this. Generally the purchasing company is much less regulated than the vendor. Typically, corporations Acts in Canada provide as ancillary and incidental to the corporate objects, the power . . .

> to purchase or otherwise acquire and undertake all or any of the assets, business property, privileges, contracts, rights, obligations and liabilities of any other company or any society, firm or person

---

88 Interim Report of the Select Committee on Company Law (1967), at pp. 1 to 3.

89 Fraser and Stewart, *Company Law of Canada* (5th ed., 1962), at p. 706.

90 *Cf., The Wall Street Journal,* March 26, 1968, at p. 7, col. 1 (The Minister refused to amalgamate British American Oil Co. and Royalite Oil Co. under section 128A.).

91 33 & 34 Vict., c. 104 (Imp.).

> carrying on any business that the company is authorized to carry on, or possessed of property suitable for the purposes of the company;[92]

For the same reasons that the directors generally have the power to sell the undertaking, they also have the power to authorize a purchase. However, as in the sale of assets, the possible application of the *de facto* merger doctrine or the existence of interlocking directorships could necessitate shareholder ratification.[93]

In many circumstances the purchasing company will have to obtain shareholder approval to increase its authorized capital to carry out a merger. An increase in the authorized capital of a company requires sanctioning by two-thirds of the votes cast at a special general meeting of shareholders.[94] However, if the purchasing company has sufficient unissued shares, this provision provides no protection for shareholders.

Purchase of Shares

Thus far we have only considered mergers and acquisitions proceeding from purchase and sale of assets. We have already noted that mergers and acquisitions may take the form of a purchase of shares.

Of all the existing legislation affecting mergers and acquisitions, the power to purchase shares in another company has the most variegated history. Existing laws exhibit the fears of untamed corporate giants of previous centuries, the presence and abandonment of the doctrine of *ultra vires*, and some concern for the shareholder.

The Canada Joint Stock Companies Letters Patent act, 1869[95] provided, "No Company shall use any of its funds in the purchase of stock in any other Corporation." At the same time, however, a company incorporated by a special Act of Parliament could purchase stock in another company if authorized by the incorporating acts of both companies.[96] This latter rule is substantially the same today for companies incorporated by special Act.[97]

---

92 Canada Corporations Act, R.S.C., 1952, c. 53, s. 14 (1) (b); The Corporations Act, R.S.O., 1960, c. 71, s. 22 (1) (b) refers only to the business of a person. The additional words "or company" were omitted in (1953), 2 Eliz. II, c. 19, s. 22 (1) (b). However, the Interpretation. Act, R.S.O., 1960, c. 191, s. 30 (28) defines "person" to include "corporation". See also, The Companies Act (1964), 13 Eliz. II, c. 3, s. 26 (1) (b) (Man.), and The Uniform Companies Act, s. 25 (1) (b).

93 Professor English implies that there are no similar considerations restricting the purchasing company: English, *Corporate Acquisitions—General Considerations*, in Ziegel, *Studies in Canadian Company Law* (1967), at pp. 605-6.

94 *e.g.*, Canada Corporations Act, R.S.C., 1952, c. 53, s. 48.

95 (1869), 32 & 33 Vict., c. 13, s. 41.

96 (1869), 32 & 33 Vict., c. 12, s. 32.

97 Canada Corporations Act, R.S.C., 1952, c. 53, s. 194.

The position of letters patent companies is opposite today. In 1874 in Ontario, it was enacted that notwithstanding the prohibition, the purchase of stock could be authorized by a by-law confirmed at a general meeting.[98] Other provinces[99] followed and Prince Edward Island still has retained the provision.[100] The Dominion Act was amended to allow the purchase of shares if authorized by the letters patent or a by-law approved by two-thirds of the votes cast at a general meeting of shareholders.[101] A similar provision is still in force in Quebec.[102] Most letters patent jurisdictions now authorize the board of directors,

> to take, or otherwise acquire and hold shares, debentures or other securities of any other company having objects altogether or in part similar to those of the company, or carrying on any business capable of being conducted so as, directly or indirectly, to benefit the company, and to sell or otherwise deal with the same;[103]

On the other hand, several memorandum of association jurisdictions have been more restrictive. Nova Scotia requires a special resolution. In British Columbia[104] and Saskatchewan[105] public companies are prohibited from purchasing shares unless authorized in each case by an ordinary resolution of the shareholders, subject in British Columbia to a general authorization which must be renewed at each general meeting of shareholders.

A summary of the authorizations necessary in each jurisdiction to purchase stock is provided in Table B.

Where the authority is vested by ancillary power, it was not intended that the power be used to act as a holding company. The ancillary power to purchase shares is restricted to securities in companies having similar objects to the purchaser. Should a conglomerate be intended, the acquisition of shares in any company should be a principle object of incorporation.

Once the proper authorization has been obtained, most of the remaining questions of corporate procedure are matters of general corporation law. These include the possibility of increasing the capital of the purchaser and in some circumstances dissolving the acquired subsidiary.

---

98 (1874), 37 Vict., c. 35, s. 45 (Ont.).

99 (1875), 38 Vict., c. 28, s. 45 (Man.); (1885), 48 Vict., c. 9, s. 63 (N.B.); (1888), 51 Vict., c. 14, s. 63 (P.E.I.).

100 Companies Act, R.S.P.E.I., 1951, c. 26, s. 61.

101 (1902), 2 Ed. VII, c. 15, s. 35 (Can.).

102 Companies Act, R.S.Q., 1964, c. 271, s. 41.

103 Canada Corporations Act, R.S.C., 1952, c. 53, s. 14 (1) (e).

104 Companies Act, R.S.B.C., 1960, c. 67, s. 150.

105 Companies Act, R.S.S., 1965, c. 131, s. 151.

A purchase of shares, or take-over bid as it is popularly called, has several advantages as well as disadvantages.

> In some amalgamations between companies it is necessary that the concern which is in substance being taken over should be kept alive and the amalgamation should be carried through by a transfer of shares and not by a sale of assets. The reason in some cases is the necessity of preserving the goodwill associated with the name of the company taken over and other cases is that part of its property (e.g., a licence to utilise a patent assignable only with a consent which cannot be obtained) cannot be assigned. The acquiring company generally desires to obtain the whole of the share capital of the company which is being taken over and in some cases will not entertain the business except on that basis.
>
> It has been represented to us that holders of a small number of shares of the company which is being taken over (either from a desire to exact better terms than their fellow shareholders are content to accept or from lack of real interest in the matter) frequently fail to come into an arrangement which commends itself to the vast majority of their fellow shareholders, with the result that the transaction fails to materialise.[106]

In order to alleviate "opression of the majority by a minority",[107] a provision was added to the English Companies Act in 1929 permitting the purchasing company to compel minority shareholders to sell their shares, where an offer is accepted within four months by the holders of 90% of the shares affected.[108] Comparable provisions were subsequently enacted in several jurisdictions in Canada.[109]

The Canadian provisions contemplate (1) a "contract" between the two companies; (2) "approval" by the holders of nine-tenths of the shares affected within four months of the making of an offer of purchase; (3) notice given by the purchasing company to "dissenting" shareholders, within two months after the expiration of the said four months, of its intention to acquire their shares; and (4) an opportunity for the dissenting shareholders to apply to a judge to prevent the compulsory sale.[110]

Procedurally, the provisions are vague.[111] They call for the "approval" of a "contract" involving the transfer of shares in a company (referred to as "the transferor company") to another company (referred to as "the transferee company"). It is difficult to

---

106 Report of the Committee on Company Law, Cmd. No. 2657 (1926), at para. 84.

107 *Ibid.*

108 Companies Act, 1929, 19 & 20 Geo. V., c. 23, s. 155.

109 Canada Corporations Act, R.S.C., 1952, c. 53, s. 128; R.S.A., 1955, c. 53, s. 138; R.S.B.C., 1960, c. 67, s. 181; R.S.N.S., 1967, c. 42, s. 119; R.S.S., 1965, c. 131, s. 189; R.S.Q., 1964, c. 271, s. 48.

110 *e.g.*, Canada Corporations Act, R.S.C., 1952, c. 53, s. 128.

111 See *Australian Consolidated Press Ltd. v. Australian Newsprint Mills Holdings Ltd.* (1961), 105 Commonw. L.R. 473, at p. 479 (High Ct. Aus.).

visualize such a contract in the traditional sense. Presumably it means a contract between the two companies.[112] However, the transfer of shares is a matter involving the transferee company and the shareholders of the "transferor" company, not the "transferor" company itself.

The English and Australian Acts use the phrase "scheme or contract", the former being held to include typical take-over bid offers to shareholders where no agreement was previously made with the "transferee" company itself.[113] The word "scheme" was omitted from Canadian legislation. Notwithstanding its omission, similar offers in Canada have been held to be within the provisions.[114] The use of the word "contract" in the English Act partly reflects the practice there. Often the purchaser first negotiates the offer with the directors of the other company with the intention of securing their individual shares and a resolution by them recommending acceptance of the offer by all shareholders. This agreement between the transferee company and the individual directors of the "transferor" company, and sometimes including its major shareholders, is referred to as "the contract".[115]

It was not intended that "approval" of the "contract" be a corporate act. Instead, acceptance of the offer by shareholders representing 90 *per cent* of the shares constitutes "approval". The acceptance authorizes the transferee company to give notice to the remaining shareholders indicating its intention to acquire their shares.

While it is clear that acceptance must take place within four months, it is not clear from the words of the statute if the offer must remain open four months. The provision reads:

> Where any contract . . . has, within four months after the making of the offer . . . been approved . . . the transferee company may . . .[116]

In *Rathie v. Montreal Trust Co.*[117] it was decided that the offer must remain open four months. Locke, J., delivered the majority opinion:

> In my opinion, the language of s-s. 1 . . . contemplates that the offer shall be open for acceptance for the period of four months by those to whom it has been made . . . The intention of Parliament in provid-

---

112 See *Rathie v. Montreal Trust Co.*, [1953] 2 S.C.R. 204, at p. 212 (Rand J.).

113 *Australian Consolidated Press Ltd. v. Australian Newsprint Mills Holdings Ltd.*, (1961) 105 Commonw. L.R. 473, at p. 479 (High Ct. Aus.).

114 *Cf.*, *Rathie v. Montreal Trust Co.*, [1953] 2 S.C.R. 204, at p. 212.

115 See *Australian Consolidated Press Ltd. v. Australian Newsprint Mills Holdings Ltd.* (1961), 105 Commonw. L.R. 473, at p. 479 (High Ct. Aus.).

116 Canada Corporations Act, R.S.C., 1952, c. 53, s. 128 (1).

117 [1953] 2 S.C.R. 204.

> ing that such an application could not be made until 4 months after the making of the offer was . . . to enable the shareholders to make such investigation as they might think advisable to enable them to determine whether the offer was fair and one that they wished to accept.[118]

Rand, J., in a concurring judgment gave a different reason. The provision provides that the transferee company may, at any time within two months after the expiration of the said four months, give the notice. He concluded that for this to make sense, the offer must remain open four months.

Both in England[119] and in Australia[120] the courts have decided otherwise. In the former, Winn-Parry, J., could not accept the view of Locke, J. There, the dissenting shareholder has "very limited rights (if any) to further information than that given in the circular setting out the terms of the offer".[121] Thus he found it difficult to attribute the intention of Parliament to provide a period for investigating the merits or demerits of the offer.[122] "Within four months" fixed the maximum period in which the offer must be accepted, not the minimum, as held by Rand, J. "The critical moment for ascertaining whether the obligation thrown on the transferee company . . . has arisen cannot possibly be the expiration of a fixed period, but must be that moment of time when the condition is fulfilled . . . [*i.e.* 90% shares acquired]."[123]

The judgment of Winn-Parry, J., has merit. Insuring adequate investigation as proposed by Locke, J., would be better achieved by maintaining a high standard of disclosure. Forcing a company to hold out its offer for four months does appear to be unduly long, especially since the general regulation of take-over bids requires it be open only twenty-one days.[124] However, his view that dissenting shareholders generally have very limited rights is without merit.

More generally, the difference in opinions reflects a difference in attitude between English and Canadian courts towards the rights of dissenting shareholders. In Canada, the company must strictly comply with the procedures set out.[125] In five of the six reported cases interpreting the provisions, the transferee company lost its

---

118 *Ibid.*, at p. 210.

119 *Re Western Manufacturing (Reading) Ltd.*, [1956] 1 Ch. 436.

120 *Lewis Emanuel & Son Ltd. v. Lombard Australia Ltd.*, [1963] N.S.W. 38 (Sup. Ct.).

121 *Re Western Manufacturing (Reading) Ltd.*, [1956] 1 Ch. 436, at p. 446.

122 *Ibid.*, at p. 448.

123 *Ibid.*, at p. 449.

124 The Securities Act (1966), 14 & 15 Eliz. II, c. 142, s. 81 (1) (Ont.).

125 *Rathie v. Montreal Trust Co.*, [1953] 2 S.C.R. 204, at p. 209.

rights by non-compliance.[126] The sixth case was referred to the trial court to be decided on the merits.[127] In Canada, the legislation has been called "drastic in the extreme"[128] and "confiscatory".[129] Laidlaw, J. A., could not satisfy himself as to the true purpose of the legislation.[130]

In addition, even where the court finds in favour of the company, dissenting shareholders are usually awarded costs.[131] They have a right to an expression of opinion from the Court.[132]

"One significant difference between the English and Canadian Acts is that the English Act provides that in computing the nine-tenths of the shares affected, there shall not be included 'shares already held at the date of the offer by, or by a nominee for, the transferee company or its subsidiary' ".[133] The inevitable conclusion has been that the section contemplates the acquisition of 90 per cent of the total issued shares independently held.[134]

Nor may the provisions be used to "squeeze out" minority shareholders. In *Re International Petroleum Co. Ltd.*,[135] Standard Oil Company of New Jersey owned all the shares of Esso Standard (Inter-American) Inc. and 96 *per cent* of the issued shares of International Petroleum Co. Ltd. Esso Standard's offer to purchase all the capital stock of International was accepted by Standard Oil.

