BUSINESS VALUATION REVIEW

FISHING EXPEDITION OR HUNTING FOR THE TRUTH?

SEEKING INFORMATION AND DOCUMENTS IN CANADIAN SHAREHOLDER LITIGATION

by

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There are a number of situations in which a business valuator will, in the course of preparing a valuation opinion, be denied access to important information and documents. Examples that immediately come to mind are valuations in minority stockholder suits and in divorce proceedings. This article outlines some of the cases in which Canadian business valuators have confronted significant scope limitations, and the reaction of the courts in these cases; it may provide reference material where similar challenges confront U.S. business valuators.

Frequently, as in the United States, when a business valuator (or forensic accountant) is denied either access to documents, permission to tour a company's operating premises, or access to the company's management (or the Independent Committee of the Board of Directors, in the case of a going-private transaction), the attorney may seek a court order forcing the company to comply with the valuator's request. Often, the motion or application filed in the court will be accompanied by an affidavit from the valuator, specifying the documents and/or information he or she requires and usually providing the reasons why each document or piece of information is relevant in the circumstances. If the expert is to be cross-examined on the affidavit, he/she will have to justify or defend the "shopping list" of documents requested and interviews and tours sought.

The Canadian federal and provincial[1] company law statutes (except for the Province of Quebec), similar to the U.S. law, grant to the minority shareholders the right to receive the "fair value"[2] of their shares when a corporation reorganizes in such a manner as to have the effect of compelling a minority shareholder of the company to terminate his/her interest therein ("fundamental corporate changes"). The Canadian statutes also contain provisions granting to minority shareholders the right to have their shares valued when the shares are subject to compulsory acquisition under the takeover-bid provisions of the company law, and when there is oppressive conduct on the part of the majority ("oppression remedy").

The dissentient or oppressed shareholder, as the case may be, may apply to the court to fix a fair value for the shares. As in the U.S., the statutes impose upon the court the responsibility of determining a "fair value". One or more valuators may, in the court's discretion, assist in the fixing of value. Of course, there is an abundance of U.S. and Canadian case law on the subject, particularly the U.S. jurisprudence emanating from the Delaware courts.

The following Canadian cases involved requests by the minority shareholders' business valuator for documents, interviews, company-site visits and (in the case of a going-private squeeze-out) access to the Independent or Special Committee, which were denied by the controlling shareholders and which therefore gave rise to legal proceedings forcing compliance with the valuator's requests:

- *Kruger Inc.* v. *Hermitage et al;*[3]
- *Xerox Canada Inc.* v. *Ontario Municipal Employees Retirement Board;*[4]
- *100779 Canada Inc. et al* v. *Télémedia Inc. et al;*[5] *and*
- *Attorney General for Ontario et al* v. *Steve A. Stavro et al.*[6]

The *Kruger* Case

In *Kruger*, a motion on behalf of the minority shareholders was presented in Quebec Superior Court (a trial court) under the appraisal-remedy provisions of the CBCA[7] asking the court to "exercise its discretionary and equitable jurisdiction" and order the production of documents, information, etc., relevant in determining the fair value of certain minority shares, the court having "a duty to ensure the most complete and accurate opinion as to the fair value of the shares". The motion stated that the documents and information being sought by the minority shareholders' business valuator would allow their expert to provide at trial a more complete and accurate opinion as to the fair value of the shares of Kruger Inc. (one of the largest newsprint manufacturers in Canada, approximately 90% of its production going to customers in the United States, including large daily newspapers such as *The Wall Street Journal*, *USA Today* and the *Boston Globe*).

The motion requested an Order by the court to permit the valuator (a) to interview Kruger's Vice-Chairman, its President and its Vice-President of Finance concerning the company's business operations, as well as (b) to inspect its five plants and mills located in Eastern Canada.

The Quebec Superior Court issued the following Orders:

> The Court, **seeing ... the letter of [the minority shareholders' expert] as to the necessity of various kinds of information to permit the determination of the fair value of the shares** of the dissident minority shareholders, and seeing the affidavits in support of the motion; ...
>
> Grants the motion in part [and] authorizes applicants to examine out of court the three [senior executives];
>
> Authorizes the issuance of *subpoenas duces tecum* to such persons with respect to all documents and information [in the list accompanied by the valuator's request for information and documents] which exist, and in respect of all documents which do not exist,
>
> **Orders [Kruger Inc.] to give communication to Applicants of all documents, books and records required to enable Applicants' expert to obtain the desired information; ...**
>
> Orders that the said examinations out of court be held *in camera*;
>
> **Orders [Kruger] to permit [minority's business valuation expert] to visit and inspect the plants and mills of [Kruger] or its subsidiaries ... .** (Emphasis added.)

