

# REORGANIZATION: A COMMERCIAL CONCEPT JURIDICIALLY DEFINED

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*Though often referred to by businessmen, mentioned in commercial contracts or contained in Canadian statutes, the concept of “reorganization” or of “reconstruction,” its British counterpart, is commercial in nature and bears no technical statutory definition. In light of the importance of the legal implications attached to such a concept, the authors chronologically analyze case law from both the UK and Canada in order to delineate the key features of such a concept, outlining that these have been constantly reaffirmed by the courts in different statutory and/or factual contexts.*

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*Même si les hommes d'affaires parlent souvent de « réorganisation » (ou de « reconstruction » au Royaume-Uni) et que c'est un terme qui apparaît fréquemment dans les contrats commerciaux ainsi que dans diverses lois canadiennes, c'est aussi un terme qui dénote un principe de nature commerciale, et pour lequel il n'existe pas de définition précise prévue par la loi. Compte tenu des importantes incidences juridiques qui se rattachent à ce principe, les auteurs ont procédé à une étude chronologique de la jurisprudence autant britannique que canadienne. Leur objectif était d'énoncer les caractéristiques clés du principe, en soulignant que celles-ci ont régulièrement été confirmées par les tribunaux, dans différents contextes législatifs et factuels.*

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## *1. Introduction*

The concept of “reorganization” is often used in a commercial context as a catch-all term by legal experts and businesspeople alike to describe a variety of transactions taking place within, in respect of, or involving one or several corporate entities. Determining the nature of the operations encompassed by such a concept is important in light of its legal ramifications for a company, its officers and shareholders. Several Canadian statutes contain this term. In the *Bank Act*,<sup>1</sup> for instance, reorganization may be what constitutes a “business combination,” which definition is in turn employed to describe a category of

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<sup>1</sup> S.C. 1991, c. 46.

“insider.”<sup>2</sup> Reorganizations also have fiscal consequences as per the *Income Tax Act*<sup>3</sup> or the *Excise Tax Act*.<sup>4</sup> Finally, the *Canada Business Corporations Act (CBCA)*<sup>5</sup> also refers to reorganization, for instance, in the context of the issuance of shares<sup>6</sup> and of insider trading.<sup>7</sup>

In addition to this statutory use of the term “reorganization,” it is also encountered in commercial contracts, often listed with other types of arrangements or transactions such as amalgamations to define categories of business combinations to which (legal) consequences are attached or the implementation of which is subject to certain conditions precedent, such as obtaining shareholders’ prior consent.

In these days of economic hardship, many companies are scrambling for breathing space. They try to do so while remaining outside the protection of statutes such as the *Bankruptcy and Insolvency Act*<sup>8</sup> and the *Companies’ Creditors Arrangement Act*,<sup>9</sup> in order to avoid the loss of control and the stigma of perceived failure attached to insolvency procedures. This means restructuring their debt, for example by passing it from one subsidiary to another, disposing of or moving some assets within the corporate group to which they belong, and even merging or simply liquidating one or more subsidiaries. In times of recession it is therefore particularly important for legal practitioners and businessmen alike to determine whether these operations amount to a reorganization and trigger the application of specific statutory provisions or contractual clauses.

Interestingly, upon closer scrutiny of the Canadian statutes which refer to this notion, one is hard-pressed to find a satisfactory legal definition of the term. Acknowledging the absence of such a definition and consequently the commercial nature of this expression, Canadian courts, when assessing the nature of a particular dealing or set of facts to decide whether or not to qualify it as a “reorganization,” have weighed the specifics of each case. Relying on English precedents, they have, however, come to consistently delineate what will be

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<sup>2</sup> *Ibid.*, s. 270(1)(c) and s. 271(3). Several provisions regulating the purchase of shares of banks and the control of such entities also refer to the term “reorganization.” See, for instance, *ibid.* at s. 373(2) and 377.1(2).

<sup>3</sup> R.S.C. 1985 (5th Supp.), c. 1, ss. 15(1), 55, 80(1) or 86.

<sup>4</sup> R.S.C. 1985, c. E-15, s. 156.

<sup>5</sup> R.S.C. 1985, c. C-44.

<sup>6</sup> *Ibid.*, s. 25.

<sup>7</sup> *Ibid.*, s. 126

<sup>8</sup> R.S.C. 1985, c. B-3.

<sup>9</sup> R.S.C. 1985, c. C-36.

recognized as the essential features of such a commercial operation. The Supreme Court of Canada recently confirmed the distinctive nature of this term in the much-discussed decision in *BCE Inc. v. 1976 Debentureholders*,<sup>10</sup> refusing to condone an all-encompassing definition which would leave room for limitless interpretation and strip this concept of its technical meaning.

In this article, after having acknowledged the insufficiency, for definitional purposes, of the existing statutory references to the concept of reorganization, and having compared this notion to that of reconstruction used in the United Kingdom (UK), the authors chronologically analyze case law from both the UK and Canada to outline the contours of reorganization as brushed by the courts over the years before the Canadian Supreme Court applied the final varnish.

## 2. Reorganization under Statutory Law

Reference to the concept of “reorganization” is found in several Canadian statutes. However, most simply refer to the term to specify that such type of corporate operation falls within the ambit of a specific disposition contained therein<sup>11</sup> or include this expression within the larger concept of “business combination” without further elaborating on its meaning.<sup>12</sup> For instance, a statutory definition of “reorganization” is set forth under section 191 of the *CBCA*.<sup>13</sup> This definition is, however, limited to the specific subject-matter of Part XV – (Fundamental changes) of the *CBCA* and the rationale for such description seems procedural only.

Section 191 of the *CBCA* stipulates that:

191. (1) In this Section, “reorganization” means a court order made under

(a) Section 241 [application to a court for oppression];

(b) the *Bankruptcy and Insolvency Act* approving a proposal; or

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<sup>10</sup> 2008 SCC 69, [2008] 3 S.C.R. 560 [*BCE*].

<sup>11</sup> See for instance *Excise Tax Act*, *supra* note 5, s. 156; *Income Tax Act*, *supra* note 4, s. 53(3)(b)(i) or *Financial Administration Act*, R.S.C. 1985, c. F-11, s. 92(1).

<sup>12</sup> See for instance *Bank Act*, *supra* note 2, s.265(1) or *Cooperative Credit Associations Act*, S.C. 1991, c.48, s.260(1).

<sup>13</sup> *Supra* note 6.

- (c) any other Act of Parliament that affects the rights among the corporation, its shareholders and creditors.<sup>14</sup>

Falling short of unveiling the legal components of this concept, its following subsections (4) (5) and (6) describe the procedural obligations incumbent upon a corporation following its reorganization as defined under subsection 1:

- (4) After an order referred to in subsection (1) has been made, articles of reorganization in the form that the Director fixes shall be sent to the Director together with the documents required by Sections 19 and 113, if applicable.
- (5) On receipt of articles of reorganization, the Director shall issue a certificate of amendment in accordance with Section 262.
- (6) A reorganization becomes effective on the date shown in the certificate of amendment and the articles of incorporation are amended accordingly.
- (7) A shareholder is not entitled to dissent under Section 190 if an amendment to the articles of incorporation is effected under this Section.<sup>15</sup>

As underlined by this example, this statutory definition of “reorganization,” merely a means to an end, fails to provide a comprehensive description of such a concept, one that would be broad enough to cover all the commercial legal endeavors to which it applies. In order to better grasp the fundamental features of “reorganization” one must thus turn to the jurisprudence of the courts. Some may argue that judges, when asked to determine whether a reorganization has occurred, do so within the specific statutory background and factual context of the case they are to try, and that any (statutory) interpretation is shaped by the specificity of the claim and cannot be applied generally. Notwithstanding this case-by-case approach, however, the meaning of reorganization has come to be consistently defined by case law.

### *3. Reconstruction and Reorganization*

Any study of the concept of “reorganization” must include a review of the decisions which have analyzed that of “reconstruction” since “[a] consistent line of Canadian and United Kingdom authorities holds that the words, ‘reorganization’ and ‘reconstruction’ have essentially the

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<sup>14</sup> *Ibid.* [our additions].

<sup>15</sup> *Ibid.*

same meaning.”<sup>16</sup> The two terms are synonymous, the latter being the English counterpart of the former, more commonly used in Canada.

