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Esso Standard (Inter-America) Inc. v. J. W. Enterprises et al., [1963] S.C.R. 144

M. L. D.

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In the case of *Esso Standard (Inter-America) Inc. v. J. W. Enterprises Inc. et al. and M. A. Morrisroe*,[1] the Supreme Court of Canada considered the meaning of s. 128 of the Dominion Companies Act[2] and declared it to be intra vires the Parliament of Canada.

The facts may be briefly stated. Esso Standard, a Delaware corporation and wholly owned subsidiary of Standard Oil Company, a New Jersey corporation, sent an offer to the shareholders of International Petroleum Company Limited, incorporated under the *Companies Act* R.S.C. 1952, c. 53, to purchase all the outstanding shares of that company, as provided by s. 128(1) of the *Companies Act*. S. 128 provides:

> (1) Where any contract involving the transfer of shares in a company . . . to any other company . . . has, within four months after the making of the offer in that behalf by the transferee company, been approved by the holders of not less than nine-tenths of the shares affected . . . , the transferee company may . . . give notice . . . to any dissenting shareholder that it desires to acquire his shares, and where such notice is given, the transferee company is, unless on an application made by the dissenting shareholder within one month from the date on which the notice was given the court thinks fit to order otherwise, entitled and bound to acquire those shares on the terms on which, under the contract, the shares of the approving shareholders are to be transferred to the transferee company.

In their offer, Esso Standard, the transferee company, stated that Standard Oil, the owner of 96 per cent of the outstanding shares of International Petroleum, intended to accept the offer. Esso Standard would thus be in a position to give notice under s. 128(1) for the compulsory acquisition of the shares of all shareholders who did not accept the offer. Less than 90 per cent of the free shares accepted within the required time.

Esso Standard obtained an *ex parte* order from the court under s. 128. The present case arose when the present respondents moved for an order setting aside the *ex parte* order. The Court of Appeal, Schroeder, J.A. dissenting, allowed appeals from Wells, J. who had dismissed the motions, and declared that "Esso-Standard (Inter-America) Inc., is not entitled nor bound to acquire the shares of the

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[1] [1963] S.C.R. 144.
[2] R.S.C. 1952, c. 53.

appellants or any of them in International Petroleum Company Limited".[3] On appeal to the Supreme Court of Canada, Judson J., delivering a unanimous judgment of the Court, upheld the decision of the Court of Appeal.

It is submitted the most interesting argument of the respondents in the Supreme Court was that s. 128 of the Companies Act was ultra vires the Parliament of Canada. In the Court of Appeal counsel for the appellant Morrisroe, Mr. Sheard, contended that s. 128 was ultra vires because it was related to property and civil rights. He urged that it overrode the general law of the Province in which the shares had their "situs," and provided for the compulsory transfer of such shares.

> s. 128 does not produce any reorganization of the company or any compromise of anyone's rights against it. It leaves the company exactly as it was before. The Section provides for the forcible transfer of the chose in action from one person to another and the sole connection the section has with company law is that it is a share of a company incorporated under the Companies Act, that is, the chose in action in question.[4]

The courts rejected the argument of Mr. Sheard and unanimously upheld the validity of the legislation. They held that it was truly legislation in relation to the incorporation of companies with other than Provincial objects, and was not legislation in relation to property and civil rights. They felt that legislative power to prescribe the manner in which shares of the capital of such companies can be transferred and acquired was incidental to the powers of the Dominion to incorporate companies, and was of general interest throughout the Dominion. Judson J. stated that in his opinion, the case was completely covered by the Supreme Court decision: *Reference re Constitutional Validity of s. 110 of the Dominion Companies Act*,[5] [1934] S.C.R. 653, 4 D.L.R. 6.

