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Article 9

Fallis and Deacon v. United Fuel Investments Ltd., [1963] S.C.R. 397

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B. COMPANY LAW

Fallis and Deacon v. United Fuel Investments Ltd., [1963] S.C.R. 397.

In *Fallis et al. v. United Fuel Investments, Ltd.*[1] the Court had occasion to review, and to confirm in the result, a unanimous decision of the Ontario Court of Appeal[2] in the obscure and controversial field of "shareholder protection." In delivering the judgment of the Court, Judson, J. not only acknowledged the very restricted status which may be asserted in ordinary circumstances for the holders of redeemable preference shares but was at pains, as well, to distinguish (as the Court of Appeal had failed to do) between the case of a "freeze-out" of preferred shareholders in accordance with their contractual liabilities, and the essentially different question of a majority using its voting control unfairly to impose upon a minority of the same class. The line between the two issues is a fine one—if, indeed, it is capable of precise delineation; academics and legislators are alike perplexed[3] by the intractable elements of the problem; the courts have sought with only limited success to illuminate the boundaries for purposes of definition and distinction; while those in the community who perceive a sinister motive in every exercise of voting control are disturbed by the inequities which appear to flow from these well-springs of principle. The case itself is a text-book illustration of the problem, but it is a virtue of the judgment that no final answer is either attempted or given. The apparently conflicting claims of "rights" and of "justice" are left in tantalizing equipoise, while the law, for this dispute, is declared in terms which do violence to neither. Judson, J. has done a service in identifying the case for what it is—an important skirmish but not by any means the final battle.

The litigation arose through an application by the respondent company for a winding-up order under s. 10 of the *Winding-up Act*.[4] Section 10 provides that:

> The court may make a winding-up order . . . (b) where the company at a special meeting of shareholders called for the purpose has passed a resolution requiring the company to be wound up.

Section 13 of the same Act provides that:

> The court may, on application for a winding-up order, make the order applied for, dismiss the petition with or without costs, adjourn the hearing conditionally or unconditionally, or make any interim or other order that it deems just.

As the result of a reorganization which was approved by the Court in 1939 after a period of severe financial reverses, the share capital of the company comprised 90,000 6% cumulative redeemable Class "A" preference shares of a par value of $50.00 ($4,500,000);

1 [1963] S.C.R. 397.
2 [1962] O.R. 162.
3 Cf. Gower, *Modern Company Law*, 2nd ed., cc. 23-25; M. A. Pickering, *The Problem of the Preference Share*, (1963) 26 Mod. L.R. 499; *Report of the Company Law (Jenkins) Committee*, 1962, H.M.S.O. Cmnd. 1749.
4 R.S.C. 1952, c. 296.

90,000 non-cumulative Class "B" preference shares of a par value of $25.00 ($2,250,000) and 90,000 common shares, without nominal or par value, which were credited on the books of the company with a contribution of $50,000. Subject to the rights of the Class "A" shares in that regard, moneys available for dividends were distributable, share for share, amongst the Class "B" and the common shares. The Class "A" shares were redeemable on notice at any time, and were entitled to priority on return of capital and a premium of $10.00 in the event of a voluntary liquidation of the company. The Class "B" shares were subject to purchase for cancellation at any time, and entitled to priority on return of capital and a premium of $5.00 in the event of a voluntary liquidation. Both classes of preferred shares were expressly excluded from any further participation in the assets on a winding-up and neither class (in the events which happened) were entitled to receive notice of or to vote at any annual or special general meeting of the company.

At the time of the proceedings in question Union Gas Company of Canada, Ltd., a distributor of natural gas in southwestern Ontario, held over 99% of the Common shares (which it had acquired in 1930), some 95% of the Class "A" shares and approximately 68% of the 69,689 Class "B" shares which still remained issued and outstanding. The preferred shares had been acquired, for the most part, as the result of an offer to purchase which had been made by Union Gas in July, 1960, to the then holders of those shares. The appellants, as Class "B" shareholders, had declined to accept that offer. The respondent company—United Fuel Investments, Ltd.—held a gas distribution franchise for the urban district of Hamilton, Ontario, and although its economic fortunes had been decidedly unstable from the time of its incorporation in 1928 (the Class "B" shares having traded on the Exchange from a low of $2.50 to a high of $70.00 in the twenty years between 1939 and 1959) it was common ground between the parties that its prospects for the future were exceptionally favourable.