In the UK case *Hooper v. Western Counties and South Wales Telephone Company Limited*, Chitty J. stated in *obiter dicta*:

Reorganisation, though a less familiar term, can have no wider meaning than reconstruction. Though it is not necessary to express an opinion, I think that the two terms are used as alternative expressions.<sup>17</sup>

In Canada, in *R. v. Santiago Mines Ltd.*, the Court of Appeal of British Columbia unanimously confirmed this opinion. Smith J.A. speaking for the court held that:

I agree, too, that the word “reorganization,” when applied to company affairs, has substantially the same meaning as “reconstruction,” the word mostly used in the English authorities.<sup>18</sup>

Thereafter, relying on UK case law, Canadian courts have repeatedly reaffirmed the synonymous nature of these two notions.<sup>19</sup> The two terms will thus be used interchangeably in this study.

#### 4. Reorganization under Case Law

##### A) United Kingdom Authorities

Close examination of the few UK cases which have attempted to define the notions of reconstruction and/or reorganization helps us find common features characterizing these concepts.

In *Hooper*, the plaintiff, who held mine debentures of the defendant company, moved against that company in order to prevent the division of its assets amongst its shareholders without first making due provision for the fulfillment to the plaintiff of the company’s covenants under the debentures. One of the conditions contained therein was that should the company be wound up for purposes other than reconstruction or reorganization, the principal money secured under the

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<sup>16</sup> *CIBC Mellon Trust Company v. Bell Canada*, [2008] 4 R.J.Q. 1029, 43 B.L.R. (4th) 39 at 60 [*CIBC Mellon Motion* cited to B.L.R.] [emphasis added]; rev’d [2008] 5 R.J.Q. 1298 [*BCE CA*], aff’g *BCE*, *supra* note 10.

<sup>17</sup> (1892) 68 L.T. 78. at 80 [*Hooper*].

<sup>18</sup> [1947] 1 D.L.R. 642 at 648 (B.C.C.A.) [*Santiago Mines*].

<sup>19</sup> See *CIBC Mellon Motion*, *supra* note 19; see also, for example *James F. Kennedy v. Minister of National Revenue*, (72 D.T.C. 6357 (F.C.T.D.)), rev’d 73 D.T.C. 5359 (F.C.A.) [*Kennedy*].

debentures would become immediately payable. The defendant company entered into an agreement with National Telephone Company Limited (NTCL), pursuant to which the two companies would be amalgamated, most of the assets and properties of the defendant company being transferred to NTCL in consideration, *inter alia*, for shares in NTCL and for the exchange of the debentures of the defendant company for debentures of NTCL. In order for the shareholders of the defendant company to be directly allotted shares in NTCL and to carry out the purpose of the agreement between the two companies, the defendant company was to voluntarily wind up. Special resolutions giving effect to the agreement and the transactions contemplated thereby, including the voluntary winding-up of the defendant company, were subsequently adopted at special meetings of the shareholders of the defendant company. The debenture holder contended that the transactions agreed upon and implemented by the two companies amounted to a reconstruction or reorganization of the defendant company and that the principal secured under the debentures had not become payable as a result thereof.

The sole issue of the case lay in the determination of the nature of the transactions contemplated by the agreement between the two companies (and more specifically the winding-up of the defendant company), that is, of the question whether or not these operations had been carried out for the purpose of reorganization or reconstruction. Chitty J. first noted that the words “reconstruction” and “reorganization” were not legal concepts and that any determination of their meaning had to borrow from their commercial usage:

The words in question are not words of art. *They have no technical meaning in law.* Mr. Upjohn asks the court to consider what meaning a layman of ordinary understanding would give to the words. That would be a dangerous course for the court to follow. (...) *The better course is to refer to persons acquainted with the subject.*<sup>20</sup>

Holding that the strict statutory definition of “reconstruction,” a winding-up order sanctioned by the court under the *Joint Stock Companies Act 1870*, was “too narrow a meaning”<sup>21</sup> in the case before him, he provided a broader definition of the term, stating that:

The usual mode of reconstruction is when a company resolves to wind itself up, and proposes *the formation of a new company, which is to consist of the old shareholders, and to take over the old undertaking*, the old shareholders receiving

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<sup>20</sup> *Hooper, supra* note 17 at 80 [emphasis added].

<sup>21</sup> *Ibid.*

shares in the new company. In that case the old company ceases to exist in point of law, and there is in form a sale to the members of a new corporation. But the company is in substance, and may be fairly said to be, reconstructed.<sup>22</sup>

While holding that the “[t]he question to be asked is whether the new company is practically the same as the old, even though in law it is a separate corporation”<sup>23</sup> and concluding that no reconstruction occurred in the case at hand, he relied on the treatises of experts in the field:

Mr. Palmer’s well-known book was the first referred to, and it deals elaborately with reconstruction (5th edit. pp.640-660). He uses the term throughout as only applicable when a new company is started to take over the business of the old company, and he treats it as essential to a scheme of reconstruction that a new company should be formed.

(...)

Mr. W.F. Hamilton ventures on a definition of reconstruction as a transfer of the undertaking and assets of one company to a new company formed for the purpose of acquiring the same.

(...)

Lindley L.J. in his treatise says that “reconstruction differs from amalgamation in that, as a rule, there is only one transferring company, and the company to which the property in question is transferred is practically the same company with some alterations in its constitution.”

(...)

According to the text-writers reconstruction does not include amalgamation, or a sale by a company of its undertaking to another existing company.<sup>24</sup>

Based on the foregoing decision, reconstruction appears to entail the creation of a new entity. Yet it also implies the continuity of the reconstructed or reorganized company in terms of its core business activities and the identity of its shareholders; it indicates the establishment of a separate corporation, owned by the members of, and for the purpose of carrying out the enterprise of, the “old” corporation.

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<sup>22</sup> *Ibid.* [emphasis added].

<sup>23</sup> *Ibid.*

<sup>24</sup> *Ibid.*

In *Re South African Supply and Cold Storage Company; Wild v. Same Company*,<sup>25</sup> following the voluntary winding-up of two corporations subsequent to entering into various commercial agreements, the Chancery Division was asked to determine whether the winding-up of each entity had been undertaken for the purpose of reconstruction and hence whether the preference shareholders and debenture stock holders of each corporation were entitled to the bonus payable in such circumstances by virtue of the corporations' respective memoranda of association and/or debenture stock deeds. Similarly to Chitty J., Buckley J. first underlined the vague legal meaning of the term "reconstruction" and its commercial undertone:

Neither of these words, "reconstruction" and "amalgamation," has a definite legal meaning. Each is a commercial and not a legal term, and, even as a commercial term, bears no exact definite meaning.<sup>26</sup>

In the absence of a clear definition, Buckley J., like Chitty J. in *Hooper*, also relied on the characterization commercial people would ascribe to the term "reconstruction" given a certain set of facts, though failing to provide any details thereof. Noting that the two wound-up corporations had transferred their assets and activities to a third one, Buckley J. then stated that:

They went into liquidation for the purpose of giving effect to this particular form of enjoying their assets, namely, by getting for them shares in another company and dividing those shares (...) among the shareholders (...).<sup>27</sup>

Having concluded that the winding-up of each corporation had occurred to further a specific purpose, Buckley J. turned to consider whether this purpose was reconstruction. In concluding that such was not the case, he ascribed the following meaning to that term:

What does "reconstruction" mean? To my mind it means this. An undertaking of some definite kind is being carried on, and the conclusion is arrived at that it is not desirable to kill that undertaking, but that it is desirable to preserve it in some form, and to do so, not by selling it to an outsider who shall carry it on – that would be a mere sale – *but in some altered form to continue the undertaking in such a manner as that the persons now carrying it on will **substantially** continue to carry it on.* It

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<sup>25</sup> *Re South African Supply and Cold Storage Company; Wild v. Same Company*, [1904] 2 CH 268 (Ch), 73 LJ CH 657 [*South African* cited to LJ CH].

<sup>26</sup> *Ibid.* at 663.

<sup>27</sup> *Ibid.* at 665.