---

126 *Rathie v. Montreal Trust Co.*, [1953] S.C.R. 204 (Noncompliance with the four month offering period requirement); *Re Waterous and Koehring-Waterous Ltd.*, [1954] 4 D.L.R. 839 (Ont., C.A.) (Extension of a thirty day offering to four months not sufficient.); *Re John Labatt Ltd.*, (1959), 29 W.W.R. 323 (B.C., Sup. Ct.) (Notice to dissenting shareholders referred to the Companies Act, 1934 which had been repealed by the Companies Act, 1952 and therefore was a nullity even though the material provisions were identical.); *Re International Petroleum Co. Ltd.*, [1963] S.C.R. 144 (A subsidiary of the purchaser already owned more than 10 per cent of the shares and therefore the purchaser could not acquire 90 per cent of the shares within four months.); *Re Canadian Breweries Ltd.*, [1964] Que. C.S. 600 (acquisition extended beyond four months).

127 *In re Canadian Food Products Limited and Picardy Limited*, [1945] 3 D.L.R. 287 (Man., C.A.).

128 *Ibid.*, at p. 290.

129 *Re John Labatt Ltd.* (1959), 29 W.W.R. 323, at p. 325 (B.C., Sup. Ct.).

130 *Re International Petroleum Co. Ltd.* (1962), 33 D.L.R. (2d) 658, at p. 667 (Ont., C.A.), aff'd., [1963] S.C.R. 204; See also *Re Hoare and Co.* (1933), 150 L.T. 374, at p. 376 (Ch. D.).

131 *Re Hoare & Co.* (1933), 150 L.T. 374 (Ch. D.); *Re Castner-Kellner Alkali Co.*, [1930] 2 Ch. 349; *In Re Canadian Food Products Limited and Picardy Limited*, [1945] 3 D.L.R. 287 (Man., C.A.).

132 *Re Hoare & Co.* (1933), 150 L.T. 374 (Ch. D.).

133 *Re International Petroleum Co. Ltd.* (1963), 37 D.L.R. (2d) 598, at p. 601.

134 *Ibid.*, at p. 604.

135 (1963), 37 D.L.R. (2d) 598.

Esso Standard then proceeded to acquire the shares of the dissenting stockholders pursuant to the compulsory acquisition provisions. The Supreme Court of Canada ordered otherwise, citing *Re Bugle Press Ltd.*[136]

> Even, therefore, though the present case does fall strictly within the terms of section 209, the fact that the offeror, the transferee company, is for all practical purposes entirely equivalent to the nine-tenths of the shareholders who have accepted the offer, makes it in my judgment a case in which, for the purposes of exercising the court's discretion, the circumstances are special—a case, therefore, of a kind contemplated by Maugham J. to which his general rule would not be applicable. It is no doubt true to say that it is still for the minority shareholder to establish that the discretion should be exercised in the way he seeks. That, I think agreeing with Mr. Instone, follows from the language of the section which uses the formula which I have already more than once read 'unless on an application made by the dissenting shareholder the court thinks fit to order otherwise'. But if the minority shareholder does show, as he shows here, that the offeror and the 90 per cent. of the transferor company's shareholders are the same, then as it seems to me he has, prima facie, shown that the court ought otherwise to order, since if it should not so do the result would be, as Mr. Instone concedes, that the section has been used not for the purpose of any scheme or contract properly so called or contemplated by the section but for the quite different purpose of enabling majority shareholders to expropriate or evict the minority; and that, as it seems to me, is something for the purposes of which, prima facie, the court ought not to allow the section to be invoked—unless at any rate it were shown that there was some good reason in the interests of the company for so doing, for example, that the minority shareholder was in some way acting in a manner destructive or highly damaging to the interests of the company from some motives entirely of his own.[137]

The more substantive rights of dissenting shareholders are sufficiently important to warrant separate treatment.[138]

Statutory Amalgamations

The final procedure available to effect a merger or acquisition is statutory amalgamation. Statutory amalgamations are possible in all jurisdictions in Canada. Typically, legislation provides:

> Any two or more companies, including a holding and subsidiary company, [having the same or similar objects][139] may amalgamate and *continue* as one company.[140] (Emphasis Added)

---

136 [1961] 1 Ch. 270 (C.A.).

137 *Ibid.*, at pp. 286-7; *accord.*, *Re International Petroleum Co. Ltd.* (1963), 37 D.L.R. (2d) 598, at p. 603.

138 *Infra*, at p. 47.

139 The requirement of similar objects is found only in New Brunswick, Newfoundland, Ontario, and Quebec.

140 The Corporations Act, R.S.O., 1960, c. 71, s. 96 (1).

The preceding provision was first enacted in Ontario and applicable generally in 1897,[141] followed by Quebec in 1920.[142] It was not until after statutory amalgamations were afforded preferred tax treatment in 1958[143] that the remaining jurisdictions enacted comparable legislation.[144]

The companies proposing amalgamation enter into an agreement setting out the terms and conditions of the plan which must then be approved by the shareholders. Some jurisdictions require the approval of two-thirds of the votes cast at a general meeting, others, three-fourths.

Procedures designed to protect the rights of dissenting shareholders vary. In Ontario, after adoption of the plan by the shareholders, the companies may immediately make a joint application for letters patent confirming the agreement.[145] On the other hand, in Manitoba the amalgamation agreement must be approved by the court,[146] judicial review being intended to afford protection to dissenting shareholders. When the Canada Corporations Act was being amended in 1965, "representations were made . . . [to] the Senate Banking and Commerce Committee that the Manitoba procedure placed an unreasonable burden upon the companies wishing to amalgamate".[147] A compromise was reached—rather than require judicial approval, the Canada Corporations Act permits dissenting shareholders representing 10 per cent of the shares in an amalgamating company to apply to the court for an order annulling the amalgamation agreement.[148] The order of the judge is final and not subject to appeal.[149] Under both the Manitoba and Federal Acts, the amalgamation must also be confirmed by letters patent.

The scheme is deceptively simple. It is the concept of continuity of the amalgamated companies that distinguishes it from a sale of assets and purchase of shares. In the latter instances, there can be

---

141 Ontario Companies Act (1897), 60 Vict., c. 28, s. 102.

142 R.S.Q., 1909, Art 5967f; 10 Geo. V, c. 72, s. 1.

143 (1958), 7 Eliz. II, c. 32, s. 35 (Can.).

144 (1958), 7 Eliz. II, c. 32, s. 35 (Can.); (1959), 8 Eliz. II, c. 10, s. 7 (Alta.); R.S.B.C., 1960, c. 67, s. 178; (1964), 13 Eliz. II, c. 3, ss. 110, 111 (Man.); (1954), 3 Eliz. II, c. 28, s. 4 (N.B.): R.S.N.S., 1967, c. 42, s. 120; (1960), 9 Eliz. II, c. 8, s. 2 (P.E.I.): R.S.S., 1965, c. 131, s. 190.

145 The Corporations Act, R.S.O., 1960, c. 71, s. 96 (3), (4).

146 Companies Act (1964), 13 Eliz. II, c. 3, s. 111 (4) (Man.).

147 Williamson, *Federal Companies Act Amendments*, 30 Business Quarterly (Fall 1965), at pp. 38 and 43.

148 The Canada Corporations Act, R.S.C., 1952, c. 53, s. 128A (5), as amended by (1964-65), 13 & 14 Eliz. II, c. 52, s. 41.

149 *Ibid.*

no fusion of corporate entities.[150] A statutory amalgamation, on the other hand, has been described "as if two rivers join and continue as one".[151]

The major difficulty attendant the continuity concept is to appreciate the full legal effect of the amalgamation. Once confirmed by letters patent, "the amalgamated company possesses all the property, rights, assets, privileges and franchises, and is subject to all the contracts, liabilities, debts and obligations of each of the amalgamating companies."[152]

In *The Stanward Corp. v. Denison Mines Ltd.*[153] the plaintiff, Stanward, conveyed eighteen mining claims in the Quirke Lake area to Can-Met Explorations Limited in consideration of $300,000 cash, 50,000 shares of Can-Met, and a royalty of $1.00 per ton for each ton of ore mined from the eighteen claims, or from fourteen other mining claims then owned by Can-Met," or [from] any other claims which [Can-Met] may acquire adjacent thereto". In 1960, Can-Met, then in financial difficulties, amalgamated with Consolidated Denison Mines Limited, the continuing corporate entity being called Denison Mines Limited. Consolidated had owned eighty-eight claims that began approximately one-quarter mile from the Can-Met claims. One of the issues before the court was whether the former Consolidated claims were, upon amalgamation, "acquired" within the meaning of the royalty agreement.

Gale, J., in the Ontario High Court,[154] noted that nothing in the statute or letters patent provided that either of the two companies amalgamated acquired the property of the other. He concluded that it could not be said that Can-Met acquired Consolidated's claims.[155] However, the liabilities imposed by the royalty agreement followed Can-Met when it subsequently amalgamated with Consolidated and Denison "acquired" the claims.

> While it may be that, for the purposes of the statute, an amalgamated company does not 'acquire' the property which prior to the amalgamation was owned by its amalgamating components, I am firmly of

---

150 Street, *The Doctrine of Ultra Vires* (1930), at pp. 146-7.

151 Cudney, *Company Amalgamations*, [1958] Tax Conf. Report 30, at p. 35; See also, *The Stanward Corporation v. Denison Mines Ltd.* (1966), 52 D.L.R. (2d) 115, at p. 121.

152 *e.g.*, Canada Corporations Act, R.S.C., 1952, c. 53, s. 128A (13) (b), as amended by (1964-65), 13 & 14 Eliz. II, c. 52, s. 41.

153 (1966), 57 D.L.R. (2d) 674 (Ont., C.A.), affirmed on other grounds [1968] S.C.R. 441.

154 (1966), 52 D.L.R. (2d) 115.

155 *Ibid.*, at p. 121.

> the opinion that Denison did 'acquire' the Consolidated claims in the sense in which that word was employed in the royalty agreement.
>
> Any other interpretation would establish the efficacy of the amalgamation procedure as an instrument of evasion and abuse.[156]

On appeal, Kelly, J. A., after pointing out that he was not considering whether there could be enforced against the defendant a liability to which Can-Met was subject prior to amalgamation, said that if Can-Met had assigned the mines to a third party, Can-Met would have remained liable if the third party mined those claims, but this would not have given the plaintiff a right to a royalty when ore was mined from the third party's own claims because the terms of the royalty provisions were not fulfilled. The royalty provisions were not changed by amalgamation.[157]

> Section 96(4) of the Corporations Act declares, so far as relevant, that 'the amalgamated company possesses all the property, rights, privileges and franchises and is subject to all liabilities, contracts, disabilities and debts of each of the amalgamating companies'. If the two companies, Can-Met and Consolidated Denison, continue as one, the statutory result that the amalgamated company becomes liable to pay the plaintiff any earned royalty cannot itself become the means of satisfying the agreement condition on which the earning depends, namely, that the tonnage be from the Can-Met group or from claims acquired by Can-Met. The amalgamated company, being 'possessed' of claims brought in by the other 'inseparable twin', does not, as statutory successor or substitute to discharge the obligations of Can-Met, satisfy by such possession the contractual condition that the claims come from Can-Met. If the amalgamated company is a new company, the effect of its statutory succession to the rights and obligations of Can-Met cannot involve a change in the terms of the royalty provisions underlying the obligations which Can-Met undertook. How can it be said that Can-Met acquired claims when it ceased to exist upon amalgamation or became swallowed up in a new company which at the same time swallowed up Consolidated Denison ?[158]

Kelly, J. A., is of the opinion that the language is unambiguous in providing that the two amalgamating companies continue as one. While the exact metamorphosis taking place is uncertain, there was no acquisition by a new entity.[159] The same conclusion was reached where a question of liability for land transfer taxes was raised. There, any technical change in ownership was part of the blending process of amalgamation.[160]

The rationale also avoids the necessity of a formal assignment of contracts and leases. If assignability is subject to third party

156 *Ibid.*, at p. 122.

157 *The Stanward Corporation v. Denison Mines Ltd.* (1966), 57 D.L.R. (2d) 674, at p. 679 (Ont., C.A.), affirmed on other grounds [1968] S.C.R. 441.

158 *Ibid.*, at p. 680.

159 *Ibid.*, at p. 681.

160 *Re Quieting Titles Act* (1962), 40 W.W.R. 182, at p. 184 (B.C., Sup. Ct.).

consent, *e.g.*, possibly with leases, this mode of merger can be particularly advantageous.

In sum, the amalgamation procedure provides many of the advantages of a sale of shares with the additional benefits of one corporate entity.

On the other hand, *The Stanward Corporation v. Denison Mines Ltd.*[161] illustrates the inherent dangers accompanying the assumption by the amalgamated company of unknown risks. Had that merger been by way of a sale of assets, it is doubtful the dispute would have been contested. As Darrell[162] points out:

> Freedom from responsibility for liabilities of the transferor or acquired corporation is frequently an important consideration in the eyes of the management of an acquiring corporation. When this is so, a simple clean-cut purchase of the desired property, leaving the transferor corporation with all responsibility for its own liabilities, has strong appeal.

The danger of assuming criminal responsibility is less great. In *R. v. J. J. Beamish Construction Co. Ltd.*,[163] Grey-Wellington Paving Co. Ltd. amalgamated under the Ontario Corporations Act with two other companies. Subsequently, Grey-Wellington, but not the amalgamated company, was charged along with eleven other companies, under the Combines Investigation Act[164] with conspiring to lessen competition during a period before the amalgamation. Grey-Wellington was acquitted on the ground that it ceased to have entity or identity once amalgamation was accomplished. Jessup, J., further indicated that the amalgamated company had not assumed the liability:

> 'Liabilities' in s. 94(4) cannot be taken to include criminal liabilities which would involve ultra vires legislation by the Province on a matter of criminal law.[165]

There are often a number of additional problems associated with statutory amalgamations. There may be restrictions in existing loan indentures or other agreements upon mergers and acquisitions. The constituent companies may have labour contracts with different unions, and then there are the problems of reconciling and meshing

---

161 (1966), 57 D.L.R. (2d) 674 (Ont., C.A.), affirmed on other grounds [1968] S.C.R. 441.

