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NOTE

ASSURING FAIRNESS IN CORPORATE MERGERS: RECENT STATE TRENDS

The recent corporate phenomenon of "going private"¹ has resulted in concern on the part of legal commentators² and the judiciary³ as to whether new or traditional standards should be applied to regulate majority shareholder actions designed to eliminate equity interests of minority shareholders. As a result of the recent Supreme Court decision in *Santa Fe Industries, Inc. v. Greene*,⁴ the law governing going private transactions and

¹ "Going private" broadly encompasses any corporate transaction resulting in the acquisition of all publicly held common stock. Note, *Going Private*, 84 YALE L.J. 903 (1975) [hereinafter cited as *Going Private*]; see text accompanying notes 12-22 *infra*.

² See, e.g., Borden, *Going Private—Old Tort, New Tort or No Tort?*, 49 N.Y.U.L. REV. 987 (1974) [hereinafter cited as Borden]; Greene, *Corporate Freeze-Out Mergers: A Proposed Analysis*, 28 STAN. L. REV. 487 (1976) [hereinafter cited as Greene]; Vorenberg, *Exclusiveness of the Dissenting Stockholder's Appraisal Right*, 77 HARV. L. REV. 1189 (1964) [hereinafter cited as Vorenberg]; *Going Private*, *supra* note 1.

³ See, e.g., *Green v. Santa Fe Indus., Inc.*, 533 F.2d 1283 (2d Cir. 1976), *rev'd*, 430 U.S. 462 (1977) (see note 4 *infra*); *Singer v. Magnavox Co.*, 380 A.2d 969 (Del. 1977); *Berkowitz v. Power/Mate Corp.*, 132 N.J. Super. 35, 342 A.2d 566 (Ch. Div. 1975); *Clark v. Pattern Analysis & Recog. Corp.*, 87 Misc.2d 385, 384 N.Y.S.2d 660 (Sup. Ct. 1976); *People v. Concord Fabrics, Inc.*, 83 Misc.2d 120, 371 N.Y.S.2d 550 (Sup. Ct.), *aff'd per curiam*, 50 App. Div.2d 787, 377 N.Y.S.2d 84 (1975); see text accompanying notes 36-113 *infra*.

⁴ 430 U.S. 462 (1977). In *Santa Fe*, a minority shareholder challenged a public corporation's attempt to go private by merging with a privately held corporation under the Delaware short-form merger statute, DEL. CODE ANN. tit. 8, § 253 (1974). 430 U.S. at 465; see note 18 *infra*. The plaintiff alleged that the merger violated Rule 10b-5 since the merger was neither preceded by notice to minority shareholders nor designed to promote any corporate purpose. The Court held that a cause of action on the ground of fraud or fiduciary breach did not lie under federal securities laws absent deception, misrepresentation or nondisclosure. 430 U.S. at 476; see 1976-1977 *Securities Law Developments—Rule 10b-5*, 34 WASH. & LEE L. REV. 882, 929 (1977); Note, *The Second Circuit Review—1975-76 Term—Securities*, 43 BROOKLYN L. REV. 1435, 1475 (1977); Note, *The Second Circuit Adopts a Business Purpose Test for Going Private*: *Marshel v. AFW Fabric Corp. and Greene v. Santa Fe Indus.*, 64 CALIF. L. REV. 1184 (1976) [hereinafter cited as *Business Purpose Test*]; 89 HARV. L. REV. 1917 (1976). The *Santa Fe* holding clearly indicates that recent federal court decisions applying Rule 10b-5 to freeze out transactions despite full and fair disclosure were unwarranted in light of a congressional intent to let state law govern such actions. 430 U.S. at 477-80; see *St. Louis Union Trust Co., v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 562 F.2d 1040, 1052 (8th Cir. 1977), *cert. denied*, 46 U.S.L.W. 3586 (No. 77-1049, Mar. 21, 1978); *Voegel v. Magnavox Co.*, 439 F. Supp. 935, 939-40 (D. Del. 1977). Cases tacitly overruled by *Santa Fe* for improperly expanding 10b-5 protection are *Merrit v. Libby, McNeil & Libby*, 533 F.2d 1310 (2d Cir. 1976) (existence of corporate purpose shelters merger from 10b-5 attack); *Marshel v. AFW Fabric Corp.*, 533 F.2d 1277 (2d Cir.) (cash out merger lacking corporate purpose subject to claim based on 10b-5), *vacated and remanded for consideration of mootness*, 429 U.S. 881 (1976); *Albright v. Bergendahl*, 391 F. Supp. 754 (D. Utah 1974) (cash out of minority shareholders amounts to scheme or artifice to defraud under 10b-5); *Bryan v. Brock & Blevins Co.*, 343 F. Supp. 1062 (N.D. Ga. 1972) (freeze out merger designed solely to eliminate minority shareholder in close corporation violation of 10b-5), *aff'd on other grounds*, 490 F.2d 563 (5th Cir.) (freeze out held

other corporate reorganizations aimed at "freezing out"⁵ minority shareholders is currently in a state of flux. *Santa Fe* held that federal securities laws may not be used to adjudicate claims of unfairness by minority shareholders when there is no alleged non-disclosure or misrepresentation by majority shareholders or corporate fiduciaries.⁶ Since *Santa Fe* clearly held that aggrieved minority shareholders must resort exclusively to state forums to adjudicate unfairness claims,⁷ recent state court decisions dealing with freeze outs merit consideration to determine if adequate relief is being afforded discontented minority shareholders.

improper under state law), *cert. denied*, 419 U.S. 844 (1974); *Box v. Northrop* [1975-1976 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 95,454 (S.D.N.Y. Feb. 26, 1976)(merger without a corporate purpose aimed at freezing out minority shareholders breach of 10b-5). See generally Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663 (1974)[hereinafter cited as Cary](advocating expanded federal supervision of corporate management); Winter, *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. OF LEGAL STUD. 251 (1977)[hereinafter cited as Winter](opposing expanded federal remedies in securities field).

Cases subsequent to *Santa Fe* suggest that the mere characterization of acts of majority shareholders as concealments or misrepresentations does not necessarily bring the alleged misconduct within the purview of Rule 10b-5. *Voegel v. Magnavox*, 439 F. Supp. 935, 941-42 (D. Del. 1977)(legal opinion in proxy statement regarding authority of corporation to consummate proposed merger even if wrong cannot be deemed a concealment or misrepresentation under Rule 10b-5 since statement is not manipulative or deceptive). See generally Greene, *supra* note 2, at 497 n.37.

⁵ The term "freeze out," as used herein, describes an action by controlling shareholders resulting in the termination of a stockholder's interest in the enterprise. See Vorenberg, *supra* note 2, at 1192. In addition, a freeze out generally connotes a forced "liquidation or sale of the stockholder's shares, not incident to some other wholesome business goal." *Id.* at 1192-93. A freeze out merger may be used to complete the acquisition of a corporation, to take a corporation private, see note 1 *supra*, or to eliminate minority shareholders from a close corporation. Greene, *supra* note 2, at 518; F. O'NEAL, "SQUEEZE-OUTS" OF MINORITY SHAREHOLDERS § 1.01 n.1 (1975)[hereinafter cited as O'NEAL].