*involves, I think, that substantially the same business shall be carried on and substantially the same persons shall carry it on.*<sup>28</sup>

Though Buckley J. confirmed, in essence, the definition of “reconstruction” set forth by Chitty J. in the *Hooper* case, he broadened its scope. He upheld the finding that reconstruction excluded the transfer of an undertaking to a third party, what he referred to as an “outsider.” He argued that reconstruction required that this undertaking, albeit in a modified fashion, be carried on by a corporation specifically created for that purpose or by the old entity having been “revamped,” what he called a “resuscitated company.” The continuance of a business enterprise is thus a key element of reconstruction. As noted by Buckley J., what distinguishes reconstruction from amalgamation “is that in the latter is involved the blending of two concerns one with the other, but not merely the continuance of one concern.”<sup>29</sup>

Buckley J. further elaborated on Chitty J.’s definition qualifying it by “substance.” Reconstruction not only occurs when a new corporation (or “resuscitated corporation”) is established for the purpose of carrying on the “old” undertaking of the reorganized corporation by the same shareholders, but also includes the continuance by a newly formed corporation (or a “resuscitated corporation”), in an altered form, of *substantially* the same undertaking by *substantially* the same persons as that of the reorganized corporation. He, indeed, maintained that

(..) it does not involve that all the assets shall pass to the new company or resuscitated company. Substantially the business and the persons interested must be the same. Does it make a difference that the new company or resuscitated company does or does not take over the liabilities? I think not. (...) It is not, therefore, vital that either the whole assets should be taken over or that the liabilities should be taken over. You have to see whether substantially the same persons carry on the same business; and if they do, that I conceive, is a reconstruction.<sup>30</sup>

The transactions which were examined by Buckley J. in the *South African* case were finally held to amount to (i) a winding-up for the purpose of reconstruction, in respect of one of the companies, since the resulting company was “a reproduction, in a new form” of the wound-up company; and to (ii) a winding-up for the purpose of amalgamation, as regards the other company, since it involved the “blending of the interests” of two companies.

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<sup>28</sup> *Ibid.* [emphasis added].

<sup>29</sup> *Ibid.*

<sup>30</sup> *Ibid.*

Sixty-five years later, in *Brooklands Selangor Holdings Ltd v. Inland Revenue Commissioners*,<sup>31</sup> Pennycuick J. cited the *Hooper* case and relied on the *South African* ratio to interpret the word “reconstruction” under section 55 of the *Finance Act 1927*,<sup>32</sup> a stamp duty statute. In this case, due to a disagreement between the minority shareholders of Brooklands Selangor Holdings Ltd. (BSR) and its majority shareholder, Plantation Holdings Limited (PH), which had recently acquired 72 per cent of BSR privileged shares and over 50 per cent of its ordinary shares pursuant to a take-over operation, the shareholders agreed to a partition of BSR’s assets, which had to be effected through a scheme of arrangement. BSR was to retain certain assets (which included shares in other companies) while the remainder of its assets were to be transferred to a taxpayer company, which the minority shareholders of BSR were to own entirely. Claiming relief from stamp duty under section 55 of the *Finance Act 1927*, one of the arguments brought forth by the taxpayer company was that the arrangement amounted to a “scheme of reconstruction” within the meaning of section 55.

In interpreting the word “reconstruction” as used in section 55 of the *Finance Act 1927*, Pennycuick J. first referred to the ordinary meaning of the term stating that it was applicable to companies. This in turn implied that such a notion had no legal definition but was merely a commercial concept:

In ordinary speech the word reconstruction is, I think, used to describe the refashioning of any object in such a way as to leave the basic character of the object unchanged. In relation to companies, the word “reconstruction” has a fairly precise meaning which corresponds, so far as the subject-matter allows, to its meaning in ordinary speech.<sup>33</sup>

He then argued that when applied to commercial matters, reconstruction denoted

the transfer of the undertaking or part of the undertaking of an existing company to a new company with substantially the same persons as members as were members of the old company.<sup>34</sup>

In support of this argument, Pennycuick J. first cited the definition of “reconstruction” drawn by Chitty J. in the *Hooper* case. He noted, however, that Chitty J. had

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<sup>31</sup> [1970] 2 All E.R. 76 (Ch) [*Brooklands*].

<sup>32</sup> This section has now been repealed.

<sup>33</sup> *Brooklands*, *supra* note 31 at 86.

<sup>34</sup> *Ibid.* [emphasis added].

put a very restricted meaning on the word “reconstruction.” He said in terms that the new company was to consist of the old shareholders. No one I think now would put quite such a restricted meaning on the term as that.<sup>35</sup>

He then examined Buckley J.’s definition of reconstruction in the *South African* case, stating that Buckley J. repeated in effect what was said by Chitty J. in the earlier case but he repeatedly inserted the qualification “substantial.”<sup>36</sup> Pennycuik J. adopted the *South African* definition of “reconstruction” stating that it was “an accurate statement of what is meant by the word ‘reconstruction.’ (...) Substantially the business and the persons interested must be the same.”<sup>37</sup> He further held, within the statutory context of section 55 of the *Finance Act 1927* which he was asked to interpret, that there appeared to exist “no reason at all to give the word ‘reconstruction’ a wider meaning than was attached to it in the two cases [he had] quoted.”<sup>38</sup> Based on this conclusion, he examined the effect of the scheme of arrangement in the case before him in terms of the identity of the members of the taxpayer company claiming relief from stamp duty in comparison to that of the shareholders of BSR. Failing to find that they were substantially the same, he concluded that no scheme of reconstruction had taken place, and that the taxpayer company could not benefit from relief under section 55 of the *Finance Act 1927*:

The effect of that transaction is that *the holders of the stock in the taxpayer company are most substantially different from the holders of stock in BSR.* (...) the transaction represents the transfer of a part of BSR’s undertaking from the holders of the whole of the stock in BSR to the holders of approximately half the stock in BSR. *That, I think, involved a substantial alteration in the membership of the two companies* within the meaning of the passages which I have quoted from the judgments of Chitty and Buckley JJ. It seems to me that transaction is not a reconstruction and that a transfer made pursuant to that transaction falls neither within the letter nor within the intent of s. 55.<sup>39</sup>

Since the scheme under consideration in *Brooklands* was held to be a partition rather than a reconstruction and involved the division of BSR’s assets between its controlling shareholders and its minority shareholders, “[t]his case has generally been taken to establish that a partition of a company’s underlying business or businesses between

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<sup>35</sup> *Ibid.* at 86-87.

<sup>36</sup> *Ibid.* at 87.

<sup>37</sup> *Ibid.*

<sup>38</sup> *Ibid.*

<sup>39</sup> *Ibid.* at 88 [emphasis added].

two groups of shareholders cannot be a reconstruction.”<sup>40</sup> It is interesting to note that this narrow interpretation of the *Brooklands* findings was adopted at the time by the English Revenue. As a result thereof, in the context of the application of capital gains tax relief statutory dispositions, the English Revenue issued a statement on October 16, 1975.<sup>41</sup> This statement has been held to imply that though a scheme which would result in a partition of a company’s business was not, in a strict legal sense, a “scheme of reconstruction,” it would in practice be considered so by the English Revenue.<sup>42</sup> This question – whether the division of a company’s undertaking between two companies can, as a matter of law, constitute a “reconstruction” – was later considered by the Chancery Division in *Fallon v. Fellows*, which will be examined below.

The meaning of the concept of “reconstruction” in section 55 of the *Finance Act 1927* came once more under the consideration of the Chancery Division two years later in *Baytrust Holdings Ltd. v. Inland Revenue Commissioners; Thos Firth and John Brown (Investments) Ltd. v. Inland Revenue Commissioners*<sup>43</sup> in a case where a newly created company claimed relief from stamp duty pursuant to said section. In the absence of a definition of “reconstruction” in the *Finance Act 1927*, Plowman J., relying on the *Hooper* and *South African* findings, held:

It is not a term of art and has no exact technical meaning in law, and even as a commercial term it bears no exact meaning (...). I was referred to a number of textbooks on company law, but they expressed no unanimity as to the meaning of the word and are not, I think, of any real assistance.<sup>44</sup>

Though the specific facts of the *Baytrust* and the *Brooklands* cases differed, Plowman J. confirmed Pennycuick J.’s interpretation of the word “reconstruction” under section 55 of the *Finance Act 1927*, including his reliance on earlier authorities to support his conclusions, namely the *Hooper* and the *South African* cases. Paraphrasing Pennycuick J. in the *Brooklands* case, Plowman J. stated that:

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<sup>40</sup> *Fallon v. Fellows*, [2001] STC 1409, 74 TC 232 at 253 [*Fallon* cited to TC].