162 Darrell, *The Use of Reorganization Techniques in Corporate Acquisitions* (1957), 70 Harv. L. Rev. 1183, at pp. 1200-1201.

163 (1967), 59 D.L.R. (2d) 6.

164 R.S.C., 1952, c. 314.

165 *R. v. J. J. Beamish Construction Co. Ltd.* (1967), 59 D.L.R. (2d) 6, at p. 11, aff'd on other grounds (1966), 65 D.L.R. (2d) 260 (Ont., C.A.). *Quaere:* Whether the same result would follow if it were a federal amalgamation.

deferred-compensation plans of the corporations. Patent-licence agreements may prohibit merger or acquisition, to mention a few.[166]

Summary of Legislation

A summary of the legislation and required authorizations relating to mergers and acquisitions in Canada is provided in Table B.

The obvious inconsistencies are a product of spasmodic amendments intended to update legislation that needed more thorough study. Many provisions date back to the nineteenth century. Not only are there many inter-jurisdictional inconsistencies but there are also intra-jurisdictional differences. The result is a great deal of corporate freedom.

Minority Rights

Introduction

On one side of the transaction stands the majority, wanting to carry out the merger or acquisition; on the other sits the dissenting minority. To the majority, the contract may be an opportunity to "cash in" or the beginning of grandeur; to the minority, "cashing in" may be forsaking future dividends or, in a merger, embarking on an unseaworthy ship bound for parts unknown. Whatever the reasons, the dilemma is a classic problem of balancing of interests.

Opposing the will of the majority to manage the company is the will of a minority that is being forced to accept the majority's terms and conditions. At early common law the doctrine of *ultra vires* afforded full protection to dissenting shareholders. In most cases, the unanimous consent of the shareholders was necessary to effect a merger or acquisition, as has already been seen.

With the decline of the doctrine of *ultra vires*, the pendulum swung to the other extreme. As a general rule, courts refused to interfere with the internal management of the company, which now included mergers and acquisitions. The majority was supreme. Engrafted on this rule were several exceptions, the most important being that minority shareholders would have a right of action if the transaction amounted to fraud. Thus stands the common law today.

In terms of policy, neither extremity is satisfactory. That any shareholder could veto the majority is, in most circumstances, an unworkable proposition; that the majority should have near absolute control over the minority rings of unfairness. Thus it is not surprising that legislatures intervened. The first step was to require greater than majority approval, *e.g.*, two-thirds or three-fourths of the votes. In Anglo-Canadian jurisdictions, minority interests were

166 See, generally, Darrell, *The Use of Reorganization Techniques in Corporate Acquisitions* (1957), 70 Harv. L. Rev. 1183.

further protected by requiring judicial review—a novel provision that, in effect, passed the basic problem of balancing of interests back to the judiciary with a conspicuous absence of any direction. In contrast, most American jurisdictions have granted dissenting shareholders the right to have their shares appraised and receive cash.

Judicial Review

Various types of mergers and acquisitions afford dissenting shareholders special rights, the most common in Canada being the right to judicial review. Typically, merger and acquisition procedures that grant minority rights require the proposed plan to be sanctioned by a court.

The concept of judicial review in this form originated in The Joint Stock Companies Arrangement Act, 1870.[167] While the legislative intent in requiring arrangements to be sanctioned by court order is not altogether clear from the words of the statute,[168] it has achieved two beneficial results. It provided protection for creditors and shareholders by requiring notice to them and a means of ascertaining if there had been compliance with the requirements. It also provided a degree of finality to the plan. Judicial sanction makes it difficult to annul the plan at a later date. In addition, the courts have read into their discretionary sanctioning power an obligation on their part to review the merits of the plan. Most generally, this means the plan must be fair and reasonable.

The first obligation of the court is to determine the legality of the plan. Courts usually require strict compliance with the procedures set down.[169]

The fair and reasonable requirement has been applied in arrangements and reconstructions,[170] statutory amalgamations,[171] winding-ups,[172] and compulsory sales following takeover bids.[173] Traditionally, procedure and the doctrine of precedent has kept each type of transaction separate. However, a comparative analysis will accentuate the differing policies exhibited by each.

167 (1870), 33 & 34 Vict., c. 104.

168 See, *supra*, at p. 33.

169 *e.g.*, *Rathie v. Montreal Trust Co.*, [1953] S.C.R. 204.

170 *Re Western Grocers Ltd.*, [1936] 2 D.L.R. 762 (Man., K.B.); *In Re Provincial Apartments Ltd.*, [1936] 3 W.W.R. 327 (Sask., K.B.); *Re National Grocers Ltd.*, [1938] 3 D.L.R. 106 (Ont., Sup. Ct.).

171 *Fogler v. Norcan Oils Ltd.* (1964), 43 D.L.R. (2d) 508, at p. 514 (Alta., C.A.), rev'd on other grounds [1965] S.C.R. 36.

172 *e.g.*, Winding-Up Act, R.S.N.B. 1952, c. 252, s. 3 (f).

173 *Re Hoare & Co.* (1933), 150 L.T. 374 (Ch. D.); *In re Evertite Locknuts Ltd.*, [1945] 1 Ch. 220; *In re Press Caps Ltd.*, [1949] 1 Ch. 434.

LE

Jurisdiction
Canada
Alberta
British Columbia
Manitoba
New Brunswick
Newfoundland
Nova Scotia
Ontario
Prince Edward Island
Quebec
Saskatchewan

TABLE B—SUMMARY

EGISLATION RELATING TO MERGERS AND ACQUISITIONS IN CANADA AND REQUIRED AUTHORIZATIONS

	Purchase and Sale of Assets			Purchase of Shares		Statutory Amalgamation
	Purchase-Authorization	Sale	Amalgamation or Reconstruction	General	Compulsory Acquisition	General
	Board of Directors	Board of Directors	¾ of the votes of shareholders	Board of Directors	90% of the shares must be tendered	¾ of the votes of shareholders
	Board of Directors	Board of Directors	¾ of the votes of shareholders	Board of Directors	90% of the shares must be tendered	¾ of the votes of shareholders
	Board of Directors	Board of Directors	¾ of the votes of shareholders	Ordinary resolution or general authorization passed every year	90% of the shares must be tendered	¾ of the votes of shareholders
	Board of Directors	⅔ of votes of share-holders	¾ of the votes of shareholders	Board of Directors		⅔ of the votes of shareholders
	Board of Directors	Board of Directors	¾ of the votes of shareholders	Board of Directors		¾ of the votes of shareholders
d	Board of Directors	Board of Directors		Board of Directors		¾ of the votes of shareholders
	Board of Directors	¾ of votes of share-holders	¾ of the votes of shareholders	¾ of the votes of share-holders	90% of the shares must be tendered	¾ of the votes of shareholders
	Board of Directors	⅔ of votes of share-holders	¾ of the votes of shareholders	Board of Directors		⅔ of the votes of shareholders
	Board of Directors	⅔ of votes of share-holders		By-law confirmed at a general meeting		¾ of the votes of shareholders
	Board of Directors	Board of Directors		Authorization in letters patent or by a by-law approved by ⅔ votes	90% of the shares must be tendered	⅔ of the votes of shareholders
n	Board of Directors	Board of Directors		Ordinary resolution necessary for each purpose	90% of the shares must be tendered	¾ of the votes of shareholders

The basic consideration is whether the court, on the recommendation of a minority, should annul a majority approved plan. By applying the fair and reasonable test in striking down such a plan, the court implies that the majority has acted to their detriment. The onus of proof is on the dissenting shareholders, "for the large preponderance of shareholders who accepted the offer affords cogent evidence that the offer was fair and reasonable".[174]

The difficulties of balancing interests are obvious and no really useful criteria have been developed. In England, under comparable provisions, courts lean much more in favour of proposals than in Canada. Vaisey, J., put the test in these terms:

> I think it rather difficult to predicate unfairness in any case in which there has been perfect good faith on the side of the person who is alleged to have been unfair.
>
> . . .
>
> A scheme must be obviously unfair, patently unfair, unfair to the meanest intelligence.
>
> . . .
>
> It must be affirmatively established that notwithstanding the view of the majority the scheme is unfair and that is a different thing from saying that it must be established that the scheme is not very fair or not a fair one: a scheme has to be shown affirmatively, patently, obviously and convincingly to be unfair.[175]

In Canada, fair and reasonable means reasonable to reasonable people conversant in the matter.[176] However, substitution of the court's opinion for that of the majority in any given factual situation leaves the test obscure. For example, acting under the reorganization provisions, a proposal to convert preferred shares into common was struck down on the application of a common shareholder who did not want to share future profits on an equal basis with preferred shareholders, even though the proposal meant cancellation of a substantial arrearage of preferred dividends.[177] The complicating factors were substantial holdings of preferred stock by common shareholders and a recent change in the profit picture of the company. On the other hand, a similar plan was not sanctioned on the objection of a preferred shareholder on the grounds that he would lose his priority rights. MacDonald, J., stated, "I cannot regard this

---

174 *In re Canadian Food Products Limited and Picardy Limited*, [1945] 3 D.L.R. 287, at p. 291 (Man. C.A.) (compulsory sale following a takeover bid).

175 *Re Sussex Brick Co. Ltd.*, [1961] 1 Ch. 289, at pp. 291—3.

176 *Re Western Grocers Ltd.*, [1936] 2 D.L.R. 762, at p. 767 (Man., K.B.); *In Re Provincial Apartments Ltd.*, [1936] 3 W.W.R. 327, at p. 331 (Sask., K.B.).

177 *Re National Grocers Ltd.*, [1938] 3 D.L.R. 106 (Ont., Sup. Ct.).

as other than confiscation of some of the property of the preferred class, . . ."[178]

It is clear that where a large portion of the shareholders have special interests in the transaction, the cogency of their evidence is substantially reduced.[179]

Thus far we have only considered situations where the proposed transaction must be sanctioned by a court. These include arrangements and reconstructions, statutory amalgamations, winding-ups, and compulsory sales following takeover bids. In the absence of special legislation, mergers and acquisitions by purchase and sale of assets or shares may be effected without dissenting shareholders having an absolute right to judicial review. The general rule is rule by the majority. However, a sale of assets, and *a fortiori*, of shares, may be set aside by an action brought by the minority on the grounds of fraud. Since there is no requirement of judicial sanctioning, the fair and reasonable test has no application.[180]

Judicial review is a poor means of affording protection to dissenting shareholders. The confirmation—annulment alternative is too rigid to effect justice. One side wins or loses, leaving no room for compromise. The result is difficulty in finding standards that meet the practical necessities of business. Rather than granting minorities the opportunity to block the will of the majority, the granting of appraisal rights would seem a much better solution.

Disclosure

Closely akin to judicial review is the right of shareholders to information concerning the merger or acquisition. While advances have been made in recent enactments in securities acts, some general guidelines have already been developed by the courts.

A court presumes, when sanctioning a transaction, that business people are much better able to judge their own affairs than the court. Underlying this presumption is the disclosure of sufficient information to enable them to determine the fairness and propriety of the plan before exercising their judgment.

> No court can determine whether [a] merging transaction is fair and no shareholder can make a decision without having knowledge of all the facts which a prudent man disposing of one stock and acquiring another would require to weigh and consider before coming to a

---

178 *In Re Provincial Apartments Ltd.*, [1936] 3 W.W. R. 327, at p. 332 (Sask., K.B.).

179 *Re National Grocers Ltd.*, [1938] 3 D.L.R. 106 (Ont., Sup. Ct.); *Re St. Lawrence Corp.*, [1948] 2 D.L.R. 107 (Que., Sup. Ct.); *Re Canadian Cottons Ltd.*, [1952] Que. C.S. 276.

180 *Garvie v. Axmith* (1962), 31 D.L.R. (2d) 65 (Ont., Sup. Ct.).

decision. The necessary facts will vary with the characteristics of the companies involved but in companies of the kind being dealt with here they may well include, for example, the following: book value for historical purposes, demonstrated earning capacity, liabilities current and long term, cash flow, provisions for depreciation and depletion, market activities, the speculative potential of the acreage of an exploratory company, proper estimates of reserves, and their marketability, as well as the benefits that might accrue to the shareholders in the future operations of the merged company that would not be available if the companies were not merged.[181]

Full disclosure is required where a company (1) intends to force dissenting shareholders to sell their stock pursuant to the compulsory sale provisions;[182] (2) intends to carry out an amalgamation or reconstruction;[183] or (3) intends a statutory amalgamation.[184] Where judicial sanctioning is not required, as in a sale of assets:

> . . . there not being, unless an action such as the present one is taken, any opportunity by the Court to consider the transaction, the notice of the special general meeting to approve the transaction should be all the more detailed and explanatory in its form.[185]

Canadian courts generally have not followed English decisions on disclosure. The latter have taken a very limited view of the rights of shareholders, especially in regard to the compulsory sale of shares legislation. *In re Evertite Locknuts Ltd.*[186] Vaisey, J., said:

> I have really no materials before me which will enable me to say either that any information with regard to that company was withheld, or whether, if so, it was withheld improperly. The difficulty I feel is that, if once it is conceded that a scheme of this kind can be upset merely for the reason that a shareholder is not given all the information which he might require or might expect from the directors of the transferor company, there would be no limit to the inquiry which would have to be set on foot as to the extent to which his demands for disclosure ought to be conceded.[187]

In contrast, Locke, J., in *Rathie v. Montreal Trust Company*[188] rationalized holding the offer open four months "to enable the

---

181 *Fogler v. Norcan Oils Ltd.* (1964), 43 D.L.R. (2d) 508, at p. 518 (Alta., C.A.); accord, Spence, J., dissenting, [1965] S.C.R. 36.

182 *Re John Labatt Ltd.*, (1959), 29 W.W.R. 323 (B.C., Sup. Ct.).