⁶ 430 U.S. at 477-79. The court held that judicial extension of Rule 10b-5 was improper, but noted that there may be a need for uniform federal fiduciary standards to govern short-form mergers utilized in going private transactions. *Id.* at 479-80; see Cary, *supra* note 4, at 696-705. The Securities Exchange Commission recently has proposed a rule expressly designed to assure fairness in going private transactions. Proposed Rule 13e-3, reprinted in [1977] FED. SEC. L. REP. (CCH) ¶ 23,703 A, SEC Securities Act Release No. 34-14185 (Nov. 17, 1977). Proposed Rule 13e-3 applies to the purchase of an equity security by the issuer, a tender offer or request for tenders, and a solicitation of any proxy, consent or authorization of a holder of equity security by the issuer. The transaction must be in connection with a merger, consolidation, reclassification, reorganization or similar transaction between an issuer and affiliate, sale of substantial corporate assets or reverse stock split. Finally, the transaction must result in the delisting of a class of equity securities from a national exchange, termination of SEC registration of a class of equity securities, or the suspension of SEC reporting obligations. In addition to prohibiting fraud, deception and manipulation, the rule provides for rigorous scrutiny of the transaction to assure fairness to shareholders. Considerations bearing on the issue of fairness include the purpose of the transaction, the tax consequences to shareholders, the consideration offered shareholders, and the approval or disapproval of the transaction by disinterested directors and a majority of the non-controlling shareholders. See generally Greene, *supra* note 2, at 506-08.

⁷ See note 4 *supra*.

Although the elimination of minority shareholders is not a novel corporate activity,⁸ freeze outs have become increasingly popular in recent years as a result of the depressed securities market.⁹ Reduced price earnings ratios of publicly traded securities and the drop in market prices below book value have resulted in the desire by insiders to reacquire publicly held shares at bargain prices.¹⁰ The motives for going private are varied and controversial, as are the devices used to accomplish the freeze out.¹¹

Corporations going private advance a myriad of reasons to justify their actions.¹² Generally, majority shareholders rationalize going private on the grounds that share repurchasing creates increased leverage, improved earnings per share, upward valuation of securities for use in various corporate transactions, and substantial savings in the cost of SEC registration and compliance.¹³ In addition, the elimination of public shareholders supposedly permits increased corporate flexibility and more prudent management resulting from the absence of pressures accompanying public ownership.¹⁴ Insiders also may be motivated, however, by the prospect of enriching themselves at the expense of the public shareholders.¹⁵ In the case of a close corporation, controlling shareholders may seek to freeze out minority shareholders because of conflicts of interest, policy disagreements, deterioration of personal relationships or lack of shareholder cooperation.¹⁶

To secure the advantages of going private, majority shareholders seeking to eliminate minority shareholders in their corporation may create a shell corporation,¹⁷ exchange their shares in the old corporation for those of the shell corporation, and then merge the two corporations under either state long or short-form merger statutes.¹⁸ To complete the freeze out, the

⁸ See, e.g., *MacCrone v. American Capital Corp.*, 51 F. Supp. 462 (D. Del. 1943); *Raff v. Darrow*, 184 Ind. 353, 111 N.E. 189 (1916); *Beloff v. Consolidated Edison Co.*, 300 N.Y. 11, 87 N.E.2d 561 (1949); *Theis v. Spokane Falls Gaslight Co.*, 34 Wash. 23, 74 P. 1004 (1904).

⁹ *Going Private*, supra note 1, at 903; Note, *Going Private: Who Shall Provide the Remedies?*, 51 ST. JOHNS L. REV. 131 (1976)[hereinafter cited as *Going Private: Remedies*].

¹⁰ *Going Private: Remedies*, supra note 9, at 131.

¹¹ See text accompanying notes 12-22 *infra*.

¹² See generally *Borden*, supra note 2, at 1006-15; *Greene*, supra note 2, at 495 n.32; *O'NEAL*, supra note 5, at §§ 2.01-2.20; *Going Private*, supra note 1, at 905-09, 922-23.

¹³ *Going Private*, supra note 1, at 905-09.

¹⁴ See *O'NEAL*, supra note 5, at § 2.11; *Business Purpose Test*, supra note 4, at 1209.

¹⁵ *Going Private*, supra note 1, at 905-06.

¹⁶ See generally *O'NEAL*, supra note 5, at §§ 2.02-2.11. Although insiders advance many reasons for freeze outs, it is questionable whether the motives of controlling shareholders justify the termination of the minority's investment. See generally *Brudney, A Note on "Going Private,"* 61 VA. L. REV. 1019, 1026-39 (1975)[hereinafter cited as *Brudney*]; see text accompanying notes 23-27 *infra*.

¹⁷ See *Braasch v. Goldschmidt*, 41 Del. Ch. 519, 199 A.2d 760, 762-64 (1964).

¹⁸ See *Borden*, supra note 2, at 994-97. Under long-form merger statutes, two or more corporations may merge upon the adoption of a merger resolution by the boards of directors of the companies followed by approval by a majority of the shareholders in the merging companies. See, e.g., DEL. CODE ANN. tit. 8, § 251 (1974); IND. CODE ANN. § 23-1-5-2 (Burns 1972); N.Y. BUS. CORP. LAW §§ 902-03 (McKinney 1963). See generally *Balotti, The Elimination of the Minority Interests by Mergers Pursuant to Section 251 of the General Corporation Law of Delaware*, 1 DEL. J. CORP. LAW 63 (1976)[hereinafter cited as *Balotti*]. A short-form

controlling shareholders can adopt a corporate resolution compelling the cash redemption of the minority's equity interest in the old corporation.¹⁹ If the majority is seeking to acquire an independent corporation, the majority may begin by making a tender offer for shares in the target corporation.²⁰ Assuming a sufficient number of shares is purchased, a merger is effected and followed by a cash out or some other means of eliminating public shareholders of the acquired corporation.²¹ Finally, if a close corporation is involved, minority shareholders may be frozen out by a variety of methods including a merger with a shell corporation, the withholding of dividends, and/or a sale of assets to majority shareholders or a dissolution.²²

Notwithstanding the fact that the foregoing freeze out techniques are condoned expressly by state legislatures,²³ freeze outs are vulnerable to

merger is accomplished solely by a resolution of the board of directors of a corporation which owns the requisite percentage of the outstanding shares of the target corporation. *See, e.g.*, DEL. CODE ANN. tit. 8, § 253 (1974)(requiring 90% ownership); N.Y. BUS. CORP. LAW § 905 (McKinney Cum. Supp. 1977)(requiring 95% ownership). *See generally* Beloff v. Consolidated Edison Co. of New York, 300 N.Y. 11, 87 N.E.2d 561 (1949); Brudney & Chirelstein, *Fair Shares in Corporate Mergers and Takeovers*, 88 HARV. L. REV. 297 (1974)[hereinafter cited as Brudney & Chirelstein]; 32 U. CHI. L. REV. 596 (1965)[hereinafter cited as *Chicago Comment*]. Freeze outs also have occurred through dissolution, Borden, *supra* note 2, at 993 n.27, citing *Rossing v. State Bank*, 181, Iowa 1013, 165 N.W. 254 (1917), issuance of new stock, O'NEAL, *supra* note 5, at § 5.09, and through sale of corporate assets to a new corporation owned by the old corporation's majority shareholders. *See, e.g.*, *Allaun v. Consolidated Oil Co.*, 16 Del. Ch. 318, 147 A. 257 (1929). *See generally* O'NEAL, *supra* note 5, at §§ 3.01-6.10; Sprecher, *The Right of Minority Stockholders to Prevent Dissolution of a Profitable Enterprise*, 33 KY. L.J. 150 (1945); Note, *Freezing Out Minority Shareholders*, 74 HARV. L. REV. 1630 (1961)[hereinafter cited as *Minority Shareholders*].