<sup>41</sup> English Revenue, Statement D14, “Division of a company on a share for share basis” (16 October 1975) being incorporated into Statement of Practice SP 5/85 (21 May 1985).

<sup>42</sup> *Fallon*, *supra* note 40.

<sup>43</sup> [1971] 3 All E.R. 76 (Ch) [*Baytrust*].

<sup>44</sup> *Ibid.* at 92-93.

[A] reconstruction normally involves the transfer of a company's undertaking (or part of it) to a new company which is going to carry on substantially the same business as the business transferred to it.<sup>45</sup>

*Prima facie*, Plowman J. expressed the opinion that there had been no reconstruction in the case. Since the ordinary shareholders of the company which had initiated the alleged scheme of reconstruction remained the same prior to and after the implementation of this scheme, Plowman J. noted:

[T]herefore, (...) the question of reconstruction or no reconstruction is closely bound up with the second question which I have to consider, i.e. whether Thos Firth [the company which was claimed to have been reconstructed] transferred any parts of its undertaking to Nitalloy [a subsidiary of Thos Firth to which certain shares held by Thos Firth in two private companies (referred to in *Baytrust* as British Acheson and High Speed) had been transferred].<sup>46</sup>

Before concluding that there had been no reconstruction in the case, for no transfer of Thos Firth's undertaking to *Baytrust* had taken place, the Court shed some light on the notion of "undertaking." Rejecting the argument of Nitalloy counsel according to whom "if a company's undertaking is the totality of its assets, any part of its assets must be a part of its undertaking," Plowman J. defined, as follows, the notion of "undertaking":

The word "undertaking", in my judgment, denotes the business or enterprise undertaken by a company (...).<sup>47</sup>

Turning to the facts of the case, Plowman J. considered that the shares held by Thos Firth in British and High Speed which had been transferred to Nitalloy had clearly been acquired in the course of Thos Firth's business but that "they were not, in [his] judgment, a part of that business."<sup>48</sup> To further clarify this concept he added that "[a] greengrocer's business is no doubt to sell fruit, but the pound of apples which you buy can hardly be described as a purchase of the greengrocer's business."<sup>49</sup>

The Chancery Division followed and reaffirmed the *Brooklands* findings in *Swithland Investments Ltd. and another v. Inland Revenue*

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<sup>45</sup> *Ibid.* at 94.

<sup>46</sup> *Ibid.* at 94 [our additions].

<sup>47</sup> *Ibid.* at 95.

<sup>48</sup> *Ibid.*

<sup>49</sup> *Ibid.*

*Commissioners*,<sup>50</sup> a further relief from stamp duty claim. In determining whether the scheme under review, which had to be looked at as a whole and not in parts, amounted to a “reconstruction” or an “amalgamation” pursuant to section 55 of the *Finance Act 1927*, the court concluded:

I consider that the transaction was not a reconstruction in the sense in which that word is used in s 55. (...) Adapting the language of Pennycuik J. in the Brooklands Selangor case, the effect of the transaction is that *the holders of the shares in each of the four companies are substantially different from the former holders of shares in Estates* [the company which had purportedly undergone a scheme of reconstruction]. The transaction represents the transfer of the greater part of Estates’ assets from the holders of the whole of the shares in Estates to Whitbread [the existing company which, pursuant to the scheme, acquired Estates’ licensed premises trade], which never held shares in Estates. (...) [T]he transaction was a partition rather than a reconstruction.<sup>51</sup>

The Court further added:

Looked at in isolation it was merely the transfer of shares in Estates. *It lacked the element of transfer of a company’s undertaking which, in the paraphrase of Plowman J. in the Baytrust case, is normally a feature of reconstruction.*<sup>52</sup>

Once more, the Court underscored the transfer of an undertaking from the transferring company to the resulting company and the substantial identity of their respective shareholders as constituting the main features of “reconstruction.”

In addition to decisions which considered the meaning of “reconstruction” in debentures and in section 55 of the *Finance Act 1927*, the Chancery Division also considered the concept of reconstruction within the statutory context of capital gains tax provisions in the more recent decision in *Fallon*.<sup>53</sup> In that case, two groups of shareholders decided to reorganize the share capital of their company which carried on its activities through two divisions, the locks division and the pressings division. It was decided that these two divisions were to be separately transferred to two shell companies specifically acquired for that purpose, each controlled by one of the group of shareholders of the transferring company, which was then put into liquidation. Seven years later, upon the sale of the ordinary shares

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<sup>50</sup> [1990] STC 448 (Ch) [*Swithland*].

<sup>51</sup> *Ibid.* [our additions, emphasis added].

<sup>52</sup> *Ibid.* [emphasis added].

<sup>53</sup> *Supra* note 41.

held in one of the shell companies by two of its shareholders, the executors of one of these two shareholders successfully (on appeal) contested the Special Commissioners' assessment of their chargeable gains on the basis that the above-described operation was not a scheme of reconstruction within the meaning of the now repealed section 86 of the *Capital Gains Tax Act 1979*. As a result, this section was not applicable. In this decision, which applied the *Brooklands* case, Park J. reviewed the principal authorities on the meaning of "reconstruction," which we have discussed above. In doing so, he clarified the meaning to be given to the *South African* reference to "persons carrying on a business." He noted:

In the context [of the *South African* case], I think it clear that, when the learned Judge [Buckley J.] referred to persons carrying on an undertaking, he had in mind the shareholders who were carrying it on through a corporate body. *He was referring to persons carrying on an undertaking in the sense of owning it, not in the sense of being involved in the management of the business operations.* (...) [H]e was referring to the concept that shareholders were persons who, through an interposed corporate vehicle, owned the undertaking and, in the sense of being the owners of it, carried it on.<sup>54</sup>

Turning to the wording of section 86 of the *Capital Gains Tax Act 1979*, he stressed, contrary to the opinion of the Special Commissioners, that the legislator had used exactly the same wording as that used in section 55 of the *Finance Act 1927*, when referring to schemes of reconstruction and therefore that the stamp duty case law (for instance the *Brooklands* case) was pertinent in addressing capital gains tax claims when determining whether a reconstruction had occurred:

The commissioners, in my view, did not attach sufficient significance to the stamp duty cases, especially *Brooklands Selangor Holdings*, on what is and what is not a reconstruction. They perceived differences between the stamp duty legislation and the capital gains tax legislation which in my view are scarcely there or at least are relatively insignificant. (...) [T]he key point in my view is that, *when the draftsman of the [capital gains tax] provisions used the critical expression "a scheme for the reconstruction of any company or companies ..."* he fairly obviously took that wording form s.55 of the 1927 Act. (...) I agree with the Revenue that *the cases on what was and what was not a reconstruction for stamp duty were relevant to what was and what was not a reconstruction for [capital gains tax]*, and I do not think that the Special Commissioners attached sufficient weight to them.<sup>55</sup>

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<sup>54</sup> *Ibid.* at 252 and 257 [emphasis added].

<sup>55</sup> *Ibid.* at 257 [emphasis added].

In his analysis of section 86 of the *Capital Gains Tax Act 1979* as applied to the facts of the case, Park J. reviewed the two arguments raised by the taxpayers' counsel as to why no scheme of reconstruction had occurred. The first argument was that "the concept of a reconstruction postulates the reconstruction of a single company into another single company,"<sup>56</sup> which was, as noted above, the general interpretation given to the *Brooklands* ratio and the predecessor decisions on the concept of reconstruction. In respect of the *Hoover* and the *South African* cases, Park J. noted that:

[T]he facts of those cases concerned reconstructions from one predecessor company into one successor company, and it was natural that the judges analysed the concept in the ways that they did. *It would be entirely wrong to regard their exposition as ossifying the law and ruling out the possibility that there could be a reconstruction in law where the movement is from one predecessor company to two or more successor companies.*<sup>57</sup>

As for the *Brooklands* holding, though the Chancery Division concluded that there had been no reconstruction, Park J. was of the opinion that this conclusion resulted from the fact that what had in essence happened was a partition rather than a reconstruction, "not because it was legally impossible for a movement from one predecessor company to two successor companies to rank as a reconstruction."<sup>58</sup> He further added, in reference to the text of section 86 of the *Capital Gains Tax Act 1979* that:

Further, the capital gains tax provision which applies to the company rather than to the shareholders (s. 267 of the 1970 Act at the time of the transaction involved in this case) contemplates that there can be a reconstruction when what is transferred may be the whole or part of the business of the company which is being reconstructed. Where what is transferred is only part of the business it will almost always be the case that business activities which were previously carried on by one company will thereafter be carried on by two companies.<sup>59</sup>

Based on the foregoing, he rejected the first argument raised by the appellant's counsel. The second argument brought forth was that what had happened in the *Fallon* case involved a partition rather than a reconstruction, as in *Brooklands*. In analyzing and discussing this point, Park J. examined the identity of the persons carrying the predecessor company's locks business, that is to say the identity of the

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<sup>56</sup> *Ibid.* at 258.