183 *Re Brazilian Traction Light and Power Co.*, [1947] 4 D.L.R. 736; *Re N. Slater Co.*, [1947] 2 D.L.R. 311; *Re St Lawrence Corp.*, [1948] 2 D.L.R. 107 (Que., Sup. Ct.).

184 *Fogler v. Norcan Oils Ltd.* (1964), 43 D.L.R. (2d) 508 (Alta., C.A.) rev'd on other grounds, [1965] S.C.R. 36.

185 *Garvie v. Axmith* (1962), 31 D.L.R. (2d) 65, at p. 86 (Ont., Sup. Ct.).

186 [1945] 1 Ch. 220.

187 *Ibid.*, at p. 224; accord, *Re Western Manufacturing (Reading) Ltd.*, [1956] 1 Ch. 436, at p. 446; see also, *In re Press Caps Ltd.*, [1949] 1 Ch. 434.

188 [1953] 2 S.C.R. 204.

shareholders to make such investigation as they might think advisable to enable them to determine whether the offer was fair and one they wished to accept".[189] Obviously he was contemplating the availability of some information.

While Canadian disclosure requirements are more akin to American legislation than British, the proxy rules of the Securities and Exchange Commission in the United States must not be considered a useful guide. In *Norcan Oils Ltd. v. Fogler*[190] over 90 per cent of the shares of the Alberta company were owned by residents of the United States and the shares were listed on the American Stock Exchange. To an allegation of lack of disclosure of certain estimates, the company countered that the proxy rules promulgated by the S.E.C. prohibited the publication of such information, in reply to which the court said:

> . . . no S.E.C. requirements or regulation should prevent shareholders in Canada having proper notice of such an important matter when considering the proposed amalgamation.[191]

Most of the cases exemplify the difficulties in formulating guidelines for disclosure in the absence of specific legislation. With the enactment of securities legislation specifically regulating takeover bids and the content of information circulars, one might argue that the corporate requirements are also delimited. However, it would probably be an error to so restrict the development of the law.

Other Minority Rights

It has been suggested that appraisal rights are a more effective remedy than judicial review.[192] In some jurisdictions, when a private company intends to sell the undertaking or amalgamate, dissenting shareholders may require the company to purchase its shares at a price agreed upon or determined by the court.[193] A possible explanation for restricting the provision to private companies was the belief that if a shareholder of a public company dissented, he could sell his shares in the open market.[194] However, many public companies, especially those traded in the over-the-counter market in Canada, have few prospective purchasers.

---

189 *Ibid.*, at p. 210; *Re John Labatt Ltd.* (1959), 29 W.W.R. 323 (B.C., Sup. Ct.) (Manson J. refused to compel the sale of shares because, *inter alia*, there was not full disclosure.).

190 (1964), 43 D.L.R. (2d) 508 (Alta., C.A.); rev'd on other grounds [1965] S.C.R. 36.

191 [1965] S.C.R. 36, at p. 50 (Spence J. dissenting).

192 *Supra*, at p. 52.

193 *e.g.*, The Corporations Act, R.S.O., 1960, c. 71, s. 99.

194 MacKinnon, *The Protection of Dissenting Shareholders*, in Ziegel, *Studies in Canadian Company Law* (1967), at pp. 507 and 521.

In conclusion, it is submitted that appraisal rights should be substituted for judicial review, as they are a better means of balancing the interests of opposing groups.

Constitutional Limitations on Corporate Mergers and Acquisitions

Confederation[195]

"Confederation was conceived as the solution for a number of political and economic difficulties and, therefore, had both political and economic aims. Politically it was designed to establish a new nation to meet the changed conditions of British policy and to brace the scattered provinces against possible American aggression. Economically it was intended to foster a national economy which would relieve dependence upon a few industries and lessen exposure to the effects of the economic policies pursued by the United States and Great Britain."[196] Politically, it was also intended to preserve local and cultural loyalties. "Thus for various reasons, the builders of the new nation planned a federation comprised of a central government with authority over matters of general and common interest and provincial governments with authority over matters of local concern."[197]

The compromise, as embodied in the British North America Act, 1867,[198] gave the provinces exclusive power to make laws in relation to matters coming within section 92 of the Act. These included such matters as the establishment of hospitals, charities, eleemosynary and municipal institutions; the management of public lands; the administration of justice; regulating local works and undertakings, and property and civil rights in the province. The Dominion was given the power "to make laws for the Peace, Order and good Government of Canada, in relation to all matters not coming within the Classes of Subjects by this Act assigned exclusively to the Legislatures of the Provinces."[199] By way of illustration, this residual power was declared to include such matters as the regulation of trade and commerce; postal service; defence; navigation and shipping; fisheries; banking and the issue of paper money; savings banks; bankruptcy and insolvency; criminal law; and certain other topics primarily of economic importance.

---

195 This section is based on 1 The Report of the Royal Commission on Dominion-Provincial Relations (1940), at pp. 24-36; see also Laskin, *Canadian Constitutional Law* (3rd ed., 1966), at pp. 1-6.

196 *Ibid.*, at p. 29.

197 *Ibid.*

198 (1867), 30-31 Vict., c. 3.

199 (1867), 30-31 Vict., c. 3, s. 91.

The general scheme was carried over into the power to incorporate companies. The incorporation of companies with provincial objects was placed within the exclusive jurisdiction of the provincial legislatures[200] and *a fortiori*, the residual power was vested in the Dominion. For greater certainty, the Dominion was given exclusive authority over the incorporation of banks.[201] Mergers and acquisitions are, at least in part, a matter incidental to the incorporation power and, in part, a matter of property and civil rights. Legislative jurisdiction may follow similar patterns.

Questions of Incorporation and Property and Civil Rights

Amalgamations and reorganizations affect corporate status and capacity; the constituent corporations became one entity with consequent changes in capital structure and management. At common law questions of corporate status and capacity are determined by the law of the domicile of the corporation, *i.e.*, the place of incorporation.[202] It would seem to follow that the incorporating jurisdiction has legislative authority over the amalgamation or reorganization of the corporations it creates.

Corporate mergers and acquisitions by purchase and sale of assets or shares, on the other hand, do not necessarily affect corporate status and capacity. A sale of assets or a takeover can be effected without alteration of the status of the constituent corporations. In the first instance the acquired corporation becomes a holding company; in the latter, a subsidiary of the acquiring corporation.

The constitutional disputes usually revolve around the question of whether the acquisition is a matter of incorporation and thus governed by the law of the place of incorporation, or whether it is a question of property and civil rights and thus within provincial jurisdiction. Obviously, the question is academic where provincially incorporated companies are involved.

(a) Changes in Corporate Status and Capacity

The provincial power to incorporate companies is limited to those with provincial objects. *A fortiori*, there is a similar limitation on its power to regulate mergers and acquisitions, which is derived from its incorporation power. The meaning of the words "with provincial objects" are critical. Generally, when the constituent corporations have been incorporated in the same jurisdiction, the legislative power of that jurisdiction to amalgamate or reconstruct the companies is beyond dispute. However, the British North

200 (1867), 30-31 Vict., c. 3, s. 92 (11).

201 (1867), 30-31 Vict., c. 3, s. 91 (15).

202 Cheshire, *Private International Law* (7th ed., 1965), at p. 179.

America Act[203] has been a major obstacle to interjurisdictional amalgamations. If the constituent corporations were incorporated in the provinces, they must have "provincial objects"; if they were incorporated in different provinces, can they then be amalgamated under one charter "with provincial objects" granted by only one province?

The question is generally answered in the affirmative.[204] Since *Bonanza Creek Gold Mining Co. v. The King*,[205] the phrase "with provincial objects" has been liberally construed, if not judicially "repealed". Prior to this decision, the meaning of the phrase was the subject of a heated controversy that is best explained historically.

The drafting of the exclusive provincial power has been traced by Professor Ziegel.[206] Resolution No. 43, item 14 of the Quebec Resolutions would have given the provinces authority over "The incorporation of private or local Companies, except such as relate to matters assigned to the General Parliament." "The wording was changed in the 'revise' stage of the first draft [of the British North America Act Bill to] . . . read 'The incorporation of companies with exclusively Provincial Objects'."[207] Finally, the word "exclusively" was omitted.

In 1910 the scope of the provincial limitation was referred to the Supreme Court of Canada.[208] Several different interpretations were placed on the legislative power. In keeping with the general scheme of the Act, one interpretation was that the power should be restricted to the incorporation of companies relating to local and private matters within Section 92. Parliament alone had the capacity to incorporate companies to do business in two provinces.[209] Another view was that the words referred to the distribution of legislative powers only and that there was no territorial limitations on provincial companies.[210] Still another approach would have permitted the province to confer on a company the "capacity to acquire rights and exercise their powers . . . outside the province, so long as the

203 (1867), 30 & 31 Vict., c. 3.

204 Ziegel, *Constitutional Aspects of Canadian Companies*, in Ziegel, *Studies in Canadian Company Law* (1967), at pp. 149 and 191; Cudney, *Interjurisdictional and De Facto Mergers*, [1964] Tax Conf. Report 29, at pp. 38-41.

205 [1916] 1 A.C. 566 (P.C.).

206 Ziegel, *Constitutional Aspects of Canadian Companies*, in Ziegel, *Studies in Canadian Company Law* (1967), at pp. 149 and 188-9.

207 *Ibid.*

208 *In the matter of the Incorporation of Companies in Canada* (1910-13), 48 S.C.R. 331.

209 *Ibid., per* Fitzpatrick, Davies, C.J.J.

210 *Ibid., per* Brodeur J., see also Idington, J.

business when looked at as a whole as that of an incorporated company (in connection, that is to say, with the capacities and powers of the company so exercisable beyond the limits of the province) is still a 'provincial' business. Whether in any particular case that is or is not so is a question to be determined according to the circumstances of that case."[211] Dissatisfied, the reference was taken to the Privy Council.

Lord Haldane refused to answer the question in the abstract fearing possible injustice to future suitors.[212] He did refer to *Bonanza Creek Gold Mining Co. v. The King*,[213] having given judgment on the same day, where he said:

> The whole matter may be put thus: The limitations of the legislative powers of a province expressed in s. 92, and in particular the limitation of the power of legislation to such as relates to the incorporation of companies with provincial objects, confine the character of the actual powers and rights which the provincial Government can bestow, either by legislation or through the Executive, to powers and rights exercisable within the province. But actual powers and rights are one thing and capacity to accept extra provincial powers and rights is quite another . . . The words 'legislation in relation to the incorporation of companies with provincial objects' do not preclude the province from keeping alive the power of the Executive to incorporate by charter in a fashion which confers a general capacity analogous to that of a natural person . . . What the words really do is to preclude the grant to such a corporation, whether by legislation or by executive act according with the distribution of legislative authority, of powers and rights in respect of objects outside the province, while leaving untouched the ability of the corporation, if otherwise adequately called into existence, to accept such powers and rights, if granted *ab extra*.[214]

Pursuing this reasoning, companies incorporated in different provinces may be amalgamated under the laws of one jurisdiction, if the domiciles of the constituent corporations both so provide.

The only legislation permitting interjurisdictional mergers is an adaption of the "reincorporation" theory. Before the amalgamation takes place, the foreign constituent corporations must all be reincorporated in the amalgamating jurisdiction. Thus, for a company incorporated in Manitoba to amalgamate with a company in Ontario, one of the companies must be reincorporated in the jurisdiction of the other. Upon reincorporation, the laws of the original jurisdiction cease to apply and the two companies being now under one jurisdiction are theoretically in a position to amalgamate.[215]

---

211 *Ibid.*, at p. 401, *per* Duff, J.

212 [1916] 1 A.C. 598, at p. 602 (P.C.).

213 [1916] 1 A.C. 566 (P.C.).

214 *Ibid.*, at p. 583.

215 Companies Act (1964), 13 Eliz. II, c. 3, ss. 112-113; The Corporations Act, R.S.O., 1960, c. 71, ss. 323 and 323a.

The reincorporation theory has not always been fully accepted. Wegenast[216] objects to the possibility of a company being subject to two jurisdictions at one time, *e.g.*, "How could the second jurisdiction alter the number of directors, the name, the chief place of business, the objects, or any other item of the company's constitution?"[217] The interjurisdictional amalgamation procedure eliminates this element by terminating control by one jurisdiction upon reincorporation in the other.

There appears to be no constitutional problem respecting the surrendering jurisdiction. "[T]he 'accepting' province is not trenching on the jurisdiction of the 'giving' province because it is acting with its consent. No delegation of powers would appear to be involved between the two provinces; they are simply acting in concert."[218]

It would thus appear that *via* this circuitous route, interjurisdictional amalgamations are constitutionally valid. However, the procedure has not been judicially tested and, in view of the necessity of certainty in corporate transactions, the procedure should be referred to the court for an advisory opinion.[219]

If the circuitous route is valid, the question naturally arises whether the provinces may do directly what is generally believed they are able to do indirectly, *i.e.*, amalgamate interjurisdictional companies. The New York Business Corporation Law provides:

> One or more foreign corporations and one or more domestic corporations may be merged or consolidated into a corporation of this state or of another jurisdication, if such merger or consolidation is permitted by the laws of the jurisdiction under which each such foreign corporation is incorporated.[220]

A similar enactment would appear to be valid if enacted by Canadian legislatures.

Thus far we have only considered amalgamations between provincial companies. Similar constitutional problems face an amalgamation of a Dominion and a provincial company. Enabling legislation was considered by the Senate Banking and Commerce Committee as part of the 1965 amendments and subsequently deleted. "It was feared that the constitutional doubts were so great that the Bill

---

216 Wegenast, *The Law of Canadian Companies* (1931), at p. 112.

217 *Ibid.*, at p. 113.

218 Ziegel, *Constitutional Aspects of Canadian Companies*, in Ziegel, *Studies in Canadian Company Law* (1967), at pp. 149 and 191-2.

219 *e.g.*, The Judicature Act, R.S.N.B., 1952, c. 120, s. 24A.