In that case s. 110, dealing with Directors' liability for declaring and paying a dividend when the company is insolvent, or when the payment of the dividend would render the company insolvent or which impairs the capital of the company, was held intra vires of the Parliament of Canada. It was settled in *John Deere Plow Co. v. Wharton*,[6] that the subject matter "Incorporation of Companies with objects not provincial" is a subject which falls within the residuary clause of s. 91 because it is excluded from those embraced within s. 92 by the terms of that section. The *John Deere* case also laid down that "Incorporation of Companies" cannot be read in a manner so strict as to limit it to the subject of bringing such companies into being. It must necessarily include powers incidental to the operation of companies. Following this reasoning Duff, C.J. held s. 110 intra vires. After canvassing the purpose of the legislation, with reference to

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3 (1963) 33 D.L.R. (2d) 658, *sub nom. Re Internat'l Petroleum Co. Ltd.*
4 *Ibid.*, cf. p. 712 (O.R.).
5 [1934] S.C.R. 653; 4 D.L.R. 6.
6 [1915] A.C. 330.

Lord Lindley's book on the law of companies, he concluded that "you are strictly within what might properly be called the defining of the constitution of the company when you are making provision . . . for the protection of the assets of the company in the interests of the creditors of the company; . . . and particularly, when in the interests of persons dealing with the company, you are providing safeguards against the improper and colourable employment by the managers or the shareholders of their powers in wasting the assets of the company."[7] Clearly, in that case the section was intra vires.

Judson J. stated that the Esso Standard case was completely covered by the reasons of the court in *re Reference 110*. It would appear to be a better view to distinguish the cases. S. 110 appears to go to the "internal" control of the company, to the status of a company qua company. On the other hand, as counsel for the appellant argued, s. 128 does not affect the status of the company at all, but only its control and management. The courts have never attempted to define what is covered by the term "internal management", but it has been decided,[8] for example, that where the transfer of a controlling interest in the company is involved, the question—in that case whether the chairman who gave his casting vote had been properly appointed—is not to be regarded as a matter of internal management.[9] This would seem to indicate it is not therefore a matter incidental to the status of the company, but is rather a question of property and civil rights. If, in the s. 110 case, the directors were permitted to impair the capital of the company, the existence of the company itself would be threatened. In contrast, s. 128 involves only the transfer of ownership in the company leaving the company itself, as a legal entity, unaffected. The members of the Board of Directors may change, but the company itself still exists and carries on business. Thus in my view, the legislation is ultra vires the Parliament of Canada, being not in relation to the incorporation of companies with other than provincial objects, but rather in relation to the proprietory rights of the owners and directors. However, the Supreme Court of Canada rejected this argument holding that power to transfer shares was incidental to the power to incorporate companies.

After holding s. 128 intra vires the Parliament of Canada, the court interpreted the section in the light of the facts. Judson J. agreed with Laidlaw, J.A. that "the court should grant the dissenting shareholders' application for 'order otherwise' for the reasons given by the Court of Appeal in England in the case of *In re Bugle Press Limited.*"[10] In his opinion there was no distinction between *Bugle Press* and the present case before the court either on fact or law.

In the *Bugle Press* case, two majority shareholders wishing to buy out a minority shareholder who rejected their first offer of purchase,

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[7] *Supra,* footnote 5 at p. 569 (S.C.R.).
[8] *Clark v. Workman,* [1920] 1 I.R. 107.
[9] Wegenast, Canadian Companies 1931, p. 327.
[10] [1961] 1 Ch. 270.

caused a transferee company, of which they held all the outstanding shares, to be incorporated. The transferee company acquired 90 per cent of the shares of the transferor company from the two majority shareholders, and then gave notice of its intention to exercise its powers of compulsory acquisition under s. 209 of the *Companies Act,* 1948. The minority shareholder moved for a declaration similar to the one sought in the present case. It was held that the minority was entitled to an order as sought on the ground that in the circumstances of the particular case the onus was on the transferee company to show that the scheme was one which the minority shareholder ought to be compelled to accept. They could not satisfy this onus. The mapority shareholders were trying to do indirectly what they could not do directly with the result that the whole proceeding was, as Laidlaw stated in the Ontario case, a sham with a foregone conclusion for the purpose of expropriating a minority interest on terms set by the majority. This the Court would not allow.

Both Laidlaw, J.A. in the Court of Appeal and Judson, J. in the Supreme Court of Canada applied the *Bugle Press* case to the Esso Standard situation and held that Esso Standard failed to meet the onus placed upon it to meet the prima facie case made out by the appellants. Therefore the discretion of the Statute was exercised in their favour.

It is my submission that the courts were wrong in finding the facts of the *Esso Standard* case to be within the four corners of *Bugle Press.* The main problem here is the interpretation of s. 128.