¹⁹ *See, e.g.*, *Stauffer v. Standard Brands, Inc.*, 187 A.2d 78 (Del. 1962); *David J. Greene & Co. v. Schenley Indus., Inc.*, 281 A.2d 30 (Del. Ch. 1971); *see Greene, supra* note 2, at 491. In almost all jurisdictions, shareholders facing a forced share redemption pursuant to a merger have the option of objecting to the offered price and receiving an independent appraisal of the value of their shares. *See, e.g.*, DEL. CODE ANN. tit. 8, § 262 (Cum. Supp. 1977); *see O'NEAL, supra* note 5, at § 5.27; text accompanying notes 31-35 *infra*.

²⁰ A tender offer is a "written offer to purchase within a specified period of time a quantity of corporate securities for cash or other securities . . . at a stated price or exchange ratio." Kerr, *Going Private: Adopting a Corporate Purpose Standard*, 3 SEC. REG. L.J. 33, 34 (1975)[hereinafter cited as Kerr]. *See generally* E. ARANOW & H. EINHORN, *TENDER OFFERS FOR CORPORATE CONTROL* 46-63 (1977); Borden, *supra* note 2, at 1003-06; Fleischer & Mundheim, *Corporate Acquisition by Tender Offer*, 115 U. PA. L. REV. 317 (1967); Greene, *supra* note 2, at 491; Langevoort, *State Tender-Offer Legislation: Interests, Effects, and Political Competency*, 62 CORNELL L. REV. 213 (1977).

²¹ A freeze out also may be completed by a reverse stock split declared by a resolution of a corporation's board of directors followed by a forced redemption of fractional shares as permitted by state statute. *See, e.g.*, *Teschner v. Chicago Title & Trust Co.*, 59 Ill.2d 452, 322 N.E.2d 54 (1974), *appeal dismissed*, 422 U.S. 1002 (1975)(600:1 split); *Clark v. Pattern Analysis & Recog. Corp.*, 87 Misc.2d 385, 384 N.Y.S.2d 660 (Sup. Ct. 1976)(4000:1 split).

²² *See O'NEAL, supra* note 5, at §§ 3.04, 5.13-5.14, 5.17, 5.23; text accompanying notes 96-113 *infra*.

²³ *See, e.g.*, N.Y. BUS. CORP. LAW §§ 901-06 (McKinney 1963)(permitting mergers and consolidations); *cf. Willcox v. Stern*, 18 N.Y.2d 195, 201-02, 273 N.Y.S.2d 38, 43 (1966)(noting legislative policy permitting freeze outs); *Tanzer Econ. Assocs., Inc. Profit Sharing Plan v.*

criticism on the ground that they result in unfair displacement of minority shareholders.²⁴ The primary objection to freeze out mergers is based on the strong likelihood that unfairness will result since controlling shareholders are permitted to set the price at which minority shareholders must redeem their shares.²⁵ Forced shareholder displacement also denies the minority the privilege of continued participation in the enterprise²⁶ and may subject eliminated shareholders to unanticipated tax liability.²⁷ In light of these factors, courts traditionally have scrutinized freeze out transactions care-

Universal Food Specialties, Inc., 87 Misc.2d 167, 383 N.Y.S.2d 472, 477 (Sup. Ct. 1976) (legislative policy clearly permits freeze out of minority pursuant to short-merger statute); Greene, *supra* note 2, at 487 (modern merger statutes permit freeze outs without prior minority consent). Almost all state statutes governing going private transactions do not require a merging corporation to offer minority shareholders a continued equity interest in the new corporation nor is proof of any legitimate corporate motive necessary to justify the transaction. *See, e.g.*, DEL. CODE ANN. tit. 8, §§ 251, 253-58 (1974); N.Y. BUS. CORP. LAW § 905 (McKinney 1963). *But see* CAL. CORP. CODE §§ 1101-1101.1 (West Cum. Supp. 1978) (in merger other than short-form merger, nonredeemable common shares of a constituent corporation may *not* be converted into cash, but must be converted into nonredeemable common shares of the surviving corporation, unless all shareholders of the class consent or the terms and conditions of the transaction are approved as fair by certain independent state authorities). Instead, legislatures, through adoption of appraisal statutes, have required only that frozen out shareholders receive fair value for their shares. *See* text accompanying notes 31-35 *infra*.

²⁴ Among the injustices of a freeze out are the minority's lack of participation in the decision to freeze out, the possibility that the transaction will be financed with corporate assets, and the likelihood that the minority's shares will be repurchased below their original sales prices. *Going Private: Remedies, supra* note 9, at 133-35. *See generally* O'NEAL, *supra* note 5, at § 1.03; sources at note 2 *supra*.

²⁵ Greene, *supra* note 2, at 490.

²⁶ *Id.*; *Business Purpose Test, supra* note 4, at 1202. The denial to the minority of continued participation in the corporation has been labeled a "pernicious practice which courts of equity cannot too promptly condemn." *Theis v. Spokane Falls Gaslight Co.*, 34 Wash. 23, 74 P. 1004, 1006 (1904); *see Outwater v. Pacific Serv. Corp.*, 103 N.J. Eq. 461, 143 A. 729, 730 (Ch. Ct. 1928) (continued membership in corporation is inherent property right), *aff'd per curiam*, 104 N.J. Eq. 490, 146 A. 916 (Ct. Err. & App. 1929). Ousted minority shareholders are forced to bear the expense and inconvenience of finding an alternative investment, are deprived of a potential market for securities, and are denied a share of the corporation's potential profits. *See Brudney, supra* note 16, at 1023; *Going Private, supra* note 1, at 927. Notwithstanding shareholders' expectations of continued participation, *Gabhart v. Gabhart*, 370 N.E.2d 345, 355 (Ind. 1977); *Brudney, supra* note 16, at 1052, most courts have held that a shareholder has no right to an equity interest in the corporation resulting from a merger. *See, e.g.*, *Krafcis v. LaSalle Madison Hotel Co.* [1972-1973 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 93,586 (N.D. Ill. 1972); *Coyne v. Park & Tilford Distillers Corp.*, 154 A.2d 893, 897 (Del. 1959), *discussed in Note, Elimination of Minority Share Interests by Merger: A Dissent*, 54 Nw. L. Rev. 629 (1959); *David J. Greene & Co. v. Schenley Indus., Inc.*, 281 A.2d 30, 35 (Del. Ch. 1971); *Norton v. Union Traction Co.*, 183 Ind. 666, 110 N.E. 113, 119 (1915). Although early state statutes contemplated that shareholders would receive an equity interest in the surviving corporation, modern statutes provide shareholders with an appraisal remedy subsequent to a merger or consolidation in lieu of an equity interest in the surviving corporation. *See Voegel v. American Sumatra Tobacco Corp.*, 241 F. Supp. 369, 374 (D. Del. 1965); O'NEAL, *supra* note 5, at § 5.03.