220 N.Y. Bus. Corp. Law, s. 907 (a).

might be seriously held up in the House of Commons."[221] The only material difference in provincial interjurisdictional amalgamations and federal-provincial amalgamations is the "with provincial objects" limitation on provincially incorporated companies. Since a company may carry on business in more than one province, and, considering the ease with which objects can be modified, the fears seem unfounded.

More generally, since the provinces and the Dominion have *de facto* concurrent jurisdiction over the incorporation of companies, an amendment to the British North America Act[222] recognizing such would be more useful.

(b) Issues of Property and Civil Rights

Where the merger or acquisition does not affect corporate status and capacity, theoretically the transaction may be a matter in relation to property and civil rights in the province rather than in relation to incorporation of companies. Characterization of enabling or restrictive legislation will determine validity of the transaction.

Historically, the provinces may not legislate in respect to Dominion companies so as to alter their status or capacity or indirectly to sterilize them.[223] However, in *Lymburn v. Mayland*[224] the Privy Council upheld the validity of legislation requiring a Dominion company issuing shares to the public to use registered brokers in Manitoba.

Likewise, corporate contracts, and *a fortiori* a sale of assets, are subject to provincial regulation, being a matter in relation to property and civil rights.[225]

Upon this landmark rests the validity of all provincial regulation of takeover bids of federal companies in the provinces.

Those who contend that the purchase of shares in a Dominion company may validly be regulated by Dominion legislation usually argue that such control is necessarily incidental to the power to incorporate companies, and Parliament, having legislative authority to create companies, also possesses the legislative power to prescribe

---

221 Williamson, *Federal Companies Act Amendments*, 30 Business Quarterly (Fall, 1965), at pp. 38 and 44.

222 (1867), 30 & 31 Vict., c. 3.

223 *John Deere Plow Co. v. Wharton*, [1915] A.C. 330 (P.C.); *Great West Saddlery Co. v. The King*, [1921] 2 A.C. 91 (P.C.); *Lukey v. Ruthenian Farmers' Elevator Co.*, [1924] S.C.R. 56; *R. v. Henderson* (1924), 51 N.B.R. 346 (N.B.C.A.); *A.G. Manitoba v. A.G. Canada*, [1929] A.C. 260.

224 [1932] A.C. 318 (P.C.)

225 *Citizens Insurance Co. of Canada v. Parsons* (1881-82), 7 App. Cas. 96 (P.C.).

the manner in which shares of the capital of such companies can be transferred and acquired. That matter is said to be one of general interest throughout the Dominion.[226]

Others argue that the purchase of shares of a Dominion company is a matter of property and civil rights in the province. The purchase of shares is a transfer of property that does not affect the company. It leaves the company exactly as it was before. The sole connection it has with company law is that it is a share of a company incorporated under the laws of the Dominion, that is, the chose in action in question.[227]

In regard to the first contention, the ancillary (necessarily incidental) doctrine is generally applicable when the provision in question is invalid per se as being legislation with an exclusive provincial head, but in its particular context, the provision derives validity because of its necessity to effective legislation under an admitted Dominion head.[228]

Under this doctrine, the Dominion enactment of compulsory sale legislation has been upheld. Its possible invalidity was first suggested *In re Canadian Food Products Limited and Picardy Limited*.[229] When the constitutional issue was properly before the court in *Rathie v. Montreal Trust Co.*,[230] Coady, J., upheld the legislation, finding the regulation of the transfer of shares to be "necessary incidental legislation and advantageous for the proper functioning of a company incorporated under the Dominion statute . . . which in effect provides a convenient way of transferring company undertaking and assets . . . and if this be so the fact that this legislation may affect property and civil rights in the province is no objection."[231] This view was later confirmed by the Supreme Court of Canada in *Esso Standard (Inter-America) Inc. v. J. W. Enterprises Inc.*[232]

In conflict with the Esso Standard Case is *British Columbia Power Corp. Ltd. v. A.G.B.C.*[233] In 1961 the Legislative Assembly of

---

226 *Esso Standard (Inter-American) Inc. v. J. W. Enterprises Inc. (Sub. nom. Re International Petroleum Co. Ltd.)* (1962), 33 D.L.R. (2d) 658, at p. 665 (Ont., C.A.), aff'd, [1963] S.C.R. 144; see also, *Citizens Insurance Co. of Canada* v. *Parsons* (1881-82), 7 App. Cas. 96 (P.C.).

227 *British Columbia Power Corporation Ltd. v. A.G.B.C.* (1965), 47 D.L.R. (2d) 633, at pp. 660-661 (B.C., Sup. Ct.).

228 MacDonald, *Judicial Interpretation of the Canadian Constitution* (1936), 1 U. of Tor. L.J. 260, at p. 274.

229 [1945] 3 D.L.R. 287, at p. 290 (Man., C.A.).

230 [1952] 3 D.L.R. 61 (B.C., Sup. Ct.), aff'd, [1952] 4 D.L.R. 448 (B.C., C.A.), rev'd on other grounds, [1953] 2 S.C.R. 204.

231 *Ibid.*, at pp. 69-70.

232 [1963] S.C.R. 144.

233 (1965), 47 D.L.R. (2d) 633 (B.C., Sup. Ct.).

British Columbia undertook to reorganize the development of its power resources. At the time, the major power resources in the Province were owned by a private provincial corporation, the British Columbia Electric Company Limited. This company owned and operated an electric power system, railway, bus, and gas lines. Of its nearly four million outstanding shares, all but fifteen were owned by the British Columbia Power Corporation Limited, a federally incorporated, public company. The shares of B.C. Electric comprised, in value, between 90% and 95% of the assets of B.C. Power.

The plan of reorganization was to vest all the shares of B.C. Electric in the Crown in right of the Province of British Columbia,[234] and B.C. Electric was to be an agent of the province.[235] As compensation, the common shareholders were to receive a sum equal to the paid-up value of their shares. The subsequent claims of injustice and unfairness of the compensation led to an embittered battle. When the government refused to grant permission to the B.C. Power Corp. to institute an action under the Crown Procedure Act contesting the amount of compensation, the Corporation instituted an action alleging that the legislation was *ultra vires*.

In early 1962 five interlocutory motions were heard, four of which were appealed. While the appeals were being heard, two bills were introduced in the Provincial Legislature which later became the Power Development Act, 1961, Amendment Act, 1962,[236] and the British Columbia Hydro and Power Authority Act.[237] By the Amendment Act, 1962, the compensation which previously had been fixed at approximately $110 million was increased to approximately $172 million and designated "as the full, fair, and adequate compensation payable".[238] The same Act purported to make the compensation final and conclusive and not open to question in any Court.[239] The other Act purported to amalgamate the British Columbia Power Commission (a Provincial Crown Corporation constituted under the Power Act[240]) and B.C. Electric into the new British Columbia Hydro and Power Authority.[241] In an attempt to block any action by B.C. Power Corp., the Authority was not suable or liable to be joined in any action relating to the Power Development Act, 1961, or the Amendment Act, 1962.

---

234 Power Development Act (1961), 10 Eliz. II, c. 4, s. 3 (a) (2nd sess.).

235 Power Development Act (1961), 10 Eliz. II, c. 4, s. 6 (1) (2nd sess.).

236 (1962), 10 & 11 Eliz. II, c. 50.

237 (1962), 10 & 11 Eliz. II, c. 8.

238 (1962), 10 & 11 Eliz. II, c. 50, s. 2.

239 (1962), 10 & 11 Eliz. II, c. 50, s. 2.

240 R.S.B.C., 1960, c. 293.

241 (1962), 10 & 11 Eliz. II, c. 8, s. 3 (1).

Before the last mentioned Acts were enacted, the B.C. Power Corporation applied for the appointment of a receiver and manager of B.C. Electric pending the action. On appeal to the Supreme Court of Canada the application was granted, thus preventing the Government from integrating the business of the two corporations, B.C. Electric and B.C. Power Commission.

At the trial Lett, C.J.B.C. held the legislation to be unconstitutional. In a judgment that "stands as a monument to detailed diligence perhaps unsurpassed in Canadian constitutional litigation,"[242] he held that under the circumstances the federal company could not constitutionally be divested of its shares in the provincial company. The legislation did not relate entirely to the incorporation of companies with provincial objects. While the vesting of shares of one owner in another ordinarily requires an entry in a share register, the corporate structure will remain the same regardless of who owns the shares.[243]

> To reconcile the B.C. Power and the Esso cases one would have to say that compulsory acquisition of ten per cent of company shares is a matter of incorporation of companies, but that compulsory acquisition of one hundred per cent of the shares is not.[244]

In summary, Canada's constitution has restricted some types of mergers and acquisitions. Interjurisdictional mergers which derive their validity from enabling legislation may be subject to attack. For this reason, a simple purchase and sale of assets may be desirable.

Taxation

Introduction

The primary aim of the Canadian Income Tax Act[245] is to levy a tax upon the income of every person resident in Canada[246] according to his ability to pay. Accordingly, marginal rates of tax for individuals range from 11 *per cent* to 80 *per cent*. Corporations are taxed 21 *per cent* on the first $35,000 of income and thereafter at 50 *per cent*. Because of such high tax rates, a critical issue in the shuffle of corporate organizations is the realization of income by one or several corporations or their shareholders and possibly both.

Theoretically, for tax purposes, a distinction can be made between a merger and an acquisition and there is considerable merit in the argument that only in the latter should income be recognized.

---

242 Laskin, *Canadian Constitutional Law* (3rd ed. 1966), at p. 586.

243 (1965), 47 D.L.R. (2d) 633, at p. 661 (B.C., Sup. Ct.).

244 Strayer, *Constitutional Aspects of Nationalization of Industry* (1964), 7 Cdn. Bar. J. 226, at pp. 228-9.

245 R.S.C., 1952, c. 148.

246 R.S.C., 1952, c. 148, s. 2 (1).

In a merger, the investments of the shareholders are not realized, but change only scope. There has been no real conversion of property in an economic sense. On the other hand, if the shareholders have "sold out", all the problems of liquidation are in the forefront.

The most common problem in mergers and acquisitions is the taxation of earned surplus. In many cases the corporation is the *alter ego* of its chief shareholder, incorporated to obtain limited liability and the favourable tax rates afforded the corporation. The tax advantage is especially noticeable where an accumulation of earned surplus occurs. Corporate rates of tax being generally lower than individual rates, there can be a considerable saving. However, on the declaration of a dividend the problems of double taxation extinguish much of the advantage. Where the company with considerable earned surplus later mergers or is acquired, the issue of earned surplus is again raised, either in the form of a deemed dividend or a non-taxable capital gain.

Surprisingly, most issues have been resolved with reference to the form rather than the substance of the merger or acquisition. A sale of shares usually means a capital gain while a sale of assets and liquidation often creates a dividend for tax purposes. Obviously the vendor prefers the sale of shares; however, because of a number of other tax factors, the purchaser prefers to acquire the assets. An appreciation of the differences in taxation is indispensable for the planning of corporate mergers and acquisitions.

The Purchase and Sale of Assets

For tax purposes, a merger or acquisition by a purchase and sale of assets may be analyzed in two steps. First, there are the taxable consequences of the purchase and sale as it affects both corporations, whether for shares, cash, or otherwise. Second, there is the problem of distribution of the proceeds to the shareholders.

(a) The Sale

Much can be learned by analogy of the sale of a business to the sale of an asset used for business purposes. Each involves study of the capital cost allowance provisions, capital gains theory, and recognition of the terminal loss provisions. A sale of assets purchased by the corporation at $100 and depreciated to $80 and subsequently sold for $130 will create taxable income of $20, *i.e.*, the difference between the original cost and the undepreciated balance. Put another way, the government recaptures the tax on the depreciation charges taken in earlier years. The balance of $30 is a nontaxable capital gain.

It will be readily seen that where a corporation has proportionally a large amount of substantially depreciated assets, a sale of assets may not have favourable tax consequences to the corporation. On the other hand, it offers the advantage to the purchaser of a greater depreciation deduction than a purchase of shares. Rather than carry the old charges forward as in a purchase of shares, the assets are recorded at their new cost, $130. Depreciation is calculated on this amount. In our example, it would make a difference of a $13 deduction rather than $8 where the capital cost allowance was 10% *per* year.

Where non-depreciable assets are involved, the problems of recapture are not present. Any gain would most likely be considered a capital gain. For the vendor, this is a highly desirable feature; however this is not desirable to the purchaser because he will be unable to deduct his expenses in future years for tax purposes. Thus, in an arms length sale of assets, the apportionment of the purchase price of assets between depreciable and nondepreciable property may have important significance for both parties.

Thus, generally, the vendor and the purchaser will always have conflicting tax interests. Not only are there conflicts in the apportionment of the purchase price between depreciable and nondepreciable property but the conflict extends to almost every item on the balance sheet. Included in this list are accounts receivable, inventory and goodwill.

At common law, accounts receivable become gross income in the year in which they arise, subject to a subsequent deduction for such of them as later become bad or doubtful. Prior to the enactment of section 85D,[247] upon the sale of the assets of a business, including accounts receivable as part of the sale of the business as a going concern, there was no allowance for tax purposes for any loss incurred on the sale of the accounts receivable, even though the loss had previously been included in income. On the other hand, the purchaser was not required to bring any subsequent change in the receivables into the computation of his income. Any such profits or loss were capital gains or losses.[248]

Section 85D makes it possible, if the vendor and purchaser agree, for the vendor to deduct the amount of his loss upon the sale of the accounts receivable and, in such event, requires the purchaser to include the same in its income, and then permits the purchaser to make deductions in respect of such of the accounts receivable as become bad or doubtful. In sum, the section permits

---

247 (1953-54), 2-3 Eliz. II, c. 57, s. 24 (Can.).

248 *Crompton v. Reynolds & Gibson* (1952), 31 Annot. Tax Cases 184 (H.L.); *Abrahams [No. 2] v. M.N.R.*, 66 D.T.C. 5453, at p. 5460 (Exch. Ct.); *Woodlon Motor Sales Ltd. v. M.N.R.*, 55 D.T.C. 295 (Tax A. Bd.).

the parties to elect ordinary rather than capital treatment of accounts receivable.