In the *Sussex Carriage*[11] case, the modern rule of Statutory Interpretation was laid down. There it was held that where the words of the statute are clear, it is the duty of the court to give effect to them without regard to the consequences, and even if the rule does not seem expedient to them.

In interpreting s. 128 in the light of the facts of the present case, the Courts seem to have chosen to disregard the plain meaning of the words in the Section, and added a gloss in the light of what they think the words ought to mean. In my respectful submission, this is not the function of the courts. Their function in interpreting statutes is to give effect to what the legislature says, even if it effects what, in their opinion, is a wrong result. Only if there is some ambiguity or absurdity are the courts in a position to "legislate." *City of Victoria v. Bishop of Vancouver Island.*[12]

In both the Court of Appeal and the Supreme Court of Canada, reference was made to the fact that s. 128 of the *Dominion Companies Act,* first enacted in 1934, is based upon s. 209 of the English Companies Act of 1948 enacted in 1929. The history and contents of the

[11] (1841) 11 Cl. & F. 85; 8 E.R. 1034; 65 R.R. 811.
[12] [1921] A.C. 384; 90 L.J.P.C. 213; 59 D.L.R. 399.

English section was reviewed, and its purpose as found by Evershed, M.R. was quoted by Laidlaw, J.A.:

> that what the section is directed to is a case where there is a scheme or contract for the acquistion of a company, its amalgamation, reorganization or the like, and where the offeror is independent of the shareholders in the transferor company or at least independent of that part or fraction of them from which the 90 per cent is to be derived.[13]

Following the English Court of Appeal, the Supreme Court of Canada held that s. 128 was not intended to operate where there was no bona fide transfer between independent parties where there was no meeting of independent minds. Applying this rule to the facts in this case they held that because Esso Standard was a wholly owned subsidiary of Standard Oil, any transfer between them was not a transfer between independent companies as required by the sections, but was an inter-company arrangement and a sham arranged solely for the purpose of imposing a majority will, as in the *Bugle Press* case, and compelling other shareholders of the company to part with shares which they were unwilling to sell.

However, I submit that the cases are distinguishable. In *Bugle Press,* the transferee company was created specifically for the purpose of acquiring the majority shares. They could not do indirectly what they could not do directly. In contrast, Esso was not incorporated for the purpose of making the offer in question, but always carried on, and is still carrying on, other commercial undertakings.

The principle was first enunciated in *Salomon v. Salomon & Co.*[14] that every validly constituted corporation is a legal entity, a corporate person distinct and separate from its Board of Directors. In the *Bugle Press* case the court decided that while the transferee company was a distinct and separate entity from its two shareholders, it was in substance the same, they were its alter ego. In the *Esso Standard* case, however, the subsidiary and its parent were separate legal entities. While there may have been an identity of interest between the two companies it seems irrelevant in interpreting the plain words of the section, unless it can be proved that they had identical Boards of Directors and that Standard Oil was really the alter ego of Esso Standard. Such facts were not alleged. The Statute says: "Where any contract involving the transfer of shares . . . in a company . . . to any other company . . .". Here there were two independent companies. The fact that one was a wholly owned subsidiary of the other should not enable the court to impose a condition into the Statute to bring about what they consider is a fair result. It is not the function of the court to determine whether what the legislature said was wise. Their only job is to apply the law as stated. In this case the Courts appear to have imposed a gloss on the Statute to bring about what they consider is a just result. In *Foss v. Harbottle*[15] it was established that the Court will not at the behest of

[13] *Supra,* footnote 3 at p. 714 (O.R.).
[14] [1897] A.C. 22; 66 L.J. Ch. 35.

a minority, interfere in the internal affairs of a company, when the irregularity could be cured by ratification by the majority. In this case the Supreme Court of Canada, having held that the transfer of shares was incidental to the incorporation of companies by the Dominion, and therefore part of its internal management, should I submit, have held that they could not interfere in a transaction between two independent companies, which could be ratified by the majority. Whether the deal was "just" or not is irrelevant. The only question that should have been dealt with by the court was whether the transaction was "legal". In my submission it was, and the "order to the contrary" should not have been issued.

M.L.D.