²⁷ Greene, *supra* note 2, at 490.

fully²⁸ and have imposed a fiduciary duty on majority shareholders to insure that controlling parties are not unjustly enriched at the expense of displaced shareholders.²⁹

Historically, minority shareholders were protected from the majority by means of their common law veto right.³⁰ In the last century, however, state legislatures almost unanimously have adopted an appraisal remedy as a means of promoting economic fairness in corporate reorganizations.³¹ The appraisal remedy is triggered by certain statutorily designated transactions and provides a dissenting shareholder the right to have his shares

²⁸ Arms length agreements between independent corporations are presumptively fair, *Gimbel v. Signal Cos.*, 316 A.2d 599, 608-09 (Del. Ch.), *aff'd*, 316 A.2d 619 (1974), and are evaluated in accordance with the business judgment doctrine which requires objecting shareholders to prove conscious abuse of discretion, gross unfairness or bad faith. *Getty Oil Co. v. Skelly Oil Co.*, 267 A.2d 883, 887 (Del. 1970); *Muschel v. Western Union Corp.*, 310 A.2d 904, 908 (Del. Ch. 1973); see 3A W. FLETCHER, *CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS* § 1039 (rev. perm. ed. 1975); O'NEAL, *supra* note 5, at § 3.03. If controlling shareholders stand on both sides of the transaction, however, as is the case in most going private transactions, Note, *Going Private: An Analysis of Federal and State Remedies*, 44 *FORDHAM L. REV.* 796, 812 (1976)[hereinafter cited as *Federal and State Remedies*], self-dealing is present and the burden of proving the fairness of the transaction shifts to the controlling parties. *Geddes v. Anaconda Copper Min. Co.*, 254 U.S. 590, 599 (1921); *Sinclair Oil Co. v. Levien*, 280 A.2d 717, 720 (Del. 1971); see, e.g., *Sterling v. Mayflower Hotel Corp.*, 93 A.2d 107, 109-10 (Del. 1952); *Berkowitz v. Power/Mate Corp.*, 132 N.J. Super. 35, 342 A.2d 566, 574 (Ch. Div. 1975); *Chelrob, Inc. v. Barrett*, 293 N.Y. 442, 461, 57 N.E.2d 825, 834 (1944), *aff'd*, 270 App. Div. 825, 60 N.Y.S.2d 1 (1946).

²⁹ Majority shareholders are bound by a fiduciary duty preventing the exercise of corporate power in a manner inconsistent with the interests of minority shareholders. *Going Private*, *supra* note 1, at 914; see, e.g., *Pepper v. Litton*, 308 U.S. 295, 306 (1939)(controlling stockholder is fiduciary and his dealings with the corporation are subject to rigid scrutiny); *Southern Pac. Co. v. Bogert*, 250 U.S. 483, 487-88 (1919)(majority's fiduciary duty prohibits the minority's exclusion from fair participation in the fruits of a sale of corporate assets); *Lebold v. Inland S.S. Co.*, 82 F.2d 351, 354 (7th Cir. 1936)(majority may not take unfair advantage of minority); *Jones v. H. F. Ahmanson & Co.*, 1 Cal.3d 93, 460 P.2d 464, 471, 81 Cal. Rptr. 592 (1969)(majority shareholders may not use power to benefit themselves alone or in any manner detrimental to minority), *discussed in* Note, *Jones v. Ahmanson: The Fiduciary Obligations of Majority Shareholders*, 70 *COLUM. L. REV.* 1079 (1970). See generally *Going Private*, *supra*, note 1, at 913-16.

³⁰ At common law, no fundamental corporate change could occur without unanimous shareholder consent. *Voeller v. Neilston Warehouse Co.*, 311 U.S. 531, 535 n.6 (1941). The veto right was based on the premise that a shareholder should not be compelled to participate in a new or altered enterprise against his will. *Greene*, *supra* note 2, at 487 n.1; see O'NEAL, *supra* note 5, at § 5.27.

³¹ Vorenberg, *supra* note 2, at 1189; see, e.g., *DEL. CODE ANN.* tit. 8, § 262 (Cum. Supp. 1977). Appraisal statutes enable a shareholder who objects to certain fundamental corporate transactions to force the corporation to purchase the shareholder's stock at its appraised value. In addition to permitting a dissenting shareholder to receive fair value for his investment rather than to accept membership in the new enterprise, the appraisal statutes permit a shareholder who objects to the price offered by the corporation for his shares in conjunction with a merger or consolidation to obtain an independent valuation of his investment. See generally O'NEAL, *supra* note 5, at §§ 5.27-5.28; Vorenberg, *supra* note 2, *passim*. Traditionally, courts regarded an appraisal as the dissenting shareholder's exclusive remedy absent fraud or illegality on the part of the controlling parties. *Id.*; see *Greene*, *supra* note 2, at 504-06.

valued and purchased by the corporation.³² Unfortunately, an appraisal may not result in an adequate substitute for the dissenting shareholder's investment since the economic value of the shareholder's interest is difficult to measure.³³ Moreover, resort to an appraisal deprives the shareholder of his right to manage the corporation, hinders the shareholder's investment goals, and denies the shareholder an interest in the increased value or profit making capability of the corporation resulting from the reorganization.³⁴ Finally, it is questionable whether an appraisal is a proper remedy when the freeze out has not been designed to promote any legitimate corporate purpose.³⁵ In light of the inadequacies of the appraisal remedy and the Supreme Court's refusal to apply Rule 10b-5 to fairness claims, state courts recently have become more sympathetic to the interests of minority shareholders.

Perhaps the most noteworthy development in regard to minority shareholder rights is a recent Delaware case, *Singer v. Magnavox Co.*,³⁶ which held that a long-form merger³⁷ may not be accomplished solely for the purpose of eliminating minority shareholders.³⁸ *Singer* is especially significant given Delaware's primacy in the area of corporate law³⁹ and the traditional reluctance of courts applying Delaware law to inquire into corporate motives in supervising mergers.⁴⁰ Arguably, however, *Singer* is a dubious

³² O'NEAL, *supra* note 5, at §§ 5.27-5.28. The right of appraisal arises in most states whenever a corporation merges or consolidates. Some states also permit an appraisal when certain charter amendments are effected. *Id.*

³³ *Minority Shareholders*, *supra* note 18, at 1634-35. The problems of corporate valuation are especially apparent when the values used to measure a shareholder's interest, such as asset value, market value, earnings value, and dividend value, are speculative. Greene, *supra* note 2, at 504; see O'NEAL, *supra* note 5, at § 2.16; Note, *Valuation of Dissenters' Stock Under Appraisal Statutes*, 79 HARV. L. REV. 1453 (1966). Furthermore, the appraisal remedy is complex and subjects the dissenting shareholder to delay and possible litigation expense. Greene, *supra* note 2, at 504. See generally 15 W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS §§ 7165 & 7165.1 (rev. perm. ed. 1973); Brudney, *supra* note 16, at 1023-25; Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L.J. 223 (1962); Vorenberg, *supra* note 2, at 1200-05.

³⁴ See *Jutkowitz v. Bourns*, No. CA 000268 (Cal. Super. Ct., filed Nov. 19, 1975); see note 123 *infra*. See generally sources at note 33 *supra*.