To be entitled to the election, the vendor must sell all or substantially all the property[249] used to carry on the business, including accounts receivable which have been taken into account in computing his income, to a purchaser who purposes to carry on the business. Literally, the vendor may be any person. However, such an interpretation would open roads for tax evasion through transactions with non-residents who are not required to file income tax returns in Canada.[250] "Section [85D] is . . . intended to afford a continuity in the treatment of accounts receivable where the sale of a business intervenes."[251]

The sale of inventory presents similar problems. In the ordinary course of takeover of inventory, gross receipts from sale are included in income. Prior to the enactment of section 85E,[252] on the sale of all the assets of a business, the profit attributable to the sale of the inventory was considered a capital gain. It was said not to be a sale *in* the business of the taxpayer, but part of a sale *of* the business and thus a capital gain.[253] It was advantageous for the purchaser to place a high valuation on inventory in order that he might reduce his gross margin on sales in the first turnover period following the sale, thus reducing profit and consequent tax at no detriment to the vendor.

Section 85E was enacted to prevent the occurrence of such valuations. It provides that on the sale of a business including inventory, the inventory will be deemed to have been sold in the ordinary course of carrying on business. Any profit attributable to the sale of inventory is taxable income.[254]

A major difficulty in the sale of a business can be the proper apportionment of the total purchase price to inventory. With the enactment of section 85E, the price apportioned by the purchase agreement is deemed for tax purposes to be the value if filed with

---

249 See *Barnaby Paperboard Ltd. v. M.N.R.*, 68 D.T.C. 12 (Tax A. Bd.)..

250 See *Office Overload Co. Ltd. v. M.N.R.*, 65 D.T.C. 290 (Tax A. Bd.).

251 *Ibid.*, at p. 697.

252 (1953-54), 2 & 3 Eliz. II, c. 54, s. 27 (1) (Can.).

253 *Frankel v. M.N.R.*, 59 D.T.C. 1161, at p. 1168 (Sup. Ct. Can.).

254 *Kendon Finance Corp. Ltd. v. M.N.R.*, 63 D.T.C. 759 (Tax A. Bd.) (sale of business including conditional sales contracts at a price including unearned financing charges held to constitute taxable income); *Raby v. M.N.R.*, 65 D.T.C. 5085 (Tax A. Bd.) (Sale of partnership interest in building project included $27,000 profit from the lots); *M.N.R. v. Carlett*, 67 D.T.C. 5058 (Sup. Ct. Can.) (profit on sale of second mortgage portfolio considered to be inventory of money lending business).

the Minister upon request.[255] Otherwise the Minister has a discretionary power to make an apportionment. The Minister, however, must act reasonably.[256]

Finally, if the sale of assets including inventory alters marginal tax rates, the taxpayer may elect to average the proceeds attributable to inventory over the three preceding years.[257]

Any balance over and above the market value of the assets sold is commonly referred to as goodwill. Goodwill is a non-depreciable capital expense, which is a capital gain to the vendor.[258]

In summary, the sale of assets is a taxable event to the vending corporation with considerable consequences to the purchaser. Generally, the taxable treatment of a sale of assets is more favourable to the purchaser than the vendor. However, there are several areas that are subject to agreement by the parties, *e.g.*, accounts receivable and inventory and often they agree to split the tax costs in some way or other.

(b) Liquidation

After the sale, the vendor usually distributes the consideration received to its shareholders. The proceeds received by the shareholders are characterized as a return of capital except to the extent the company has undistributed income on hand. The latter is deemed a dividend[259] and defined as the aggregate of the incomes since 1917 less numerous items including losses, some non-deductible expenses, net capital losses, and dividends.[260] Undistributed income in hand usually corresponds closely to retained earnings.

Dividends are taxed at ordinary rates subject to a 20 *per cent* tax credit.[261] Where a corporation has substantial undistributed income on hand and the shareholder is in the 80 *per cent* marginal tax bracket, the sale of assets procedure loses most of its attractiveness, since he is taxed on this sum at a 60% net rate.

"The heavy taxation of corporate earnings and the high personal income tax rates early gave rise to a tendency on the part of closely-

---

255 R.S.C., 1952, c. 148, s. 85 E (2).

256 *Hersey v. M.N.R.*, 60 D.T.C. 528 (Tax A. Bd.) (Minister's arbitrary acceptance of the purchaser's valuation of inventory contrary to the original agreement of sale was erroneous); *Thibault v. M.N.R.*, 63 D.T.C. 76 (Tax A. Bd.) (Minister erroneously included fixed assets in inventory).

257 R.S.C., 1952, c. 148, s. 85 E (4).

258 *Jeffrey v. M.N.R.*, 50 D.T.C. 274 (Tax A. Bd.); *Quenneville v. M.N.R.*, 52 D.T.C. 108 (Tax A. Bd.).

259 R.S.C., 1952, c. 148, s. 81 (1).

260 R.S.C., 1952, c. 148, s. 81 (3).

261 R.S.C., 1952, c. 148, s. 38 (1).

held corporations to refrain from distributing their earnings to shareholders."[262]

> The main difficulty with respect to undistributed surpluses arose upon the death of any of the principal shareholders of closely held corporations. Large succession duties on the estates of these shareholders frequently required the raising of large sums of money by estate administrators. Where other assets were insufficient, it was often necessary to declare a dividend in order to meet this demand; and the combined impact of income taxes and succession duties frequently had been known to result in the confiscation of the entire share estate.[263]

Parliament alleviated the problem by providing a procedure whereby the corporation may elect to pay a tax of 15% on an amount equivalent to undistributed income on hand at the end of the 1949 taxation year plus all dividends paid since that date.[264] The qualifying sums less the tax paid may then be paid to the shareholders tax free.

These provisions apply where there is a winding-up, discontinuance or reorganization of the business.[265]

The limitation imposed on post 1949 taxation years prevents the legislation being used solely as a means of paying out accumulated earnings at favourable rates. To be utilized to its fullest extent, the corporation would have to pay ordinary dividends equal to half its earnings since 1949.

The Purchase and Sale of Shares

For the vendor, a sale of shares instead of a sale of assets has many advantages. Unless he is in the business of buying and selling shares, the consideration received is a capital gain (or loss). All the problems of inventory, accounts receivable, depreciation, and, of course, winding-up are avoided. All this is premised on the transaction's being characterized as a sale of shares.

In *Merritt v. M. N. R.*[266] the boards of directors of the Security Loan and Trust Company and the Premier Trust Company entered into a "Provisional Agreement" whereby Security agreed to sell all its assets and undertaking to Premier. Subject to ratification, Premier was to issue to each shareholder of Security one and one-half shares, or, at the option of each shareholder, to pay $102 in cash and issue one-half share, for each share held. There being three parties involved, Security, Premier, and the shareholders of Security, the transaction

262 LaBrie, *The Principles of Canadian Income Taxation* (1965), at p. 497.

263 *Ibid.*, at p. 498.

264 R.S.C., 1952, c. 148, s. 105.

265 R.S.C., 1952, c. 148, s. 81 (4).

266 2 D.T.C. 513 (Exch. Ct.).

had elements of a sale of assets and a share exchange. Without actually deciding this question, the court held the transaction to be a "winding-up, discontinuance or reorganization" within section 81. Substance, not form, was to govern. Adopting the opinion of Buckley, J.[267] none of the words ". . . has any definite legal meaning. Each is a commercial term and not a legal term, and, even as a commercial term has no exact definite meaning."[268] Security had discontinued its business in a real and commercial sense. "What was done with the business of the Security Company fell somewhere within the meaning and spirit of those words . . . It is immaterial in my opinion that the consideration received by the appellant for her shares happened to reach her directly from the Premier Company and not through the medium of the Security Company."[269] Thus, through faulty planning, the transaction had the legal effect of a sale of assets.

Where the transaction is a sale of shares, the vendor's tax gains are the purchaser's tax losses. The two major disadvantages of a purchase of shares are (1) usually lower capital cost allowances than afforded on a purchase of assets and, (2) the "locking-in" of undistributed income.

Often the purchase price for the shares or assets of a company is higher than the book value of the company. Since property is recorded at cost, where a purchase of assets is undertaken, the book value of the property may be written up to its fair market value. Where there is depreciable property, the purchaser will obtain a greater capital cost allowance than that currently allowed the vendor. Where the transaction is a sale of shares, the company retaining its corporate identity, the depreciated capital costs of the company are continued. The tax effects can be substantial.

The "locking-in" of undistributed surplus is a tax concept enacted to block tax avoidance schemes but having much broader ramifications.[270] Prior to 1950, taxpayers owning companies with a large surplus would sell the shares to another company owned by the taxpayer for a small amount of capital and considerable debt. Repayment of the debt was a capital gain to the taxpayer. The earned surplus was paid to the new company in the form of a dividend, which, being an intercorporate dividend, was tax free. Thereby the funds became available to pay off the indebtedness. The process is known as "dividend stripping".

---

267 *In re South African Supply and Cold Storage Company*, [1904] 2 Ch. D. 268.

268 *Merritt v. M.N.R.*, 2 D.T.C. 513, at p. 515 (Exch. Ct.).

269 *Ibid.*, at p. 516.

270 This part is based on Kelsey, *Some Taxation Aspects of Corporate Amalgamations* (1960), 8 Can. Tax J. 236.

The remedy enacted by Parliament was to prevent the payment of the tax free dividends under these circumstances. The circumstances however include any transfer of control of the corporation,[271] control being defined as 50 per cent of the issued share capital having full voting rights.[272] Where control is transferred, the earned surplus of the acquired company at the time of purchase becomes "designated", and dividends paid therefrom are taxable in the hands of the parent corporation.

This problem is only acute if the parent company wants the use of funds of the newly acquired subsidiary or plans to liquidate it.

On the other hand, the purchase of shares is the only means of effecting a merger or acquisition and maintaining the right to deduct prior losses of the acquired company. However, where a transfer of control of a company with a business loss occurs, the acquired corporation must continue to carry on the business in which the loss was sustained.[273]

Amalgamations—Section 85I

Where (1) the amalgamated corporation acquires all the assets and liabilities of the predecessor[274] corporations and, (2) all the shareholders of the predecessor corporations become shareholders in the amalgamated corporation, the transaction may be subject to a number of special rules. Section 85I exemplifies the theory that a merger does not radically alter the economic position of the shareholders or the corporations and therefore the usual rules attendant normal sales transactions should not apply. Section 85I, however, is limited to statutory amalgamations, mergers by a sale of assets being expressly excluded.[275]

Generally, section 85I stipulates specific individual rules for the accounting of each item affected by the amalgamation.

(a) Taxation Year of the Corporation

Section 85I provides that upon amalgamation, the taxation year of the constituent corporations is deemed to have ended and the taxation year of the amalgamated company is deemed to have commenced. This treatment is comparable to a consolidation where two companies sell their assets to a third. In contrast, in a merger involving a sale of assets, the taxation year of the surviving corporation continues.

---

271 R.S.C., 1952, c. 148, s. 28 (2).

272 R.S.C., 1952, c. 148, s. 28 (3).

273 R.S.C. 1952, c. 148, ss. 27 (1) (e), 27 (5a); *Holiday Knitwear Limited v. M.N.R.*, 63 D.T.C. 116 (Tax A. Bd.).

274 Section 85 I refers to the heretofore named constituent corporations, as predecessor corporations.

275 R.S.C., 1952, c. 148, s. 85 I (1).

The rule is not without significance. In a few situations, the timing of the amalgamation may result in a considerable tax saving. Consider two corporations contemplating amalgamation with the following quarterly earnings:

Quarter	*Company A*	*Company B*
First	$ 6,000	$ 6,000
Second	11,000	11,000
Third...................................	18,000	18,000
Fourth	15,000	15,000
Total	$ 50,000	$ 50,000

Amalgamation of the companies at the end of the second quarter would cause tax liabilities as follows:

Company A	21% of $17,000 =		$ 3,570
Company B	21% of $17,000 =		3,570
Amalgamated Co.	21% of $35,000 =	$ 7,350	
	50% of $31,000 =	15,500	22,850
			$ 29,990

On the other hand, waiting until the end of the third quarter changes the tax liabilities to:

Company A	21% of $35 000 =	$ 7,350
Company B	21% of $35,000 =	7,350
Amalgamated Co.	21% of $30,000 =	6,300
		$ 21,000

The difference is the result of using the initial lower tax rate to its fullest possible extent before amalgamation. In future years, the loss of the initial lower tax rate for each company is substantial. An amalgamation of four unassociated companies each earning in excess of $35,000 per year increases the tax burden by $21,450 per year.

(b) Inventory

Section 85I also permits the transfer of inventory without recognition of any gain or loss. The provision states that inventory shall be deemed to have cost the new corporation the value attributed to inventory by the predecessor corporation in computing its income for its last taxation year.

(c) Capital Cost Allowance

Pursuant to an amalgamation within section 85E, the capital cost and undepreciated capital cost of the property to the predecessor corporations are carried forward to the new corporation for tax purposes. No recapture or terminal losses are recognized.

(d) Business Losses

The carryover loss provisions have a long history of attempts by taxpayers to offset losses of one business against the income of another.[276] Section 85I prohibits a deduction by the new corporation of business losses sustained by predecessor corporations.

(e) Undistributed Income

In keeping with the continuity theory, the undistributed incomes of the predecessor corporations are added together for purposes of taxation. The total is available for dividends. In the continuing game of dividend stripping, section 85I was an easy alternate route.[277] The section avoids the concept of designated surplus, and consequently, the protection it afforded the Department of Revenue.