<sup>57</sup> *Ibid.* [emphasis added].

<sup>58</sup> *Ibid.*

<sup>59</sup> *Ibid.*



shareholders,<sup>60</sup> before and after the implementation of the scheme. Similarly to what had been held in *Swithland*, this scheme was to be looked at as a whole and not in distinct parts. The identity of the shareholders carrying on the locks business was not the same prior to and after the implementation of the scheme. Applying *South African, Park J.* thus concluded that what had occurred was a partition rather than a reconstruction.

The *Fallon* decision is important in three respects: (i) the application of the predecessor authorities on the meaning of reconstruction despite their differing statutory and/or factual contexts; (ii) the extension of such meaning to situations where the business of one company is divided between two companies; and (iii) the confirmation that the persons carrying on a business, for the purposes of determining whether a reconstruction has taken place, are not those involved in its management but the persons who own that business, that is to say its shareholders.

Three years later, the above-examined authorities on the meaning of reconstruction were applied by the Chancery Division in a corporate law context in *Re MyTravel Group plc*.<sup>61</sup> In this case, MyTravel Group plc., the holding company of a group of companies operating in the travel industry, experienced financial difficulties which led to its insolvency. In order to address this situation and failing the conclusion of a consensual arrangement with its creditors, MyTravel proposed the adoption of a scheme and associated agreements to restructure the company. The intended effect of this arrangement was that the assets and business of MyTravel would be transferred to a new company, which would assume a limited number of the company's liabilities while the first four major creditors of MyTravel would be issued 94 per cent of the shares in the new company. Under this scheme, the existing shares in MyTravel were to be transferred to the new company, the shareholders of MyTravel being granted 4 per cent of the shares in the new company. The new company finally offered to the bondholders of

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<sup>60</sup> Again, Park J. stated, *ibid.* at 260-61:

They [the commissioners] said that, because it was the Norman Morgan group who, before the scheme, were involved in the management and running of the locks business, that sufficed to meet the necessity for substantially the same persons, before and after, to be the persons carrying on that particular business. (...) Mr Furness [for the Revenue] does not support this part of the reasoning of the commissioners. He accepts that the cases look not to management participation in a particular business, but to shareholder participation. I agree with Mr Furness on this, and I cannot agree with the Special Commissioner's decision.

<sup>61</sup> [2004] EWHC 2741(Bailii) [*MyTravel*].

MyTravel, who held convertible bonds subordinated in the event of the winding up of the company, to acquire their bonds in exchange for shares. In order to convene shareholders' and creditors' meetings for the purpose of adopting the above-described arrangement, an application was filed before the court in accordance with section 425 of the *Companies Act 1985*. Since the arrangement involved the transfer of MyTravel's undertaking to a new company, it also had to be approved by the court pursuant to section 427 of the *Companies Act 1985*. Two issues were examined by the Chancery Division: (i) whether the court had jurisdiction to make an order under section 427, that is, whether the arrangement was a "scheme of reconstruction" within the meaning of section 427; and (ii) whether the economic interests of the bondholders were sufficient enough to allow them to vote at a meeting specifically called for adopting said scheme.

Mann J., in the initial hearing, first reviewed the historical background behind the enactment of sections 425 and 427 of the *Companies Act 1985*. He found that both the *Companies Act* and stamp duty legislation had common roots and that such common sources needed "to be borne in mind in construing the expression 'reconstruction,'"<sup>62</sup> notably by taking into account "how that word has been construed in a fiscal context,"<sup>63</sup> that is, in authorities like *South African, Brooklands* or *Fallon*. Since pursuant to the proposed arrangement, the shareholders of MyTravel would only be allocated 4 per cent of the shareholding in the new company, it could hardly be claimed that the shareholders of the old and new company were substantially the same. Applying the case law on the construction of the concept of "reconstruction," Mann J. concluded that the proposed scheme was not a reconstruction and that section 427 did not apply:

What Mr. Crystal says one gets from these cases is first, that the common source of the fiscal and corporate legislation indicates that the same approach should be adopted to the word "reconstruction" in both limbs, and second that the notion of "reconstruction" seems to require that there should be a substantial identity between the body of shareholders in the old and new companies. They do not have to be precisely identical; but the cases do tend to indicate that they should be substantially identical. If that is the test then it is quite clear to me that state of affairs which would prevail were the scheme to be brought into effect would not comply with that requirement. A state of affairs in which 4% by value of the shareholding in the new company is held by 100% of the shareholders in the old is not one in which there is substantial identity between the two bodies of shareholders.<sup>64</sup>

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<sup>62</sup> *Ibid.* at para. 17.

<sup>63</sup> *Ibid.*

<sup>64</sup> *Ibid.* at para. 24.

Counsel for MyTravel attempted to dismiss the precedents on the meaning of “reconstruction,” first by pointing out that they had been decided within their specific factual and/or statutory contexts, which called for a restricted meaning of “reconstruction” not applicable to section 427 of the *Companies Act 1985*. However, he was unable to cite any authority in support of this argument. He then argued that when considering whether the persons interested in the business of MyTravel would be substantially the same before and after the implementation of the scheme, the court should disregard the shareholders since the company was insolvent. Because the debts of the company rather than the company itself were being reconstructed, the persons interested in the business of the company had become its creditors.

Mann J. refuted both arguments. He reaffirmed the binding nature of the precedents on the concept of “reconstruction,” holding that they should be applied generally and not be limited to the specific context within which they were decided:

(...) I do not consider that the authorities can be dismissed in the manner which Mr. Sheldon suggests. Although the stamp duty cases were obviously decided in their own legislative context, and whilst I accept that the statutory provisions in issue in those cases contain express qualifications in relation to shareholdings, *the remarks made by the judges are general in their nature and they make sense in conceptual terms*. The thrust of them involves treating the company for these purposes as the same as its corporators. *The company is reconstructed when those corporators, who for these purposes are treated as carrying on the business of the company, are the same in both the old and the new companies. In the present case, where that substantial identity is not present, what might be said to be reconstructed is not so much the company as its debts*. The undertaking of the company is, for these purposes, different from the company itself.<sup>65</sup>

Specifically commenting on Buckley J.’s findings in *South African*, Mann J. concluded that “the persons carrying out the undertaking of a company” are the shareholders and not the creditors. He refused to import the principles adopted in cases dealing with directors’ duties and shareholder sanctions referred to by MyTravel’s counsel in support of his argumentation to a decision on the construction of “reconstruction”:

Furthermore, and more importantly, the tax cases take as their parting point, either directly or indirectly, the dicta of Buckley J. in *South African Supply*. (...) In my view, despite the earlier words which suggest that the word has no definite meaning, and which suggest that it should be given its commercial meaning, when Buckley J considers what it means ([1904] 2 Ch 268 at 286) *he was elaborating some of the*

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<sup>65</sup> *Ibid.* at para. 30 [emphasis added].