³⁵ Appraisal and merger statutes are silent on the issue of corporate purpose and motive, but many recent decisions reviewing corporate reorganizations have examined the purpose of the transactions to determine if the freeze out of the minority shareholders is justifiable. See text accompanying notes 36-113 *infra*.

³⁶ 380 A.2d 969 (Del. 1977).

³⁷ See note 18 *supra*. The Delaware long-form merger statute, DEL. CODE ANN. tit. 8, § 251 (1974 and Cum. Supp. 1977), requires that the merger agreement state the terms and conditions of the merger and the manner in which shares of the corporations will be redeemed. Cash redemption is expressly permitted. *Id.* at § 251(b).

³⁸ 380 A.2d at 980.

³⁹ Cf. Cary, *supra* note 4, at 668 (recognizing Delaware's liberal and popular approach to corporate law).

⁴⁰ Historically, Delaware courts have not enjoined mergers absent fraud, illegality or gross abuse of discretion by majority shareholders. See *MacCrone v. American Capital Corp.*, 51 F. Supp. 462, 466 (D. Del. 1943) (reasons for merger or business necessity not matters for judicial determination); *Federal United Corp. v. Havender*, 11 A.2d 331, 337 (Del.

victory for opponents of freeze out mergers since the test established to govern such transactions may be satisfied with little difficulty.⁴¹

Singer involved an attempt by North American Phillips Corporation (North American) to acquire an independent, unaffiliated corporation, The Magnavox Company (Magnavox), and to eliminate Magnavox's public shareholders.⁴² To accomplish the merger, North American created a subsidiary, North American Development Corporation (Development) for the purpose of making a tender offer for the publicly held Magnavox shares.⁴³ Following the purchase of eighty-four percent of the outstanding Magnavox shares, Development created a subsidiary, T.M.C. Development Corporation (T.M.C.) to consummate the acquisition.⁴⁴ Magnavox then was merged into T.M.C. pursuant to Delaware's long-form merger statute and the remaining Magnavox shareholders were offered cash for their stock.⁴⁵ After the merger, the minority shareholders in Magnavox chose not to resort to an appraisal remedy, but brought suit in the Court of Chancery alleging that the merger was fraudulent in that it was devoid of corporate purpose, that the cash redemption price was inadequate, and that the merger violated the Delaware Securities Act.⁴⁶

The Court of Chancery dismissed the minority shareholders' complaint on the ground that Delaware law did not require a corporation complying with the express language of the long-form merger statute to show any independent corporate purpose for a merger.⁴⁷ On appeal, the Delaware

1940)(power to merge not qualified by any limitation or exception). Until recently, New York courts also have indicated a reluctance to inquire into corporate motives for a merger. See note 43 *infra*.

⁴¹ See text accompanying note 72 *infra*.

⁴² 380 A.2d at 971.

⁴³ Development offered to purchase Magnavox stock at eight dollars per share. *Id.* The tender offer statement included an explanation of the effects of an acquisition of Magnavox shares and alternative methods of establishing control in the event that the tender offer failed.

⁴⁴ *Id.* at 971-72. Initially, the Magnavox board of directors opposed the tender offer as inadequate given Magnavox's book value of eleven dollars per share. Pursuant to an agreement between North American, Development, and Magnavox, the offer price was increased to nine dollars per share, contracts of employment were offered to various Magnavox officers, and Magnavox's opposition to the tender offer was withdrawn. See text accompanying notes 17-21 *supra*.

⁴⁵ *Id.* at 972; see note 37 *supra*.

⁴⁶ 380 A.2d at 972. The minority stockholders were offered the merger price of nine dollars per share and were advised of their statutory appraisal rights under DEL. CODE ANN. tit. 8, § 262 (1974), *current version* at DEL. CODE ANN. tit. 8, § 262 (Cum. Supp. 1977); see text accompanying notes 31-34 *supra*.

⁴⁷ *Singer v. Magnovox [sic] Co.*, 367 A.2d 1349, 1356-58 (Del. Ch. 1976). The Court of Chancery did not depart from the traditional Delaware approach despite the existence of two recent unreported Court of Chancery opinions which made references to a business purpose test. See *Pennsylvania Mut. Fund, Inc. v. Todhunter Int'l, Inc.*, No. 4845 (Del. Ch. filed Aug. 5, 1975)(questioning whether a long-form merger can be consummated without a business purpose); *Tanzer v. International Gen. Indus., Inc.*, No. 4945 (Del. Ch. filed Dec. 23, 1975)(upholding a merger after noting that the parent corporation had a compelling business reason to merge with a subsidiary), *aff'd*, 379 A.2d 1121 (1977); see text accompanying notes 63-71 *infra*. The Court of Chancery also held that the complaint failed to state a cause of

Supreme Court reversed holding that a long-form merger accomplished solely for the purpose of eliminating minority shareholders was void in that it constituted a breach of the majority shareholder's fiduciary obligation to deal fairly with the minority.⁴⁸ Although no previous Delaware Supreme Court decision had embraced such a broad notion of the majority's duty of fair dealing,⁴⁹ the *Singer* court relied heavily on earlier cases which recognized in general terms the fiduciary obligations of parties controlling corporate reorganizations.⁵⁰ Despite the court's reliance on the established Delaware fiduciary doctrine, *Singer* is clearly unprecedented in view of the fact that earlier Delaware decisions, have upheld transactions substantially similar to the *Singer* merger.⁵¹

action under the Delaware Securities Act and that an appraisal was the appropriate remedy for alleged price inadequacy. *Singer v. Magnovox [sic] Co.*, 367 A.2d 1349, 1361-62 (Del. Ch. 1976).

⁴⁸ 380 A.2d at 980. The court affirmed the dismissal of the plaintiff's claim based on the Delaware Securities Act, DEL. CODE ANN. tit. 6, § 7303 (1974), on the ground that the Act did not apply to the *Singer* transaction since contracts and sales of securities which take place outside of the territorial jurisdiction of the state are not within the purview of the Act. 380 A.2d at 981-82.

⁴⁹ Delaware courts previously have scrutinized carefully mergers in which a dominant party stands on both sides of a merger, and have required the controlling party to demonstrate the fairness of the transaction. *See, e.g.*, *Bastian v. Bourns, Inc.*, 256 A.2d 680, 681 (Del. Ch. 1969), *aff'd*, 278 A.2d 467 (1970); *David J. Greene & Co. v. Dunhill Int'l, Inc.*, 249 A.2d 427, 430-31 (Del. Ch. 1968). The Delaware Supreme Court, however, previously had not held a merger designed to eliminate minority shareholders invalid per se. Courts in other jurisdictions have required majority shareholders to demonstrate some business reason for freezing out a minority shareholder. *See, e.g.*, *Bryan v. Brock & Blevins Co.*, 490 F.2d 563, 570-71 (5th Cir. 1974) (applying Georgia law to bar freeze out of minority shareholder in close corporation), *noted at Kessler, Elimination of Minority Interests by Cash Merger: Two Recent Cases*, 30 BUS. LAW. 699 (1975); *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657, 664 (Mass. 1976) (barring freeze out of minority shareholder without a legitimate business purpose in close corporation); *Tanzer Econ. Assocs. v. Universal Food Specialties, Inc.*, 87 Misc.2d 167, 383 N.Y.S.2d 472, 479 (Sup. Ct. 1976) (*see text accompanying notes 85-93 infra*); *Matte-son v. Ziebarth*, 40 Wash.2d 286, 242 P.2d 1025, 1031 (1952) (upholding merger upon demonstration of lawful business purpose).