In allowing the motion, the judge said that he would grant the business valuator access to information required under "the broad equitable jurisdiction of the Court under the *Canada Business Corporations Act*, and the Court's jurisdiction to permit examinations before trial under the Quebec *Code of Civil Procedure*".

Kruger attempted to have this ruling overturned by the Quebec Court of Appeal. The appellate court unanimously rejected the appeal and upheld the decision of the trial court:

> One aspect of this matter that has not been emphasized by either party and which should be stressed is that **Respondents are shareholders, 'members', of Appellant, and as such entitled to a great deal of information about their company. In this way it differs from, say, a case of a stranger suing the company for damages; in that situation the plaintiff's right to information would be more limited. But here we have shareholders asking the court to fix a value of their own shares in their own company**, which I think is an important factor in judging how far they can go.
>
> There are good arguments on both sides in this appeal; I have come to the conclusion that those of Respondents prevail. ... [I]n the circumstances ... and for the limited purposes envisaged, the orders of the Superior Court are lawful and reasonable.
>
> The orders for discovery and production of documents have similar counterparts in the rules of the Quebec *Code of Civil Procedure*; even the order to permit Respondents' expert to visit plants and mills is analogous to the provisions of Article 420, which

> **authorizes an expert appointed by the court to visit any place which he considers useful**. (Emphasis added.)

The *Xerox Canada* Case

In the *Xerox Canada* case[8], the Ontario court followed the rulings in *Kruger.* The trial judge stated that "the object, as I see it, is to give [the valuator] as good an opportunity as possible, while at the same time protecting the individuals and intruding on the affairs of Xerox Canada as little as possible". An Order was made by the court as follows:

- Only one representative of Xerox Canada Inc., its President, would be interviewed;
- To the extent that commercially sensitive information would be divulged, a confidentiality agreement must be entered into;
- In light of the oppression-remedy application brought by the dissenting shareholder in conjunction with the fair value proceedings, the management interview would be recorded and conducted in the presence of counsel;
- The interview would take place in the President's office, so that conditions are as close to "normal" as possible; and
- The interview would be conducted by the dissenting shareholder's business valuator. Counsel would not to take any part except to object to a question, or the form of a question. The object would be to have as little involvement by counsel as possible.[9]

The *Télémedia* Case

This case related to a going-private transaction by Télémedia Inc., the largest radio broadcasting company and magazine publisher in Canada (publisher of, among others, *TV Guide* in Canada).

While the business valuator was given access to most of the documents that he requested, he was denied access to management as well as to members of the Independent Committee of the Board. Counsel for the dissenting minority shareholders therefor sought a court order which would grant the valuator access to three Independent Committee members. In doing so, counsel asked the valuator to provide reasons why he wanted to interview members of the Independent Committee, so counsel could include these in the motion filed in court. The valuator's reasons were outlined as follows:

In our opinion, the visits and interviews will help accomplish the following objectives with respect to our valuation:

(a) gaining a better understanding of the Company's operations;

(b) having a better understanding of the information contained in the Company's financial statements and other financial documents;

(c) identifying current and potential changes that might cause the Company's future results to differ from those indicated by an extrapolation of historical data; and

(d) providing additional insight as to the future prospects of the Company's business, major risks, concerns, etc.

The valuator believed that the information to be gathered during the course of interviews with members of the Independent Committee would represent a critical component of the valuation process. After all, the members of the Independent Committee must have been provided with relevant documents, information and professional opinions to assist them in determining whether the proposed offer was fair, from a financial point of view, to the shareholders, and in recommending whether the offer should be accepted or rejected. In fact, directors have a statutory duty to act honestly and in good faith, with a view to safeguarding the best interests of the corporation and to exercise the care, diligence and skill that a reasonably prudent person would demonstrate in comparable circumstances. This standard of care typically requires that directors devote the necessary time and attention to be able to apply their own judgment on the matter and, prior to making a decision, to inform themselves of all material information reasonably available to them.

Furthermore, directors are required to disclose in reasonable detail (a) the material factors on which their beliefs regarding the offer are based, (b) the background of their deliberations, and (c) their analysis of the expert opinions they obtained. As to the role of the Independent Committee concerning the opinion received from the fairness opinion provider ("FOP") in connection with the transaction, it was presumed that the Committee's initial involvement and subsequent monitoring of the process would (or should) have likely included the following matters, as appropriate:

- The appropriate definition of "fairness" from a financial point of view.
- Disclosure to the FOP of any valuation issues particular to the circumstances already identified by the Independent Committee.