*key features*, or perhaps indicating what he thought that the term would mean to commercial men. Reading that passage fairly, it seems to me to be clear that he thought *it was of the essence of a reconstruction that substantially the same shareholders should be involved in both old and new companies*. He refers to the fact that “the persons now carrying it [i.e. the undertaking] on will substantially continue to carry it on.” *It is clearly implicit that the persons who are carrying it on are the shareholders*. It is true that he uses the expression “the persons interested” (...). However, in its context *that seems to me to be a synonym for the shareholders* (...) Of course, he was not considering an insolvent company, but *I do not think that the persons who, for these purposes, are carrying on the business change when a company becomes insolvent*. The shareholders are still carrying on the business as much they were before (for these purposes), but the interests of the people who have to be taken into account change because the interests of the creditors intrude (...). I think that his [Buckley J.] emphasis on the identity of shareholders is reinforced by what he says ([1904] 2 Ch. 268 at 287) when, in the context of an amalgamation, he requires that substantially all the incorporators be parties.<sup>66</sup>

Based on the foregoing, Mann J. concluded that the proposed scheme was not a scheme of reconstruction in the case at hand and that section 427 of the *Companies Act 1985* did not apply. That portion of the decision was not overturned on appeal.<sup>67</sup>

This review of the main UK authorities on the definition of reconstruction enables us to note that the key features of reconstruction have been constantly reaffirmed in different statutory and/or factual contexts, though refined since the *Hooper* case. Based on these authorities, reconstruction involves:

- the transfer of the whole or a substantial part of a company’s undertaking (its business or enterprise);
- to one or two new companies or a resuscitated company;
- where the persons carrying on that undertaking – that is, the shareholders as opposed to the persons involved in its management or, in the case of an insolvent company, its creditors – are substantially similar before and after the transfer.

#### *B) Reorganization under Canadian Case Law*

Canadian case law on the concept of reorganization is largely based upon UK precedents on the meaning of “reconstruction,” the ratio of

<sup>66</sup> *Ibid.* at para. 31 [emphasis added].

<sup>67</sup> *Fidelity Investments International plc v MyTravel Group plc*, [2004] EWCA Civ 1734.

which were first imported by Canadian courts with the *Santiago Mines* decision, a decision by the Court of Appeal of British Columbia.<sup>68</sup>

In this case, the directors and shareholders of Santiago Mines Limited (SML), which was in a difficult financial situation, adopted resolutions to increase its authorized share capital for the purpose of securing additional capital. It then proceeded to allot shares to the president of one company for services rendered and cash advances and to another corporation in accordance with the terms of an option agreement. When that latter corporation exercised its option, the superintendent of brokers informed SML that the issuance of those shares was in contravention of section 4(1) of the *Securities Act*<sup>69</sup> since SML did not hold a certificate of registration as a broker when it traded in its own securities. SML was eventually convicted under this section. SML argued that it should benefit from the exemption provided for under section 3(g) of the *Securities Act* as the issuance of its shares had been effected in the course of the reorganization of the company. On appeal, the Court analyzed the meaning of the concept of “reorganization” in order to determine whether the transactions during which the sale of stock occurred “were in the nature of a reorganization of the company.”<sup>70</sup> Based on the evidence brought before him on the construction of the term “reorganization,” which he agreed had substantially the same meaning as “reconstruction” and had no definite legal meaning, being more of a commercial term, Sidney Smith J.A., speaking for the majority, referred to both the *Hooper* and *South African* cases, to conclude that

[t]he Company in its own resolutions made before any of these questions arose, referred to its activities as being a “reorganization,” and for my part I think upon the evidence that this is not an inapt word to express in a commercial sense what took place here.<sup>71</sup>

He further added, relying on *South African*:

Moreover, it seems to me that this conclusion is borne out by the passage relied upon by the Crown from the language of Buckley, J. (as he then was), in the *South African* case, (...) in which he considers the meaning to the equivalent word there used – “reconstruction.”<sup>72</sup>

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<sup>68</sup> *Santiago Mines*, *supra* note 18.

<sup>69</sup> R.S.B.C. 1936, c. 254.

<sup>70</sup> *Santiago Mines*, *supra* note 18 at 648.

<sup>71</sup> *Ibid.*

<sup>72</sup> *Ibid.*

The interest of this decision does not rest on the light shed on the features of reorganization under Canadian law, given the pragmatic reasoning of Sidney Smith J.A. – since the transactions under review had been described as being a reorganization in the company’s resolutions then it was convincing enough evidence – but on its reference to UK precedents. It is also worth mentioning due to the dissenting opinion of Robertson J. Where Sidney Smith J.A. had referred to *Hooper* and *South African* only to outline the versatile nature of the transactions which could be characterized as reorganization, such a concept having no technical meaning in law, Robertson J. quoted these precedents to attempt to define such a concept. In addition to stating, referring to *Hooper*, that the terms reconstruction and reorganization had similar meanings, and to acknowledging the commercial nature of the term, relying on the *South African* case, he also added:

At p. 80 of the *Hooper* case, Mr. Justice Chitty describes the usual mode of reconstruction, namely, winding-up, the formation of a new company the shareholders of the first company to be its shareholders to take over the old undertaking, the old shareholders receiving shares in the new company. (...) See also *South African Supply* case.<sup>73</sup>

To confirm the idea that a reorganization must involve the transfer of an undertaking to a “new” (in the largest sense of the term) corporation, he also referred to the *Oxford Dictionary*:

One of the meanings given of “reorganization” in vol. viii of the Oxford Dictionary, at p. 455, is a “fresh” organization.<sup>74</sup>

In analyzing the transactions which had taken place, he interestingly distinguished the reorganization of a company from the reorganization of the capital of the company by way of an increase in capital, which does not involve the creation or establishment of a “fresh” corporation to conclude that he was of the opinion that what had occurred was merely the latter.

UK case law was also relied upon in *James F. Kennedy v. Minister of National Revenue*.<sup>75</sup> In that case, the sole shareholder of an automobile dealership company personally guaranteed the acquisition by the company of the property on which it operated. Some improvements were thereafter made to the premises on the land so

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<sup>73</sup> *Ibid.* at 647.

<sup>74</sup> *Ibid.*

<sup>75</sup> *Supra* note 19.

acquired, with some of the costs being directly borne by the shareholder. The company and the sole shareholder then entered into an agreement whereby the latter would be sold the property, which he would lease back to the company. The company paid for additional improvements to the existing buildings, which were assessed by the Minister of National Revenue as taxable benefits conferred on the shareholder. The shareholder contended *inter alia*, that even if it could be argued that a taxable benefit had indeed been bestowed on him, it should only be taxable to the extent of the company's undistributed income in accordance with section 81(1) of the *Income Tax Act*<sup>76</sup> since a reorganization of the company had occurred. The change which was claimed to amount to a reorganization was "that the Company was no longer the owner of the premises from which it conducted its business but rather it was the tenant of those premises."<sup>77</sup> The Federal Court had to determine whether such a change could be so qualified. Cattanach J. first confirmed that "reconstruction" and "reorganization" were alternative expressions citing *Hooper* as confirmed by *Santiago Mines*:

In *Hooper* (...) Chitty J. (...) concluded that the word "reorganization" could have no wider meaning than the word "reconstruction." He thought the words to be alternative expressions.

In *Rex v. Santiago Mines* (...), it was unanimously agreed by the Court of Appeal that the words "reorganization" and "reconstruction" were synonymous.<sup>78</sup>

He further quoted *Hooper's* definition of reorganization as an illustration of the traditional mode of reorganization: the winding-up of a company which thus ceases to exist and the transfer of its undertaking to a new company, the shareholders of the wound-up company becoming the shareholders of the new company. He noted, however, that a reorganization could occur even if only some of the circumstances outlined by Chitty J. in *Hooper* were present.

If an undertaking of some definite kind is being carried on but it is concluded that this undertaking should not be wound up but should be continued in altered form in such manner that substantially the same persons will continue to carry on the undertaking, that is what I understand to be a reorganization. It is that *the same business is carried on by the same persons, but in a different form.*<sup>79</sup>

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<sup>76</sup> R.S.C. 1952.

<sup>77</sup> *Ibid.* at 6362.

<sup>78</sup> *Ibid.*

<sup>79</sup> *Ibid.* [emphasis added].

He further relied on the *South African* decision to outline that because a “reorganization” was a commercial term and had no precise legal meaning, “[i]n the end, what must be looked at is the facts and substance of the transaction.”<sup>80</sup>

Turning to the interpretation of the word “reorganization” in the specific context of the *Income Tax Act*, Cattanach J. held that:

In Section 81(1) the word “reorganization” is used in association with the words “winding-up” and “discontinuance.” Both of those words *contain an element of finality*. The company is ended, It (sic) is therefore logical to assume that *the word “reorganization” presupposes the conclusion of the conduct of the business in one form and its continuance in a different form.*<sup>81</sup>

Similarly to Robertson J. in *Santiago Mines*, he finally referred to the definition of “reorganization” in the *Shorter Oxford Dictionary*, which also associated “reorganization” with a sense of “changing the old into something new”:

In the *Shorter Oxford Dictionary*, 3d Ed. at page 1704, the word “reorganization” is defined as “a fresh organization” and the verb “reorganize” is defined as “to organize anew.”<sup>82</sup>

Turning to the facts of the case, he concluded that:

In the circumstances of the present case there has been no fresh organization. The same Company *continued the same business in the same manner and in the same form.*

(...)