⁵⁰ 380 A.2d at 976-80. The court began its analysis by acknowledging the Delaware rule that statutory compliance does not bar review of a transaction by a court of equity. *Id.* at 975; *see Schnell v. Chris-Craft Indus., Inc.*, 285 A.2d 437 (Del. 1971) (involving advancement of the date of an annual meeting accomplished in compliance with relevant statute); *Bennett v. Breuil Petro. Corp.*, 99 A.2d 236, 239 (Del. 1953) (stock issuance with requisite statutory vote not immune from judicial scrutiny of allegations of bad faith, improper motive, and gross price inadequacy). Numerous Delaware cases have imposed a fiduciary obligation on majority shareholders in their dealings with minority shareholders. *See, e.g.*, *Sterling v. Mayflower Hotel Corp.*, 93 A.2d 107 (Del. 1952); *Guth v. Loft, Inc.*, 5 A.2d 503 (Del. 1939); *David J. Green & Co., v. Dunhill Int'l, Inc.*, 249 A.2d 427 (Del. Ch. 1968); *Allied Chem. & Dye Corp. v. Steel & Tube Co. of America*, 14 Del. Ch. 1, 120 A. 486, *preliminary injunction denied*, 14 Del. Ch. 64, 122 A. 142 (1923), *dismissed*, 124 A. 414 (1925). Under the fiduciary duty rule, emphasis traditionally has been placed on the fairness of the price offered shareholders and not on the purpose of the merger. *See, e.g.*, *Stauffer v. Standard Brands, Inc.*, 187 A.2d 78, 80 (Del. 1962) (only issue in short-form merger, absent fraud, is value); *Sterling v. Mayflower Hotel Corp.*, 93 A.2d 107, 113-14 (Del. 1952) (test of fairness is that minority shareholder receive substantial equivalent of prior value).

⁵¹ The *Singer* court concluded that *Stauffer v. Standard Brands, Inc.*, 187 A.2d 78 (Del.

In arriving at its holding, the *Singer* court did not endorse expressly the approach of recent cases which require merging corporations to demonstrate a legitimate business reason for eliminating minority shareholders.⁵² The court chose instead to balance the interests of the parties to the transaction.⁵³ Since the defendants in *Singer* conceded that the merger was designed exclusively to freeze out the minority shareholders,⁵⁴ the court focused on whether the statutory power to consummate a merger provided the majority the right to merge the corporation at the minority's expense.⁵⁵ In determining whether the minority was afforded proper treatment, the court began by taking notice of the fact that an appraisal remedy does not necessarily assure a shareholder an adequate substitute for his investment in terms of form and value.⁵⁶ In conjunction with this premise, the court

1962), was not authority justifying the *Singer* merger since *Stauffer* did not involve a straight cash out merger. 380 A.2d 978-79. In *Stauffer*, the controlling corporation created a subsidiary which was merged with the minority shareholders' corporation through a share-for-share exchange. *Stauffer v. Standard Brands, Inc.*, 187 A.2d 78, 79 (Del. 1962). Thereafter, the subsidiary was merged into the controlling corporation and the minority was cashed out. The *Singer* court attempted to distinguish *Stauffer* on the ground that the dispute in *Stauffer* was over the value of the minority shareholder's investment and not over the purpose of the transaction. Although the specific issues litigated were not identical in the two cases, this should not obscure the fact that the underlying transactions in *Singer* and *Stauffer* were the same. In both cases, minority shareholders were forced to accept cash for common stock and in both the merging corporation advanced no purpose for the merger. Indeed, *Stauffer* is generally recognized as express authority for a cash freeze out of minority shareholders. See O'NEAL, *supra* note 5, at § 5.14. Similarly, in *Coyne v. Park & Tilford Distillers Corp.*, 154 A.2d 893 (Del. 1959), the court noted that under the short-form merger statute minority shareholders could be cashed out. *Id.* at 897; see Balotti, *supra* note 18, at 68-69. The *Singer* court noted, however, that to the extent earlier merger cases are inconsistent with *Singer* they are overruled.

⁵² 380 A.2d 975-76. As the court recognized, the business purpose approach, although growing in popularity, see note 49 *supra*, is not an ideal solution to freeze out problems since courts have not established a clear standard for determining the types of mergers to which such an approach should apply, whose purpose must be satisfied, and what purposes justify a freeze out. Greene, *supra* note 2, at 499-502; see text accompanying notes 115 *infra*.

⁵³ 380 A.2d at 976.

⁵⁴ *Singer v. Magnovox [sic] Co.*, 367 A.2d 1349, 1353 (Del. Ch. 1976).

⁵⁵ 380 A.2d at 976-80.

⁵⁶ *Id.* at 977-78. The court stated categorically that an appraisal remedy is not a dissenting shareholder's exclusive remedy if he is dissatisfied with a merger. In addition to appraisal rights, the court noted that a shareholder has the right to enjoin a cash out merger designed for the sole purpose of eliminating the shareholder's equity interest. *Id.* at 977-80. The court did not go so far as to recognize a right of continued equity participation in the merged corporation. Other courts have granted minority shareholders the right to enjoin any merger which does not promote a corporate purpose. See note 83 *infra*. In California, common shareholders are afforded by statute the right of continued equity participation subsequent to a merger other than a short-form merger. See note 23 *supra*. Finally, commentators have advocated granting cashed out minority shareholders the right to a share of the increased value of a corporation following a merger. See Brudney & Chirelstein, *supra* note 18; text accompanying notes 119-23 *infra*.

In the past, Delaware courts have not regarded an appraisal as a bar to judicial review of the substantive fairness of a transaction. See generally Vorenberg, *supra* note 2, at 1205-17. When an appraisal is available, however, the chances of enjoining a merger under Dela-

reiterated the Delaware fiduciary doctrine that the corporate majority may not direct activities in a manner detrimental to the minority.⁵⁷ On the basis of these propositions, the court concluded that it was a fortiori a breach of fiduciary duty to transact a cash out merger absent some reason other than a desire simply to eliminate minority shareholders.⁵⁸

Singer marks a departure from the traditional Delaware approach to mergers in that it broadens the scope of the majority's fiduciary duty.⁵⁹ The opinion is substantially deficient, however, in that it promulgates no discernible guidelines for determining what constitutes sufficient justification for a freeze out.⁶⁰ Arguably, *Singer* will afford little solace to discontented minority shareholders⁶¹ in light of a more recent Delaware Supreme Court decision, *Tanzer v. International General Industries, Inc.*⁶² In *Tanzer*, minority shareholders of a subsidiary corporation sought to enjoin a long-form merger of the subsidiary into its parent corporation.⁶³ Plaintiffs contended that a cash freeze out designed solely for the benefit of the parent corporation violated the parent's fiduciary duty as a majority shareholder.⁶⁴ In

ware law have been slim. See *Stauffer v. Standard Brands, Inc.*, 187 A.2d 78, 80 (Del. 1962)(very purpose of short-form merger statute is to permit elimination of minority shareholders); *David J. Greene v. Schenley Indus., Inc.*, 281 A.2d 30, 35 (Del. Ch. 1971)(rights of minority under long-form merger statute, no greater than under short-form statute; absent fraud and over-reaching, appraisal is only remedy); *Balotti, supra* note 18, at 66-73; *Going Private, supra* note 1, at 920 (most recent Delaware cases suggest courts prefer that minorities settle for an appraisal in nearly every situation).