In October, 1960, notice of a special general meeting was given to the holders of the Common shares, and on that occasion it was decided by a vote of 89,920 to 8 (a further eight shares abstaining) that the company's undertaking should be wound up and its assets liquidated. 89,906 of the affirmative votes represented common shares owned by Union Gas Ltd. That company conceded, moreover, that it proposed to bid for the assets in the liquidation proceedings, and in view of the common shareholders' entitlement to the whole of the proceeds after payment-off of the preferred capital, it was apparent that Union could defeat all other bidders by offering an excessive price which would be returned to it in any event as the holder of virtually all the common shares. The result, of course, was the appropriation of the company's promising potential to the holder (five months earlier) of less than 1% of the company's paid-up capital, the preferred shares having sustained the company in its years of adversity and suffered a tangible loss of at least $60.00 a share, on contributed capital and relinquishment of dividends, in a successful effort in 1939 to preserve the company from total collapse. It was not disputed, moreover, that some $3,000,000 of otherwise distributable earnings had been reserved for reinvestment in the company's undertaking, a prudent restraint for which the Class "B" holders would now be repaid through loss of their contractual right of participation. Acknowledge, finally, that the whole arrangement could be carried by the shares of the beneficiary itself—for neither the Class "A" nor the Class "B" shares had even received notice of the meeting, let alone been given an opportunity to vote on the resolution—and the picture of injustice and oppression would appear to be complete.

Unfortunately, however, the cause of the protesting minority of Class "B" shares was doomed to defeat from the outset, since it was plain from the language of the preference that the right to vote had been relinquished without reservation or qualification, and that $30.00 was the most they could hope to receive on a liquidation of the shares, whether through purchase by the company for cancellation or by way of return of capital on a winding-up, and regardless of the fortunes of the company or the extent to which its sanguine expectations might in fact be realized. In only one respect could it be argued that the winding-up would impair or destroy the economic value of their investment and that, of course, was their right to share rateably with the common capital in such of the earnings as might be distributed from time to time by way of dividend. Only this right could account for their volatile performance on the Exchange, but even then the purchaser or holder faced "redemption" by the company when the market price fell to $30.00 or lower—a price which could easily be effected by a determined management with unfettered discretion in the distribution of profits. The preference of participation had a special value, therefore, only if the company maintained a high level of earnings and the holders of the "B" shares could in some way establish a vested right in the company's continued existence. But in this latter proviso lurked the two threads of a fatal dilemma, for without a vote they could not prevent a winding-up of the company unless, in turn, those holding the voting strength, however minor their contribution to the paid-up capital, could be compelled to continue the company's operations for the common benefit of both majority and minority. Only a sacrifice of clear legal rights could establish a proposition of such patent frailty, and only then at the expense of what the majority—of votes at least—might reasonably assert to be their own claims for justice. It is true that the Judge of first instance (McLennan, J.) dismissed the petition for the winding-up order on the ground that the "shareholders" referred to in s. 10(b) of the Act[5] were not in terms limited to "voting shareholders"[6]—an interpretation which was rejected in both the Court of Appeal and the Supreme Court—but even he declined to endorse the further proposition which had ultimately to be established if the claim of

[5] *Ibid.*
[6] [1961] O.R. 801.

the minority was to be sustained. Such, then, is the power of voting control, even though that control should represent something less than 1% of the company's contributed capital.

This, in turn, raises the disquieting prospect of judicial sanction for the decisions of even a bare majority of votes, however offensive the result may be to the sensitivities of a fair-minded observer. Indeed, had the case not been carried to the Supreme Court it would be difficult in such cases to justify any effective restriction on the will of the majority since Schroeder, J.A., in delivering the judgment of the Court of Appeal, expressed the view[7] that:

> . . . there is nothing in the evidence which points to the conclusion that in their decision to have the company wound up there was bad faith or fraud or anything inclining toward that disposition of mind on the part of the majority of the holders of common shares. What the company proposes to do is completely *intra vires* and if the holders of the Class B preference shares receive the price stated in the terms of the supplementary letters patent of 1938, they can have no just grievance against those responsible for the passing of the resolution.