This was merely the sale by the Company of a capital asset which did not result in the end of the business of the Company. (...) Obviously this would not affect the conduct of its business per se but only the manner in which the Company held the premises from which it conducted its business.

In my view this is not a “reorganization” of the business in a commercial sense nor in the sense of the word as contemplated in Section 81(1).<sup>83</sup>

Not only did Cattanach J. confirm the relevance of English precedents in interpreting the meaning of “reorganization,” but he also delineated

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<sup>80</sup> *Ibid.*

<sup>81</sup> *Ibid.* [emphasis added].

<sup>82</sup> *Ibid.*

<sup>83</sup> *Ibid.* at 6263 [emphasis added].



some of the features of this term under Canadian law: the discontinuance of the conduct of a business in one form (though not necessarily through the winding-up of the company carrying it on); and its continuance in another form by substantially the same persons (the shareholders) as in respect of the “old” undertaking. He also confirmed, similarly to Buckley J.’s affirmation in *South African*, that the transfer of a company’s capital assets to a third party which does not result in the end of the business of the former company constitutes “a mere sale,” not a reorganization.

The *Kennedy* holding was followed in several subsequent taxation cases which analyzed the meaning of the word “reorganization” in the statutory context of section 84(2) of the *Income Tax Act* (to which section 81(1) was a predecessor). In *Geransky v. R.*<sup>84</sup> it was concluded that the sale by a company of a significant part of its business and the assets to carry it on to a third party, the seller’s company not discontinuing the other parts of its business, did not constitute a reorganization within the meaning of section 84(2) of the *Income Tax Act*. In *McMullen v. The Queen*<sup>85</sup> it was held that the sale by company A of one of its branches to company B, owned by one of its two shareholders, which thereafter severed any links with company A, did not constitute a reorganization within the meaning of section 84(2) of the *Income Tax Act*. This conclusion was based on the fact that, subsequent to that scheme, company A had continued to carry on part of its business and was no longer controlled by the same shareholders.

The decision of the British Columbia Supreme Court in *National Trust Co. v. Daon Development Corp.*<sup>86</sup> shed further light on the nature of the transactions which would constitute a reorganization through its analysis of the meaning to be ascribed to a company’s affairs. In that case, two trust companies, National Trust Company and Central Trust Company (collectively the trust companies), petitioned the court to object to the implementation of a share exchange offer which BCE Development Corporation (BCED) wished to make to the common shareholders of Daon Development Corporation (Daon) without their consent. One of the arguments of the trust companies, which had lent funds to Daon, was that the proposed exchange would breach their loan modification and override agreements which prohibited Daon from effecting a reorganization of its affairs without the prior consent of the lenders.

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<sup>84</sup> [2001] 2 C.T.C. 2147.

<sup>85</sup> 2007 TCC 16, [2007] 2 C.T.C. 2463.

<sup>86</sup> [1985] B.C.J. No. 605 (QL) [*Daon*].

The Court thus had to determine whether the exchange offer, once accepted, would effect a reorganization of Daon's affairs. After noting that in accordance with the general rules of interpretation of contracts "restrictive covenants in corporate financing instruments will be strictly construed against the party relying upon them,"<sup>87</sup> Gibbs J. turned to analyze the three words on which the lenders relied: "effect," "reorganization" and "affairs."

Quoting the *Shorter Oxford English Dictionary*, he stated that "to effect" means "to cause or produce; to bring about; to accomplish."<sup>88</sup>

On the meaning to be given to "reorganization," Gibbs J. assessed the argument of the trust companies. They claimed that the case law on reorganization was to be discarded since these cases examined what could be considered a reorganization of a company, while the present case concerned the reorganization of a company's affairs. Relying on precedents which the trust companies argued were of no relevance to the case, Gibbs J. rejected this distinction in the following terms:

(...) I find the distinction difficult to follow for *it seems to me that reorganization of a company necessarily includes reorganization of its affairs or, conversely, that reorganization of a company's affairs necessarily involves reorganization of the company. In one of the cases cited to me there seems to be an unspoken assumption that there is no difference, in terms of reorganization, between a company and its affairs.* See Sidney Smith, J.A., speaking of the identity of meaning of the words reorganization and reconstruction, at page 285 of *Rex v. Santiago Mines Limited* (1946) 2 C.R. 279:

I agree with His Honour Judge Lennox that this is a border-line case. I also agree that the crux of the matter is whether the transactions outlined in the evidence amounted to a reorganization of the company. I agree, too, that the word "reorganization," when applied to company affairs, has substantially the same meaning as "reconstruction," the word most used in the English authorities.<sup>89</sup>

He further held that even if such a distinction could be made between the reorganization of a company and that of its affairs, a company's affairs consisted in its business and for a reorganization to occur some fundamental changes to that business had to have taken place:

(...), it seems to me that there is a *useful principle to be extracted from the reported cases and that is that at the very least reorganization entails significant change in*

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<sup>87</sup> *Ibid.* at para.15.

<sup>88</sup> *Ibid.* at para. 16

<sup>89</sup> *Ibid.* at para. 17 [emphasis added].

*the rights of investors in the company or in its affairs, and that "affairs" in that context must mean in the conduct by the company of its business.* A case relied upon by the trust companies equates affairs with company business.

In *Regina v. Board of Trade* (...) the court was called upon to interpret the words "the affairs of the company" in section 165 of the Companies Act, 1948. At page 613, Phillmore, J. said: "In speaking of 'its affairs' in connection with a company the natural meaning of the words connotes 'its business affairs.'" At page 618 Winn, J. said: "For myself, I would think that apart from some controlling consideration, contextual or other, the phrase 'affairs of the company' comprises all its business affairs, interests or transactions, all its investment or other property interests, all its profits and losses or balance of profits or losses, and its goodwill."<sup>90</sup>

Since the offer for shares had not been caused by Daon (that is, not effected by Daon) but by BCED and since it would not lead to any significant change in the business of Daon, which remained mostly unaffected by the share exchange, Gibbs J. concluded that this offer could not be said to constitute a reorganization of Daon's affairs.

Except for some change in shareholder identity, Daon will be the same as before. None of the apprehended results [of the share exchange] necessarily leads to a significant change in Daon's interests or transactions, in Daon's investment or other property interests, in Daon's profits and losses or balance of profits or losses, or in Daon's goodwill.

Neither, in my opinion, would the apprehended results be viewed by those experienced in corporate financing or by the market place, as representing a reorganization of Daon's business.<sup>91</sup>

This reference to those experienced in corporate financing or to the market place clearly outlines the commercial and not legal nature of the concept of "reorganization." The *Daon* decision further confirms the relevance of precedents on what constitutes a reorganization, while, as held for instance in *South African*, outlining that each case depends on its own facts.

The courts were recently called upon to interpret the word "reorganization" in trust indentures in the much talked-about *BCE* case. On June 29, 2007, BCE Inc. (BCE) and 6796508 Canada Inc. (the purchaser) entered into a definitive agreement (which was subsequently amended) whereby, *inter alia*, they agreed to the implementation of a plan of arrangement pursuant to section 192 of the *CBCA* (the plan).

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<sup>90</sup> *Ibid.* at para. 18 [emphasis added].

<sup>91</sup> *Ibid.* at paras. 20 and 21 [our additions].