⁵⁷ 380 A.2d at 976-77.

⁵⁸ *Id.* at 980. Although the court restricted its holding by stating that the majority's fiduciary obligation prevents a merger designed solely to freeze out the minority, *Singer* makes ambiguous references to a business purpose requirement. *Id.* at 975 & 980; see text accompanying notes 59-69 *infra*.

⁵⁹ *Cf. Kemp v. Angel*, 381 A.2d 241, 245 (Del. Ch. 1977)(noting broad reach of *Singer* in terms of majority's fiduciary duty to minority shareholders); see text accompanying notes 49-50 *supra*.

⁶⁰ 380 A.2d at 976-80. *Singer* did refer broadly to the importance of demonstrating a business purpose, but did not indicate whether the purpose must be that of the majority shareholders or of the corporation. Small, *The Function of Directors in Acquisition of Controlled Corporations*, in *PLI NINTH ANNUAL INSTITUTE ON SECURITIES REGULATION* 47, 52-53 (Mundheim, Fleischer & Vandegrift eds. 1978) [hereinafter cited as Small]; see text accompanying notes 65-69 *infra*.

⁶¹ The dissenting shareholders in *Singer* also failed in their attempt to invalidate the merger in federal court on the basis of claims under Rules 10b-5 and 14a-9 that the proxy statement issued prior to the merger contained material misrepresentations and concealments and was erroneous as to the legality and effect of the merger. *Voege v. Magnavox Co.*, 439 F. Supp. 935, 940-41 (D. Del. 1977).

⁶² 379 A.2d 1121 (Del. 1977). The *Singer* opinion was edited after *Tanzer* in order to remove language expressly adopting a business purpose test. Small, *supra* note 60, at 52.

⁶³ 379 A.2d at 1122. Plaintiffs, shareholders in Kliklok Corporation (Kliklok), named as defendants International Industries, Inc. (International), which owned eighty-one percent of the shares of Kliklok, and International's directors. International had created KKK Corporation for the purpose of transacting a long-form merger with Kliklok. Thereafter, the boards of directors of the three corporations and the requisite shareholders of each corporation approved the merger plan and the plaintiff shareholders sought an injunction. *Id.*

⁶⁴ *Id.* Various policy arguments favor parent-subsidiary mergers. Consolidation of parent and subsidiary engaged in similar operations often results in elimination of conflicts of inter-

examining the merger the court focused, as in *Singer*, not on the business purposes of the merging corporations, but on the interests of the majority and minority shareholders.⁶⁵ In balancing the interests of the parties, the *Tanzer* court recognized the established Delaware rule that shareholders are entitled to exercise voting rights in accordance with their own self-interests,⁶⁶ subject only to the duty owed other shareholders.⁶⁷ Consequently, the court reasoned that majority shareholders may vote to eliminate minority shareholders provided the transaction promotes a bona fide purpose of the majority.⁶⁸ The *Tanzer* court found that a bona fide majority purpose was demonstrated since the merger was accomplished to facilitate long term debt financing by the parent corporation.⁶⁹ Therefore, the *Singer* rule was not breached since the merger was not designed solely to freeze out the minority.⁷⁰ The court remanded the case, however, with directions that the trial court scrutinize the transaction not only in terms of the

est, economies of combined operation, greater managerial efficiency, and tax savings through the filing of consolidated tax returns. See Borden, *supra* note 2, at 1018. These reasons also support a merger whenever the merging corporations are engaged in similar business pursuits. See Grimes v. Donaldson, Lufkin & Jenrette, Inc., 392 F. Supp. 1393, 1402 (N.D. Fla. 1974). The same reasons do not apply, however, to a freeze out in a close corporation or a pure going private transaction when there is no consolidation of management or operational facilities between two distinct corporate entities. See Borden, *supra* note 2, at 1018-20; Greene, *supra* note 2, at 491-96, 503-13; Vorenberg, *supra* note 2, at 1198-99. See generally Chirelstein, Sargeant & Lipton, "Fairness" in Mergers Between Parents and Partly Owned Subsidiaries in PLI EIGHT ANNUAL INSTITUTE ON SECURITIES REGULATION 273 (Mundheim, Fleischer & Vandegrift eds. 1977)[hereinafter cited as Chirelstein, Sargeant & Lipton].

⁶⁵ 379 A.2d at 1123.

⁶⁶ *Id.* at 1123-24, citing Ringling Bros.-Barnum & Bailey Com. Shows v. Ringling, 53 A.2d 441, 447 (1947)(shareholder may exercise wide liberality of judgment and motive in voting subject to this duty to fellow shareholders); Heil v. Standard Gas & Elec. Co., 17 Del. Ch. 214, 151 A. 303, 304 (1930)(shareholder may admit personal profit, whims, and caprice as voting motives as long as no advantage is gained at expense of fellow shareholders); W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 2031 (rev. perm. ed. 1973).

⁶⁷ 379 A.2d at 1123. Majority shareholders may not vote so as to obtain an advantage at the expense of fellow shareholders. *Id.*

⁶⁸ *Id.* at 1124. Generally, courts applying some type of "valid purpose test" have stated that the purpose advanced be that of the corporation and not merely that of the majority shareholders. See generally Bryan v. Brock & Blevins Co., 490 F.2d 563, 570 (5th Cir. 1974)(applying Georgia law); Gabhart v. Gabhart, 370 N.E.2d 345, 356 (Ind. 1977)(merger must be for corporate purposes not merely for the benefit of selected shareholders); Kavanaugh v. Kavanaugh, 226 N.Y. 185, 123 N.E. 148 (1919)(see note 93 *infra*); *Going Private*, *supra* note 1, at 922-24. Since majority shareholders may have valid reasons to effectuate a merger which are not necessarily corporate purposes, the majority purpose test of *Tanzer* is more permissive than the business purpose test. Nevertheless, since majority shareholders in corporate reorganizations are usually corporations, courts applying the *Tanzer* rule should require that corporate purposes be advanced. *Tanzer* does, however, avoid much of the ambiguity of the business purpose test with respect to which corporation's business must be promoted by a merger by declaring that the purpose advanced by a merger be that of the majority shareholder. Furthermore, *Tanzer* has not sanctioned unrestrained majority voting discretion since the court recognized that the majority's rights are subject to the fiduciary duty doctrine.

⁶⁹ 379 A.2d at 1124-25.