- The scope of review undertaken by the FOP, including consideration of any restrictions which were likely to be encountered.

- Requirement for the retention of experts other than the FOP, such as tax or other counsel.

- Identification of members of management of Télémedia Inc. and of the acquiror, who would have knowledge with respect to Télémedia's history and future prospects, the industries in which it operates, and who may be aware of any "distinctive material value" that might accrue to the acquiror.

- Identification of outside parties (independent of Télémedia and the acquiror) who would be knowledgeable as to the industries in which Télémedia operates, who may be able to offer special insight regarding the industries as well as relevant valuation issues.

- Discussions with the FOP as to the market for the company's shares or the underlying assets, including consideration of possible strategic acquirers (including, but not limited to, the acquiror and the "distinctive material value" that might accrue to it); efforts of the company to divest of the securities or the underlying assets; and comparable transactions, if any.

- Request for the FOP's draft fairness opinion that would have been circulated for critical review and comment by the Independent Committee as well as representatives of Télémedia's management and the acquiror.

In this connection, it is interesting to note the policy of the securities regulator, the Ontario Securities Commission ("OSC"), prevailing at the time.[10]

Section 28 of OSC *Policy Statement 9.1*, "Disclosure, Valuation Review and Approval Requirements and Recommendations for Insider Bids, Issuer Bids, Going Private Transactions and Related Party Transactions", provided comfort for the valuator's contention that the members of the Independent Committee were well placed to provide him with the insight he required for the valuation.

> **28. Directors' Valuation Review and Assessment of Fairness**
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> 28.1 It is the view of the Commission that an issue involved in a transaction with an interested party is obliged to provide sufficient information to security holders to enable them to make an informed decision. Accordingly, directors should disclose their reasonable beliefs as to the desirability or fairness of the proposed transaction to security holders.

> **28.2 In reaching a conclusion as to the fairness of a transaction, the directors should disclose in reasonable detail the material factors on which their beliefs regarding the transaction are based. The disclosure disseminated by the directors should discuss fully the background of deliberations by the directors and any special committee and any analysis of expert opinions obtained, including the directors' assessment of the formal valuation and their view of the various components of the formal valuation.**
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> **…**
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> **29. Directors' Recommendation**
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> 29.1 The recommendation of directors of an issuer involved in a transaction with an interested party generally plays an important role in the decision of security holders. Accordingly, the Commission expects that in the case of a transaction involving an interested party a useful recommendation to security holders will be made by the directors in respect of the proposed transaction. A statement that the directors are unable to make or are not making a recommendation with respect to the transaction, without detailed reasons, will generally be viewed as insufficient disclosure for this purpose. Disclosure should be made of the review conducted by the directors and any special committee, of the report of the special committee, and of any disagreement or contrary view of any member of the special committee, or any director or between the special committee and the directors.[11]

The Independent Committee would therefore have been in an ideal position to critically review the fairness opinion provided by the FOP to the Independent Committee. Furthermore, an interview by the valuator with each of the members of the Independent Committee may have even disclosed contrary views or disagreements among some of them. Accordingly, considering the critical role of the Independent Committee in assessing the fairness of the value of the shares of Telemedia, their comments and insight on their decision-making process would be a highly instructive complement to the valuation process.

The foregoing reasons were incorporated in the minority shareholders' motion that the Quebec Superior Court:

> Grant an Order permitting [the business valuator] to interview the following members of the Board of Directors of Télémedia Inc. who are also members of the Independent Committee ... to be examined about all facts relating to the fair value of Class A Subordinate Voting Shares of Télémedia Inc. as at October 30, 1997 and to produce value-related documents, information and professional opinions that they were provided with and which was not made available to [the issuers of the fairness opinion], if any.

The court then ruled:

> For purposes of this discussion, one thing should be remembered: That one or other of the parties, i.e., the controlling group or the minority shareholders, will possibly be required in future (unless they can settle) to make their case before the Court in this matter. In my opinion, there is one important point which will be the basis of my decision and that is something which has been considered by the Quebec Court of Appeal in *Kruger Inc.* v. *Michelle Hermitage et al*, 1991 RDJ 259."