The plan mainly provided for the forced acquisition by the purchaser of the outstanding shares of BCE (and resulting privatization), as well as for the addition of debt to be guaranteed by Bell Canada, a wholly-owned subsidiary of BCE. The plan was subsequently approved by BCE and the approval of the Quebec Superior Court was sought. The debenture holders of three trust indentures issued by Bell Canada, including a 1976 trust indenture (the 1976 trust indenture) governed by laws of both Quebec and Canada, opposed the plan as not being fair and reasonable. They also sought relief under section 241 of the *CBCA*. The Quebec Superior Court dismissed the claim for oppression and approved the plan. Its decision was quashed on appeal by the Quebec Court of Appeal. The Supreme Court of Canada set aside the decision of the Court of Appeal, holding that “the debenture holders have failed to establish either oppression under s. 241 of the *CBCA* or that the trial judge had erred in approving the arrangement under s. 192 of the *CBCA*.”<sup>92</sup>

For the purposes of this study, we will only focus on the *CIBC Mellon Motion*,<sup>93</sup> and more specifically on the portion thereof which interpreted the meaning of “reorganization” and “reconstruction” as used under clause 8.01 of the 1976 trust indenture. Clause 8.01 permitted, *inter alia*, the reorganization or reconstruction of Bell Canada with any other corporation, provided certain conditions were met including the prior approval by Bell Canada and the trustee, CIBC Mellon Trust Company (CIBC), of the terms, time and conditions of the reorganization or reconstruction as being in no way prejudicial to the interests of the debentureholders. Relying on that clause, one of the arguments raised by CIBC in the *CIBC Mellon Motion* was that the implementation of the plan was subject to prior approval by Bell Canada and CIBC, since the plan involved a reorganization of Bell Canada. Interestingly, clause 8.01 of the 1976 trust indenture replicated a provision contained in a 1967 trust indenture (also issued by Bell Canada and one of the three trust indentures referred to above) governed by the laws of the state of New York, except for the addition of the words “reorganization” and “reconstruction,” and the reference to the protection of the interests of the debentureholders. However, no credible evidence was provided to the Court justifying the inclusion of these words in the 1976 trust indenture.<sup>94</sup>

In examining CIBC’s argument, Silcoff J.S.C. first examined the general rules of interpretation applicable to the interpretation of the

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<sup>92</sup> *BCE*, *supra* note 10 at 625.

<sup>93</sup> *CIBC Mellon Motion*, *supra* note 16 at 59-60.

<sup>94</sup> *Ibid.* at 56-57.

1976 trust indenture.<sup>95</sup> Accordingly, he stated that effect should be given to the common intention of the parties. Where ambiguous clauses are included in complex corporate contracts, such as the 1976 trust indenture, “the Courts have generally favoured an interpretation that is commercially reasonable and that gives effect to the intention and reasonable expectation of the parties at the time the agreements were negotiated.”<sup>96</sup> Such intention is established by examining the nature of the contract, the origin and context of its adoption as well as the interpretation offered by the parties thereto and the market.

We will limit our review of the decision of the Superior Court of Quebec in the *CIBC Mellon Motion* to the analysis by the trial judge of the context and origin of clause 8.01 to determine the nature of the transactions covered by the words “reorganization or reconstruction of the Company” which are most relevant to our study. Silcoff J.S.C. refused to adopt the extensive interpretation of clause 8.01 offered by the reports of expert witnesses for the debentureholders, and more specifically of the words “reorganization” and “reconstruction” in that clause. According to the expert reports, clause 8.01 was intended to cover any fundamental or structural change to Bell Canada’s credit profile, any transformational transaction or any transaction that would modify the nature of Bell Canada, its risk or those of the debentureholders. The trial judge considered that accepting such interpretation would

(...) paralyze BCE and Bell Canada in its day to day operations and could result in irreparable harm to both corporations. Moreover, it would constitute a dangerous precedent that could seriously undermine the confidence of the financial markets at large in the sanctity of the wording of Trust Indentures, in particular, and contracts in general.<sup>97</sup>

Noting that the words “reorganization” and “reconstruction” have had a “well defined meaning in both Canadian and United Kingdom statute and case law,”<sup>98</sup> Silcoff J.S.C. then examined that case law. Referring to *Hooper, South African, Brooklands* and *Baytrust* and the Canadian

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<sup>95</sup> Since the 1976 trust indenture was issued in 1976, in accordance with *An Act respecting the implementation of the Civil Code of Québec*, S.Q. 1992, c.57, s. 4, this 1976 trust indenture is to be interpreted according to the rules contained in the *Civil Code of Lower Canada* which are however substantially similar to those contained in the *Civil Code of Québec*, implemented in 1994.

<sup>96</sup> *CIBC Mellon Motion*, *supra* note 16 at 54; this principle was also stated by the Supreme Court of Canada in *Eli Lilly & Co. v. Novopharm Ltd.* [1998] 2 S.C.R. 129.

<sup>97</sup> *Ibid.* at 59.

<sup>98</sup> *Ibid.*

*Santiago Mines* decision, he affirmed (i) that the UK and Canadian cases (as supported by the language of the statutes preceding the *CBCA* which were applicable at the time of the execution of the 1976 trust indenture)<sup>99</sup> had consistently held that the words “reorganization” and “reconstruction” were interchangeable notions; (ii) that these were commercial rather than technical legal terms; and (iii) that they referred to “the transfer of a corporation’s undertaking (or part of it) to a new entity that is intended to carry on substantially the same business and that will be ultimately owned by substantially the same shareholders.”<sup>100</sup> Based on these conclusions, Silcoff J.S.C., concluded that the words “reorganization” and “reconstruction” in clause 8.01 only applied in the “event of a transaction whereby all or substantially all of Bell Canada’s undertaking, property and assets were transferred to another entity,”<sup>101</sup> and that the transactions to be implemented pursuant to the Plan did not fall within that category.

Though the Court of Appeal decision was eventually overturned by the Supreme Court of Canada, it is interesting to note that it confirmed the interpretation of the Superior Court on the meaning of the term “reorganization” (or “reconstruction”) under clause 8.01 of the 1976 trust indenture. This finding was based on the Court’s review of the applicable UK and Canadian authorities, including the *Kennedy* decision and subsequent taxation judgments, and on the treatises of corporate law experts:

The Court agrees with the interpretation consistently given to the term “reorganization” by the aforementioned line of authorities [*Santiago Mines*, *Kennedy* and subsequent decisions decided in a taxation law context and the authors William K. Fraser, J.L. Stewart and M. Laird Palmer] in the context of commercial and corporate law.<sup>102</sup>

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<sup>99</sup> Under of the *Dominion Companies Act*, R.S.C., 1927, c.27, s. 122(4) and the *Canada Corporations Act*, S.C. 1964-1965, c.52, s. 134(4) : “The expression “amalgamation or reconstruction” means an arrangement pursuant to which a company (in this subsection called the “transferor company”) transfers or sells or proposes to transfer or sell to any other company (in this subsection called the “transferee company”), the whole or a substantial part of the business and assets of the transferor company (..).”

<sup>100</sup> *CIBC Mellon Motion*, *supra* note 16 at 59.

<sup>101</sup> *Ibid.* at 62.

<sup>102</sup> *BCE CA*, *supra* note 16 at paras. 41 to 51 [our additions].

### 5. Conclusion

As underlined by the foregoing review, Canadian courts adopted, in taxation and corporate law contexts alike, the basic tenets of the definition of “reorganization” (a synonym of the British expression “reconstruction”) delineated by UK courts. According to these precedents, a reorganization entails the transfer of a company’s undertaking (or part thereof), involving an element of finality, discontinuance or fundamental change of that undertaking in that form, to a “fresh” entity owned by substantially the same shareholders as the predecessor company. The courts also identified certain transactions which do not fall within the scope of reorganization such as a sale of a company’s assets to a third party.<sup>103</sup> They have also consistently confirmed and insisted on the commercial nature of the term, which bears no legal meaning *per se* (as held in *Hooper* and confirmed in *South African*). Canadian courts have consequently adopted a case-by-case approach when assessing whether a transaction or scheme, taken as a whole, may be considered reorganization. However, far from adopting a far-reaching interpretation, which would ultimately strip the term of any technical meaning, and relying on the principles of contractual interpretation, Canadian courts have kept in line with previous authorities on the key characteristics of this concept while leaving room for further refinement. In practice, this means for legal counsel and parties to commercial contracts that proper weight should be given to a definition of, or reference to, the concept of reorganization. When the concept is so referred to or defined, they can rest assured that the courts will not unduly widen its scope to cover a heterogeneous range of transactions bearing little resemblance to the jurisprudential definition of reorganization.

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<sup>103</sup> Unlike UK courts, they were not called upon to examine the question of whether such a concept could extend to the transfer of a company’s business to two resulting companies or to the old “resuscitated” company.