In a countermove to dividend stripping, Parliament enacted section 105C,[278] which imposes a tax of 20% on the amount by which the undistributed incomes of the predecessor corporations exceeds the value of the assets (excluding goodwill) less liabilities. More generally, a tax is payable on the amount by which the undistributed incomes of the predecessor corporations exceed the equity of the amalgamated corporation. In effect, shareholders may not convert their interests in the predecessor corporations into debt of the amalgamated company for an amount greater than their original equity without paying a tax. Only common shares are considered capital for the purpose of section 105C. Thus redeemable preferred shares may not be used to circumvent the section. However, there are other possible loopholes, of concern only to those involved in dividend stripping, of which we are not.[279]

While there is no authority, it would appear that any "boot"[280] accompanying a section 85I amalgamation would be deemed a dividend.[281] Legally, an amalgamation is not a purchase and therefore such payment could not be considered as part of any "price". In addition to the question of *ultra vires*, it would be even more difficult to constitute it as a gift. Further, the use of "boot" may disqualify the merger from section 85I which requires that "all the property of the predecessor corporations immediately before the

276 e.g., *Holiday Knitwear Limited v. M.N.R.*, 63 D.T.C. 116.

277 Kelsey, *Some Taxation Aspects of Corporate Amalgamations* (1960), 8 Can. Tax J. 236.

278 (1959), 7 & 8 Eliz. II, c. 45, s. 26.

279 See Kelsey, *Some Taxation Aspects of Corporate Amalgamations* (1960), 8 Can. Tax J. 236.

280 The term "boot" refers to a cash payment to the shareholders accompanying the amalgamation.

281 R.S.C., 1952, c. 148, s. 8 (1) (b) or s. 81 (1). *Quaere:* does the recipient satisfy the definition of "shareholder"?

merger becomes property of the new corporation by virtue of the merger."[282] Here, much depends upon the judicial interpretation of the words "immediately before".

The section refers to the amalgamated company as a "new corporation"[283] for tax purposes, while the corporations and companies acts refer to it as a continuing corporation. The technical difference is of considerable importance, for the special rules set out in the section do not completely cover all the problems that arise on a statutory amalgamation. More generally, the question is whether the corporate continuity theory in corporate law applies to statutory amalgamations for tax purposes.

In *John H. Scott v. M. N. R.*[284] Assistant Chairman Fordham held that although the corporate law reads to the contrary, for tax purposes the corporate entity formed as a result of an amalgamation is deemed to be a new corporation. The decision denied the taxpayer a deduction for certain mining and exploration expenses advanced to one of the predecessor corporations when he later sold his shares in the amalgamated corporation. Presumably, a contrary holding would have permitted the deduction.

In contrast, Assistant Chairman Fordham in *Palmer-McLellan (United) Ltd. v. M. N. R.*[285] accepted prevailing opinion that an amalgamation is to be regarded as a continuation of the predecessor corporations and not a new corporation. This time the taxpayer was denied a deduction after amalgamation for interest on borrowed money because the funds previously had been used to earn non-taxable income, i.e., dividends. Amalgamation and the disappearance of the shares changed nothing.[286]

John H. Scott v. M.N.R., as well as *La Tribune Inc. v. M.N.R.*[287] are under appeal to the Exchequer Court.[288] Hopefully, the conflicting views will be resolved.

Financing—The Deductibility of Interest

Interest payable on borrowed money used for the purpose of earning income from a business or property (other than borrowed money used to acquire property the income from which would be exempt) is a deductible expense for income tax purposes.[289] The deductibility of interest paid on funds used to finance a merger or

282 R.S.C., 1952, c. 148, s. 85 I (1) (a).

283 R.S.C., 1952, c. 148, s. 85 I (1).

284 66 D.T.C. 306 (Tax A. Bd.).

285 67 D.T.C. 323 (Tax A. Bd.), affirmed 68 D.T.C. 5304 (Exch. Ct.).

286 *Accord, La Tribune Inc. v. M.N.R.*, 67 D.T.C. 507 (Tax A. Bd., St. Onge).

287 *Ibid.*

288 Dominion Tax Cases (Current), 9025.

289 R.S.C., 1952, c. 148, s. 11 (1) (c).

acquisition is often met with two objections. First, there is the question of using the funds to earn exempt income. Inter-corporate dividends are normally tax free.[290] Therefore, interest paid on funds used in the acquisition of shares is not deductible.[291]

Second, section 11 (1)(c) requires that the funds be used for the purpose of earning income from a business or property. And even though the preamble to section 11 states that section to be notwithstanding paragraphs (a), (b) and (h) of section 12 (1), those sections appear to have overshadowed section 11 (1) (c). Section 12 (1)(b) disallows capital expenditures. When interpreting section 11 (1)(c), the courts tend to disallow a deduction for interest paid on funds used to provide capital for a business:

> It is important to remember that in the absence of an express statutory allowance, interest payable on capital indebtedness is not deductible as an income expense. If a company has not the money capital to commence business, why should it be allowed to deduct the interest on borrowed money? The company setting up with its own contributed capital would on such a principle be entitled to interest on its capital before taxable income was reached, but the income statutes give no countenance to such a deduction. To extend the statutory deduction in the converse case would add to the anomaly and open the way for borrowed capital to become involved in a complication of remote effects that cannot be considered as having been contemplated by Parliament. What is aimed at by the section is an employment of the borrowed funds immediately within the company's business and not one that effects its purpose in . . . an indirect and remote manner.[292]

The distinction between funds used for the purpose of earning income immediately within the company's business and funds used for the acquisition of capital assets to earn income is without merit. There is no justification for imputed interest deduction of a company setting up with its own capital any more than we should impute interest income for idle capital. The only anomaly is the fact one company must pay interest and one need not.

In sum, interest paid on funds used to acquire shares in another company is not a deductible expense because of the exempt income rule. Where the funds are used to acquire capital assets, a deduction is also disallowed, this time on the ground section 11 (1)(c) is somehow restricted to funds used for the purchase of non-capital assets.

Accounting Aspects

Some Business Considerations

In the valuation of a company the present tendency is to place substantial weight on the earning power of the business. But capital-

290 R.S.C., 1952, c. 148, s. 28 (1).

291 *Cf. Palmer-McLellan (United) Ltd. v. M.N.R.*, 67 D.T.C. 323, at p. 324 (Tax A. Bd.).

292 *Canada Safeway Ltd. v. M.N.R.*, 57 D.T.C. 1239, at p. 1244 (Sup. Ct. Can.).

ization of earnings is a deceptively simple procedure. For one thing, the proper rate of capitalization is difficult to determine and it often differs substantially from firm to firm in the same industry. Inter-industry comparison is impossible. Those divergencies have important consequences in putting together either a small merger or a conglomerate.

If two companies are currently trading on the market at different rates of capitalization, a merger will have the net effect of increasing the earnings *per* share of one of the companies and if the higher capitalization is continued to be used, there will be an increase in the market price. Compare Company A earning $1 *per* share and trading at $10, e.g. capitalized at 10% and Company B earning $2 *per* share and trading at $10, *e.g.* capitalized at 5%. If each company has 100 shares outstanding and Company A acquires Company B by issuing another 100 shares to Company B or its shareholders, Company A now earns $1.50 *per* share. If Company A continues to be capitalized at 10 *per cent*, the market price will increase to $15 *per* share. With the change in management control of Company B, the application of the old capitalization factor may not be as illogical as it might first appear. In conglomerate circles, there is a continuing search for sound companies trading at low price-earnings ratios.

In special situations, the plan must be modified to be attractive to Company B. Consider the case where Company B has been paying out large dividends and Company A has not, *e.g.*, suppose Company A has paid no dividends and Company B, $1 *per* share. The shareholders of Company B may not want to lose their dividend. One solution is for Company A to issue convertible preferred shares carrying a $1 preferred dividend. Not only is the dividend issue resolved but, in the example, the earnings *per* share on the common is increased to $2 *per* share. This, however, is somewhat illusory. When the preferred shares are converted into common, earnings *per* share drop back to $1.50.

Purchase and Pooling Concepts

The preceding plan is dependent on there being no substantial change in the accounts of both companies. General accounting principles require that all items be recorded at cost. The cost of the merger to Company A is the fair market value of the assets of Company B, received as consideration for the issuance of shares. Assuming the fair market value of the assets of Company B to be greater than the book value, the consequences of the purchase principle echo through the accounts of the company.

Assets will be written up to their fair market value. Except in a section 85I amalgamation, the write up will offer greater capital cost allowance deductions. While there is a beneficial tax reduction, the procedure also reduces earnings. Further, the tax usefulness of the write-up depends on the extent of depreciable property.

More critical is the treatment of sums paid in excess of the fair market value of the assets, usually referred to as goodwill. The amount paid for goodwill can be substantial. The usual practice is to write it off over a period of years against earnings. But while this reduces reported earnings, it is an expense which is not deductible for income tax purposes.

Finally, the purchase concept forbids the pooling of retained earnings. Any sums received for the newly issued shares must be credited to the capital accounts.

In sum, although there are possible tax advantages resulting from increased capital cost allowances, the purchase concept as it relates to mergers has several undesirable features in the market place. It is in direct conflict with attempts to create an appearance of increased earnings.

To alleviate the problem, the accounting profession has distinguished two types of business combinations—a purchase and a pooling of interests. Broadly speaking, the definitions correspond to the distinction made earlier between a merger and an acquisition. Accounting Research Bulletin Number 48: Business Combinations,[293] issued by the Committee on Accounting Prodecure of the American Institute of Accountants,[294] differentiates the types as follows:

> For accounting purposes, a *purchase* may be described as a business combination of two or more corporations in which an important part of the ownership interests in the acquired corporarion or corporations is eliminated or in which other factors requisite to a pooling of interests are not present.
>
> In contrast, a *pooling of interests* may be described for accounting purposes as a business combination of two or more corporations in which the holders of substantially all of the ownership interests in the constituent corporations become the owners of a single corporation which owns the assets and businesses of the constituent corporations . . .[295] (Emphasis in original)

"When a combination is deemed to be a pooling of interests, a new basis of accountability does not arise."[296] The accounts of the constituent corporations are carried forward, including assets, liabilities, surpluses and deficits "except to the extent otherwise

293 (February, 1957), 103 Journal of Accountancy 54.

294 The Committee is now named the Accounting Principles Board.

295 Accounting Research Bulletin Number 48: *Business Combinations* (February 1957), 103 Journal of Accountancy 54.

296 *Ibid.*, at p. 55.

required by law or appropriate corporate action."[297] Thus there is no write-up of assets or accounting for goodwill. In sum, the unfavourabe features of a purchase are avoided.

The pooling principle can be rationalized on the theory that it is illogical to record the accounts of one company in the merger at book value and the other at its fair market value when nothing has been withdrawn or invested.[298] On the other hand, the theory that one company may acquire the retained earnings of another has been criticized, as it distorts the entire concept of income.[299]

One major difficulty is to determine when it is and when it is not proper to use the pooling of interests concept. The most important test is a continuity of interest of all shareholders. In the classic situation, all the shareholders of the constituent corporations receive common shares of the new corporation evidencing proportionally the same interest. However, Accounting Research Bulletin Number 48 is not that restrictive.

For one, there is the problem of proportionality. In addition to common stock, some shareholders receive cash or other securities as "boot" in the merger. How much "boot" they may receive and the merger still to qualify as a pooling is uncertain. In the United States it has been suggested that the limitations imposed on "boot" by the Internal Revenue Code under section 368 type reorganizations be applied. To qualify, voting stock must constitute 80% of the fair market value of the consideration received. Interlocking accounting and taxation principles has logic. But since the question of quantity of "boot" is irrelevant under the Income Tax Act, this policy has no application. The matter still remains open.

While a continuity of interest or, in terms of the bulletin, "ownership interests", refers basically to common stock, "in some cases the term may also include other classes of stock having senior or preferential rights as well as classes whose rights may be restricted in certain respects".[300] In particular, it would appear to include convertible preferred.

In Canada, the restrictions often appear to be ignored.[301] In such circumstances, it is useful to keep in mind the possible liabilities and sanctions that may result. The accountant must consider the

---

297 *Ibid.*

298 Lay, *Accounting for Business Combinations* (1967), 91 Cdn. Chartered Acc. 329, at p. 333.

299 Paton and Paton, *Corporation Accounts and Statements* (1955), at p. 41.

300 Accounting Research Bulletin Number 48: *Business Combinations* (Februrary 1957), 103 Journal of Accountancy 54, fn. 1.

301 Lay, *Accounting for Business Combinations* (1967), 91 Cdn. Chartered Acc. 329, at p. 331.

possibility of disciplinary action being taken by his professional association. Equally important is possible civil liability.[302] It is doubtful, although possible, that pressures similar to those exerted by the United States Securities Exchange Commission for regulation of accounting practices may be attempted by Canadian securities commissions.[303]

Legal Problems[304]

The major obstacle to the pooling of interests concept is understanding the extent to which established legal doctrines relating to the accounting of consideration received on the issuance of shares apply in merger situations. Traditionally in Canadian company law the consideration received on the issuance of shares is part of the capital of the company and not retained earnings.[305] The latter represents corporate profits that are available for dividends. Since no dividend may be declared that will impair the company's capital,[306] *a fortiori*, if the consideration received is capital and dividends may be paid out of earnings but not capital, no part of the earnings of the acquired company should become earnings of the acquiring company.

The same result follows whether par or no par value shares are used. The aggregate amount of the consideration received by the company for the issuance of no par value shares must be attributed to paid up capital.[307] Prior to 1965, section 12 (10) provided that where a company acquired a going concern with earned surplus by issuing no par value shares, the directors could set aside as distributable surplus, *i.e.*, available for dividends, "such part of the consideration for the issue and allotment of such shares without nominal or par value as does not exceed the un-appropriated balance of realized

302 *Boyd v. Ackley* (1962), 32 D.L.R. (2d) 77 (B.C., Sup. Ct.); *Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd.*, [1964] A.C. 465 (H.L.).

303 Lewis, *The Accountants Are Changing the Rules, Fortune* (June 15, 1968), at pp. 177, 179.

304 This section is based on the problems discussed in Gormley, *The Pooling of Interests Principle of Accounting—A Lawyer's View* (1968), 23 Bus. Law. 407. "The treatment of business combinations and acquisitions in financial statements presents problems of both accounting and law. It provides material for reflection on the responsibilities and relationships of accountants and lawyers in advising their mutual clients on particular transactions. It can sometimes be difficult to identify the point at which such an accounting problem becomes a legal problem, and vice versa. A part of the subject matter is within the legitimate jurisdiction of both professions. The resolution of such mixed problems often calls for intimate collaboration between accountant and lawyer.": *Ibid.*, at p. 407.