Referring to the comments of the Quebec Court of Appeal in *Kruger* (*supra*), that the company's minority shareholders were "members" of Télémedia and, as such, should have access to the pertinent information, the court stated:

> And I am mindful of this aspect that appears to me to be of the utmost importance. The minority shareholders are the members of the company, Telemedia, and, accordingly, they have the right of access to pertinent information. In my humble opinion, **why should they not have the right to the same sources of information that the controlling shareholders would have**?
>
> In my opinion, **the minority's experts have the right to have access to the very same sources of information as the experts for the majority shareholders**. The *Canada Business Corporations Act* has introduced **the concept of fairness in the legislation such that neither group of shareholders should be disadvantaged *vis-à-vis* the other.** For this reason, the Court grants the request of the minority shareholders.[12] (Emphasis added.)

Télémedia sought leave to appeal this decision, but leave was denied.[13] The minority shareholders' valuator was finally able to interview members of the Independent Committee. The matter was settled shortly thereafter.

The *Maple Leaf Gardens* Case

The *Maple Leaf Gardens* case involved a valuation, commissioned by the Attorney General of Ontario and the Public Trustee of Ontario, of the Toronto Maple Leafs hockey franchise, for purposes of determining the price at which the controlling shares of the company (which was publicly traded) could be purchased from the Estate of Harold Ballard by one of its executors, Mr. Steve Stavro. The Attorney General's/Public Trustee's valuator was constantly being blocked and checked! There were numerous motions and applications made to the court for

access to relevant documents and information. The business valuator was finally able to interview Maple Leaf Gardens' management, but only after a court order was issued.

Some of the difficulties and frustrations encountered in the valuator's attempt to value this NHL franchise can be highlighted from the following extract from the book, *Offside: The Battle for Control of Maple Leaf Gardens*:[14]

> The transcripts of the discoveries read like a script in a soap opera: constant interruptions, thinly veiled insults, badgering, grandstanding and **refusals to produce documents**, especially from [Mr. Steve] Stavro's side. With every objection, they hauled each other before Justice Ground, the case management judge assigned to fast-track this extremely complicated case through the court. ...
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> With each refusal for material from either camp, the litigators' strategy was to file motion records crammed with all kinds of documents putting out onto the public record as much damning evidence as they could. ...
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> ...
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> ... For eight months, the Public Trustee had been demanding that its opponents hand over confidential documents in the [Toronto-Dominion] Bank's files ... every time ... the TD Bank's lawyers had steadfastly refused, supported by a battery of lawyers.
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> ...
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> ... TD Bank had its own reasons for refusing to oblige. The threat of being named as a co-defendant in such a high profile and controversial legal battle could severely undermine its credibility with its other clients. Like many in this case, the country's fifth largest bank feared the media spin ... . 'We didn't want to hand over sensitive documents to a government agency ... . You'd be asking for trouble by exposing [the documents] to the public'. (Emphasis added.)

Conclusion

These are but a few of the more well-known Canadian cases on point. In these types of disputes, the valuator often has to file a lengthy, comprehensive affidavit enumerating each document and piece of information required, while simultaneously providing the court with a credible explanation as to the relevance of each requested item. The "spin" from opposing counsel will be that this is nothing more than a fishing expedition — even an attempt by the valuator to "churn" fees. The valuator must therefore be prepared to satisfy the court that this expedition involves nothing more than hunting for the truth.

Endnotes

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(1) In Canada, a company has the choice of incorporation under the laws of one of Canada's ten provinces, or it may incorporate federally under the *Canada Business Corporations Act* ("CBCA").

(2) In certain states, the value term is "fair cash value".

(3) (1991) R.D.J. 259 (Quebec CA).

(4) (1991), 3 BLR (2d) 68 (Ont. Gen. Div.).

(5) Settled. Quebec Superior Court No. 500-05-038643-985.

(6) Court File No. 94-CQ-54358, Commercial List No. B217/94.

(7) Section 190.

(8) *Supra*, note 4.

(9) The court ruled that Section 7 of the Canadian *Charter of Rights and Freedoms* (which deals with the right to life, liberty and security of the person) was not applicable to proceedings of this kind.

(10) The Policy has since been replaced by Rule 61-501, "Insider Bids, Issuer Bids, Going Private Transactions and Related Party Transactions".

(11) Extracted from Ontario Securities Commission *Policy Statement 9.1.*

(12) *10079 Canada Inc. et al* v. *Télémedia Inc. et al*, Quebec Superior Court (No. 500-05-038643-985), December 7, 1998.

(13) Quebec Court of Appeal, February 12, 1999.

(14) Theresa Tedesco, *Offside: The Battle for Control of Maple Leaf Gardens*, Penguin Books Canada Ltd. (Toronto: 1996), p. 247.