And again:[8]

> There is no real significance in the fact that United Fuel and Union Gas have, except as to one director, interlocking directorates. The resolution with which we are concerned is a resolution passed not by the directors but by an overwhelming majority of the shareholders entitled to vote upon the matter. Union Gas being the owner of the majority interest, the principle applicable was that stated by Sir Richard Baggallay in *North-West Transportation Co. v. Beatty* (1887) 12 App. Cas. 589 at p. 593, as follows: 'The general principles applicable to cases of this kind are well established. Unless some provision to the contrary is to be found in the charter or other instrument by which the company is incorporated, the resolution of a majority of the shareholders, duly convened, upon any question with which the company is legally competent to deal, is binding upon the minority, and consequently upon the company, and every shareholder has a perfect right to vote upon any such question, although he may have a personal interest in the subject-matter opposed to, or different from, the general or particular interests of the company.'

But with great respect, this is surely an instance of begging the very question at issue between the parties, for it can reasonably be argued, on both principle and authority, that the appropriation by one group of shareholders of a company's assets under another corporate guise—in a case, in other words, where there is no real termination of the company's undertaking but merely an exclusion of one group (in this case the largest group) from the rewards of success—in itself constitutes that very element of "bad faith or fraud" of which the victims complain.

In the leading case of *Menier v. Hooper's Telegraph Works*[9] the majority carried a resolution for the winding-up of the company and the discontinuance of a claim for a valuable franchise which appeared subsequently to have come into the possession of the majority shareholder. According to James, L.J.:[10]

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7 [1962] O.R. at p. 179.
8 *Ibid.*, at 181.
9 (1874) L.R. 9 Ch. App. 350.
10 *Ibid.*, at p. 353.

The case made by the bill is very shortly this: the Defendants, who have a majority of shares in the company, have made an arrangement by which they have dealt with matters affecting the whole company, the interest in which belongs to the minority as well as to the majority. They have dealt with them in consideration of their obtaining for themselves certain advantages. Hooper's Company have obtained certain advantages by dealing with something which was the property of the whole company. The minority of the shareholders say in effect that the majority has divided the assets of the company, more or less, between themselves, to the exclusion of the minority. I think it would be a shocking thing if that could be done, because if so the majority might divide the whole assets of the company, and pass a resolution that everything must be given to them, and that the minority should have nothing to do with it. Assuming the case to be as alleged by the bill, then the majority have put something into their pockets at the expense of the minority. If so, it appears to me that the minority have a right to have their share of the benefits ascertained for them in the best way in which the Court can do it, and given to them.

Where, then, does one draw the line? Plainly, in the instant case, the majority were appropriating, not an existing asset, but the promise of future profits which belonged in both law and equity to the Class "B" shareholders as well as to the common—but only, again, if the common shares could be restrained from exercising their voting control to wind up the company. As was said at the outset, it is the virtue of Judson, J.'s analysis that the complaints of the appellants were held to be unfounded, not because the voting shares must in all cases carry the day, but rather because the very terms of the preferred capital exposed the holders at all times to the redemption which was now being effected. If, however, the appellants had been, not the holders of redeemable "B" shares, but the eight *common* shareholders who were not subject to redemption and had voted against the resolution in question, we have a clear intimation that the Supreme Court would reject the majority principle endorsed by Schroeder, J.A. and examine the propriety of the move in the spirit of *Menier v. Hooper's Telegraph Works*.[11] At the conclusion of his judgment, Judson, J. is reported as having said:[12]

Counsel for the Class 'B' shareholders relied on certain authorities in the United States relating to the dissolution of solvent, prosperous corporations. . . . Without going into details, these cases are all concerned with a common problem, an attempt of a majority of common shareholders to get the assets of the corporation into another corporation in which they alone are interested and the minority is not, and to pay off the minority common shareholders in case. This is an entirely different problem from the right to wind up for the purpose of redeeming preference shares. The dangers inherent in the use of dissolution procedure in such a case are obvious. The first is that the assets may be sold by the majority to themselves under the cloak of a new corporation at an unfair price and the second is the denial to the minority of the opportunity to participate.

I am not overlooking the case of *Castello v. London General Omnibus Co. Ltd.*, (1912) 107 L.T. 575, referred to in the reasons for judgment of the Court of Appeal. In that case the Court of Appeal in England refused to restrain a sale of assets to another company exclusively owned by the majority in the old company and compelled the minority in the old company to take a cash payment. It is true that the cash payment was, on its face, a very generous one but the shareholders did not want

11 *Ibid.*
12 *Supra*, footnote 1, at p. 408.

> cash. They wanted to stay with the company instead of being paid off. The case is referred to with approval in the judgment of the Court of Appeal but it is not the present case and I do not think it should receive approval in this Court.

The trap was set by the compelling circumstances of the case at hand; it is to the Court's credit that it declined to be caught.

D.B.S.