305 *Toronto v. Consumer's Gas Co.*, [1927] 4 D.L.R. 102 (P.C.).

306 Canada Corporations Act, R.S.C., 1952, c. 53, s. 83 (2).

307 Canada Corporations Act, R.S.C., 1952, c. 53, s. 12 (7).

net profits of the going concern immediately before such acquisition." This, however, is now no longer possible.

In the case of par value shares, the result is not as certain. Section 12 (12) of the Canada Corporation Acts reads:

> Shares having a nominal or par value shall not be issued as fully paid except for
> (a) a consideration payable in cash at least equal to the product of the number of shares allotted and issued multiplied by the nominal or par value thereof; or
> (b) a consideration payable directly or indirectly in property or past services that the directors in good faith determine by express resolution to be in all the circumstances of the transaction the fair equivalent of the cash consideration mentioned in paragraph (a).

The wording of the section indicates that Parliament was more concerned with the problem of stock watering than with the hidden or secret reserves. Thus, the question of accountability of any consideration received over and above the amount attributable to the stock is left open. However, on the basis of the capital and dividend rules, it would appear that the consideration must be attributed to a capital account. Usually it is shown as premium on common shares.[308] There is no legal foundation for the view that it may be attributed to retained earnings.[309]

In sum, the earnings of the constituent corporations may not legally be combined and carried forward on the balance sheet of the merged enterprise.

A merger by statutory amalgamation may be an exception to the above view. The amalgamation agreement must contain details of "the manner of converting the authorized and issued capital of each of the companies into that of the amalgamated company."[310] It is possible that this provision is broad enough to circumvent the difficulties referred to above.[311]

While technically corporate law forbids a pooling, it is impliedly recognized by the Income Tax Act, which contemplates the addition of earned surpluses on a statutory amalgamation.[312] Section 30 of the Regulations of the Ontario Securities Act also contemplates pooling of interests:

> A statement of profit and loss contained in a prospectus shall be consolidated with respect to a subsidiary and the company only

---

308 See *Toronto v. Consumers' Gas Co.*, [1927] 4 D.L.R. 102 (P.C.).

309 *Contra*, Parker and Bonham, *Professional Accounting* (1965), at p. 212.

310 Canada Corporations Act, R.S.C., 1952, c. 53, s. 128A (3) (h).

311 Parker and Bonham, *Professional Accounting* (1965), at p. 214.

312 Income Tax Act, R.S.C., 1952, c. 148, s. 851 (2) (k).

> from the date upon which control of the subsidiary was acquired by the company unless the 'pooling of interests' accounting concept has been applied.

Other Considerations

There are a number of other matters associated with mergers and acquisitions that warrant recognition but, in most cases, will offer little difficulty in corporate planning in Canada. Most of these matters have been adapted from United States regulatory legislation but the legislation, its administration, and the judiciary have lacked the vitality of their model. Included in this area is securities regulation and anti-trust legislation. In addition, there has been a slight tendency toward national economic independence from the rest of the world, and in recent years, in particular, from the United States.

Securities Regulation

With one broad brush, corporate mergers and acquisitions are for the most part exempted from regulation under the Ontario Securities Act.

> A trade in a security of a company that is exchanged by or for the account of such company with another company or the holders of the securities of such other company in connection with a consolidation, amalgamation, merger or reorganization of either company or in connection with a take-over bid as defined in Part IX.[313]

is exempted from registration.[314] The provision was probably based on Rule 133 promulgated under the Securities Act of 1933 of the United States.

> The theory is based on the proposition that in the described situations the alteration of the stockholder's security occurs not because he consents individually to an exchange but because the corporation by authorized corporate action converts his security from one form to another. In other words, certain types of corporate action require only a vote of directors; other types require a vote of stockholders; and, when a stockholder votes on a proposed merger or the like, he is simply acting as a member of one of the corporate organs to effectuate corporate action and not exercising his volition the way he would if each stockholder were individually offered a new security in exchange for his old.[315]

Under a provision similar to the predecessor of Section 19 (1) 9 in British Columbia, a company needing additional funds increased its capital and distributed its shares to the public. The transaction was exempt from registration, being a "reorganization". Sidney Smith, J. A. formulated the policy in terms of criminal law. After

313 The Securities Act (1966), 14 & 15 Eliz. II, c. 142, s. 19 (1) 9 (Ont.).

314 The Securities Act (1966), 14 & 15 Eliz. II, c. 142, s. 58 (Ont.).

315 Loss, *Securities Regulation* (2nd ed., vol. 1, 1961), at p. 521.

finding "reorganization" is a word of vague import, being a word of art and having no technical legal meaning, and that it is a commercial rather than a legal term, it was not inapt here.

> It was urged upon us that we should have regard to the mischief which the Act under review was intended to remedy. This is true enough, and it is a most important consideration; but there are opposing considerations and I do not think the argument sufficient to outweigh them . . . One must bear in mind that this is a penal statute which must be strictly construed and the party charged brought strictly within its terms; and that, as in all criminal proceedings, the charge must be driven home beyond reasonable doubt.[316]

If he is right, every private company going public could be exempt from registration by merely changing the authorized capital prior to distribution. Such an interpretation would nullify the entire statute.

In sum, most mergers and acquisitions are exempt from securities regulation. The major exception is the take-over bid. Where the purchaser offers to purchase more than 20 *per cent* of the outstanding equity shares of a company, the offer is subject to special regulation. Exempted from this definition are offers made by private agreement with individual shareholders and not made to shareholders generally; offers made through a stock exchange; purchases of shares of private companies and public companies with less than 15 shareholders; and offers exempted by court order.[317]

The legislation requires the offering period to remain open 21 days, and grants the shareholder 7 days in which to withdraw his shares. If the bid is for less than all the equity shares and a greater number is tendered, they must be taken up on a *pro rata* basis.[318] Finally, a take-over bid circular which must disclose specific information must accompany the take-over bid.[319]

Antitrust Legislation

> Every person who is a party or privy to or knowingly assists in, or in the formation of, a merger or monopoly is guilty of an indictable offence and is liable to imprisonment for two years.[320]
>
> Merger means the acquisition by one or more persons, whether by purchase or lease of shares or assets or otherwise, of any control over or interest in the whole or part of the business of a competitor, supplier, customer or any other person, whereby competition
>
> (i) in a trade or industry,
>
> (ii) among the sources of supply of a trade or industry,

---

316 *R. v. Santiago Mines Limited*, [1946] 3 W.W.R. 129, at p. 137 (B.C., C.A.).

317 The Securities Act (1966), 14 & 15 Eliz. II, c. 142, ss. 80 (b) & (g) (Ont.).

318 The Securities Act (1966), 14 & 15 Eliz. II, c. 142, s. 81 (Ont.).

319 The Securities Act (1966), 14 & 15 Eliz. II, c. 142, s. 85 (Ont.).

320 Combines Investigation Act, R.S.C., 1952, c. 314, s. 33.

(iii) among the outlets for sales of a trade or industry, or

(iv) otherwise than in subparagraphs (i), (ii) and (iii),

is or is likely to be lessened to the detriment or against the interest of the public, whether consumers, producers or others;[321]

Despite "a strongly-worded statute pertaining to mergers",[322] there are relatively few obstacles to the planning of a business combination.

> To date the efforts that have been made to apply the merger provisions have been conspicuously ineffective. A total of eight investigations of the possibly detrimental effects of a merger has been made under the Act, five of them since the second World War. Of that total, only four have resulted in prosecution in the courts. Of the other four, the Restrictive Trade Practices Commission found no action necessary in two cases; it recommended in one that prosecution be considered, and it concluded in another that no effective action against the mergers in question was possible. In all four of the court cases, the Crown was totally unsuccessful in proving to the court that an offensive merger had taken place. In the two most recent of these, in fact—The Canadian Breweries and the Western Sugar cases—the judgment was such as to raise a question whether the existing legislation could ever be given practical effect, or whether an impasse had been reached in Canada's merger policy.[323]

Because of a curious dichotomy between combines agreements and mergers, the legislation relating to the latter has been severely restricted. Combines agreements were illegal by virtue of a provision in the Criminal Code if they "unduly" lessened competition.[324] Mergers were illegal by virtue of the Combines Investigation Act if they were "to the detriment or against the interest of the public." By judicial interpretation the two terms became synonymous. "An agreement . . . becomes criminal when the preventing or lessening agreed upon reaches the point at which the participants in the agreement become free to carry on these activities virtually unaffected by the influence of competition, which influence Parliament is taken to regard as an indispensable protection of the public interest . . ."[325] The Director of Investigation and Research has not accepted the above pronouncement.

> The following questions give some indication of the range of factors considered in the Combines Branch in assessing a particular merger from the standpoint of the statutory test whether competition

321 Combines Investigation Act, R.S.C., 1952, c. 314, s. 2 (e).

322 Phillips, *Canadian Combines Policy—The Matter of Mergers* (1964), 42 Can. Bar. Rev. 78, at p. 87.

323 *Ibid.*, at pp. 82-3.

324 Criminal Code (1953-54), 2 & 3 Eliz. II, c. 51, ss. 409-412 (Can.).

325 *Howard Smith Paper Mills Ltd. v. The Queen*, [1957] S.C.R. 403, at p. 426.

is or is likely to be lessened 'to the detriment or against the interest of the public':

1. Is there a sensibly defined product for which there are no close substitutes?
2. Is there evidence that a substantial market (even though this may be regional) is likely to be affected by the merger and is capable of fairly unambiguous definition?
3. In the absence of competition among domestic suppliers, is there evidence in the form of a substantial tariff or statistics showing that only a small proportion of the market is supplied by imports, that foreign suppliers cannot be looked to, to protect the public?
4. Is there reasonable assurance that there is no significant government regulation?
5. Is there evidence that existing concentration ratios are high or that there is a large size-differential between the acquiring company and its rivals?
6. 'Is there evidence that the barriers to entry in the industry are high or that they will be raised by the merger or that new firms have not in fact entered the industry for some significant period of time?
7. Is there evidence that competition remaining in the market is likely to be ineffective?
8. Does the acquiring firm have a history of growth by merger or a history of coercive or predatory action or any other anti-competitive behaviour?
9. Is there any evidence of intent to reduce competition or to dominate the industry?
10. Is there any likelihood that there will be foreclosure of an important market or source of supply to firms unconnected with the acquiring company?
11. To what extent is there evidence of a real possibility of increased efficiency via economics of scale or the transfer of assets from incapable into capable hands?
12. Is there direct evidence of detriment such as excessive profits or price enhancement following the merger?[326]

International Mergers and Acquisitions

Organization of a multi-national corporation presents numerous difficulties not found in the usual merger or acquisition. Differing tax structures, corporate control legislation, and general political attitudes may be critical factors.

Most factors have tended to attract foreign investment in Canada, especially from the United States. In 1963 foreign ownership of Canadian manufacturing industries was 54 per cent and foreign control, 60 per cent. Foreign ownership and control of mining and smelting was 62 and 59 per cent respectively; petroleum and natural gas, 64 and 74 per cent.[327] Put another way, 45 of Canada's 100

---

326 Report of the Director of Investigation and Research (1966), at p. 19.

327 Task Force on the Structure of Canadian Industry, Foreign Ownership and the Structure of Canadian Industry (1968), at pp. 9-10.

largest manufacturing, resource and utility companies are foreign controlled.[328]

The trend has been increasing and of some concern to Canadian political and economic independence.[329] Several measures have been taken and others proposed that directly relate to the acquisition of a Canadian company by a foreign corporation.

Via the Canadian Income Tax Act, an attempt has been made to maintain at least 25 per cent of the capital stock of Canadian corporations in Canada. Dividends of Canadian-based corporations paid to non-resident shareholders are subject to a surtax of 15 *per cent*. If 25 per cent of the shares having full voting rights were owned by one or more individuals resident in Canada or listed on a Canadian stock exchange, and 25 *per cent* of directors are resident in Canada, then the surtax to non-residents is reduced to 10 *per cent*.[330] Because of the provision, some acquisitions have been limited to 75 per cent of the share capital acquired by foreign corporations. However, its effectiveness is questionable.[331]

> Corporations going abroad exhibit a marked preference for direct investment in a branch or subsidiary rather than licensing arrangements or joint ventures with local firms, and show a further, and very strong preference for a wholly-owned subdidiary rather than a subsidiary with local minority shareholders. Such corporations are reluctant either to share the return that results from their special advantages, or to dilute ownership in such a way that it becomes more difficult to maintain control over the subsidiary. In part the firms want to capture all the rents; in part they wish to avoid the inconveniences that result from letting outsiders have a voice in how the firm should be run.[332]

More effective legislation has been enacted in some industries. The Trust Companies Act[333] restricts non-resident shareholders from individually holding more than 10 *per cent* of the capital stock of a trust company and aggregate shares held by non-residents to 25 *per cent*. Non-resident shareholders of banks are subject to similar restrictions.[334]

---

328 *The Financial Post* (July 20, 1968), at p. 11, col. 1.

329 See, generally, Task Force on the Structure of Canadian Industry, Foreign Ownership and the Structure of Canadian Industry (1968); Gordon, *A Choice for Canada* (1966).

330 Income Tax Act, R.S.C., 1952, c. 148, ss. 106 (1a), 139A (1).

331 Scase, *The Degree of Canadian Ownership: An Exercise in Futility?* (1965), 3 Osgoode Hall L.J. 295.

332 Task Force on the Structure of Canadian Industry, Foreign Ownership and the Structure of Canadian Industry (1968), at pp. 43-44.

333 (1964-65), 13 & 14 Eliz. II, c. 40, s. 36B (Can.).

334 (1966-67), 15 & 16 Eliz. II, c. 87, s. 53 (Can.).