⁷⁰ *Id.*

fairness of the price offered the minority, but also in terms of the "entire fairness" of all aspects of the transaction as required by *Singer*.⁷¹

Tanzer reveals the narrow scope of *Singer* since *Tanzer* suggests that any alleged benefit to majority shareholders short of a naked desire to eliminate minority shareholders might satisfy the majority's fiduciary duty.⁷² Notwithstanding the conservative application of the *Singer* rule by the *Tanzer* court, the Delaware Court of Chancery in *Kemp v. Angel*⁷³ has interpreted those two supreme court cases as substantially broadening the fiduciary obligations of majority shareholders. In *Kemp*, minority shareholders of Aid, Inc. (Aid), a corporation engaged in the ownership and operation of health care facilities, sought to enjoin the merger of Aid into Ina Capital Corporation (Capital), a wholly owned subsidiary of Ina Corporation (Ina).⁷⁴ Ina, a broad based financial services company, initiated a short-form cash out merger⁷⁵ for the alleged purpose of obtaining tax benefits through the filing of consolidated tax returns, eliminating managerial overlap among various health care operations under Ina's control, and avoiding potential conflicts of interest involving the right to acquire particular hospital facilities.⁷⁶ The *Kemp* court did not dispute the majority's assertion that the minority shareholders were offered generous value for their shares.⁷⁷ The court reasoned, however, that the *Singer* rule requiring judicial inquiry into the purpose of a long-form merger, applied equally to short-form mergers.⁷⁸ Thus, the court on the basis of *Singer* did not follow

⁷¹ *Id.* at 1125. In remanding the case, the court noted that the test required by *Singer* is based on the "entire fairness" rule of *Sterling v. Mayflower Hotel, Corp.*, 33 Del. Ch. 293, 93 A.2d 107, 109-10 (1952). The *Sterling* rule embodies the general fiduciary principle that shareholders controlling a merger must exercise utmost good faith, honesty, and loyalty to ensure that no advantage is obtained at the minority's expense. Since the fairness rule traditionally required only that majority shareholders provide the minority shareholders fair value, *see* note 50 *supra*, the only change in the "entire fairness" rule effected by *Singer* is the requirement that majority shareholders demonstrate that the merger was not designed solely to oust minority shareholders.

⁷² 379 A.2d at 1124; *see* Small, *supra* note 60, at 53.

⁷³ 381 A.2d 241 (Del. Ch. 1977).

⁷⁴ *Id.* Plaintiffs, in a derivative action, alleged that the merger was fraudulent in that it was designed for the sole purpose of eliminating minority shareholders at a grossly inadequate price. *Id.* Plaintiffs also contended that the controlling parties falsely represented to Aid shareholders the purposes of the acquisition and merger and concealed the fact that Aid was financially strong. *Id.* at 242.

⁷⁵ *Id.* at 241-42. International began acquiring Aid common voting stock in 1969. After obtaining fifty-six percent of Aid's stock through open market purchases, International increased its ownership to eighty-five percent by means of a tender offer. Finally, International succeeded in obtaining a ninety percent interest in Aid voting common stock by converting its holdings of non-voting Aid shares into voting common stock. *Id.*

⁷⁶ *Id.* at 243. Defendants claimed that the economic desirability of the merger arose from the fact that International recently had acquired a hospital chain comparable to Aid. Moreover, International was in a position to deny Aid future corporate opportunities because of International's control over independent health care facilities. *Id.*

⁷⁷ *Id.*

⁷⁸ *Id.* at 244. Previous Delaware decisions have established the principle that the rights of a dissenting shareholder are the same under the short-form merger statute as under the long-form merger statute. *See* note 56 *supra*.

previous Delaware cases which have held value to be the primary issue under the short-form merger statute.⁷⁹ Instead, the Chancellor enjoined the merger pending a trial on the merits in order that the "entire fairness" of the merger could be evaluated.⁸⁰ Although *Kemp* contains no definitive statement as to what majority purposes justify a freeze out, the issuance of the injunction is particularly significant since other courts have found a legitimate merger purpose under similar circumstances.⁸¹ More importantly, *Kemp* indicates that *Singer* and *Tanzer* require Delaware courts to review more rigorously than in the past the fairness of freeze out mergers and impose more stringent fiduciary obligations on majority shareholders.⁸²

In addition to the recent Delaware cases, decisions in other states acknowledge the need to scrutinize more carefully freeze out transactions.⁸³ In New York, for instance, the judiciary is broadening the scope of the majority shareholder's fiduciary responsibilities.⁸⁴ In *Tanzer Economic*

⁷⁹ 381 A.2d at 243-44; see note 51 *supra*.

⁸⁰ 381 A.2d at 245. As in *Tanzer*, see note 71 *supra*, the court did not specifically interpret the "entire fairness" requirement. At a minimum, however, *Kemp* confirms the *Singer* rule that minority shareholders objecting to a merger are not relegated to statutory appraisal rights. See Small, *supra* note 60, at 53.

⁸¹ See, e.g., *Grimes v. Donaldson, Lufkin & Jenrette, Inc.*, 392 F. Supp. 1393, 1402 (N.D. Fla. 1974) (valid business purpose exists for merger between companies engaged in similar businesses if potential conflict of interest claims by minority shareholders are avoided, and there exist ascertainable operational savings); *Tanzer Econ. Assoc., Inc. v. Universal Food Specialists, Inc.*, 87 Misc. 2d 167, 383 N.Y.S.2d 472 (Sup. Ct. 1976) (see text accompanying notes 85-93 *infra*); *Schulwolf v. Cerro Corp.*, 86 Misc.2d 292, 380 N.Y.S.2d 957, 962 (Sup. Ct. 1976) (noting business purposes of combining management and resources of companies engaged in related businesses and of achieving tax savings); *Business Purpose Test*, *supra* note 5, at 1210-11; see note 64 *supra*.

⁸² 381 A.2d at 245.

⁸³ See, e.g., *Jutkowitz v. Bourns*, No. CA 000268 (Cal. Super. Ct., Nov. 19, 1975) (recognizing minority's right to continued participation in corporation); *Jones v. H. F. Ahmanson & Co.*, 1 Cal.3d 93, 460 P.2d 464, 81 Cal. Rptr. 592 (Sup. Ct. 1969); *Teschner v. Chicago Title & Trust Co.*, 59 Ill.2d 452, 322 N.E.2d 54, 58 (1974), *appeal dismissed*, 422 U.S. 1002 (1975) (implying corporate purpose requirement for reverse stock split resulting in elimination of minority shareholder); *Wilkes v. Springside Nursing Home, Inc.*, 353 N.E.2d 657, 662-63 (Mass. 1976) (in closed corporation, majority afforded large measure of discretion in setting corporate policy; nevertheless, the majority must demonstrate a legitimate business purpose in order to remove minority shareholder); *Berkowitz v. Power/Mate Corp.*, 135 N.J. Super. 36, 342 A.2d 566, 573-74 (1975) (though failing to adopt expressly a business purpose test, court applied rigorous fairness standards to going private transaction and reasoned that mere fairness of price is dubious indication of fairness of merger), *noted at* 49 TEMP. L.Q. 444 (1976). See generally *Going Private: Remedies*, *supra* note 9, at 143; see also *Zidell v. Zidell, Inc.*, 277 Ore. 413, 560 P.2d 1086, 1089 (1977) (majority shareholders' duty to minority in close corporation satisfied with respect to dividend policy if policy is made in good faith and reflects legitimate business purpose rather than private interests of controlling parties).

⁸⁴ See *People v. Concord Fabrics, Inc.*, 83 Misc.2d 120, 371 N.Y.S.2d 550 (Sup. Ct.), *aff'd per curiam*, 50 A.D.2d 787, 377 N.Y.S.2d 84 (1975). *Concord* held that the New York Blue Sky statute, strikingly similar to federal Rule 10b-5, see *Federal and State Remedies*, *supra* note 28, at 808-09, barred a going private merger. The court reasoned that the elimination of minority shareholders without a real corporate purpose and with use of corporate funds was a breach of the insiders' fiduciary duty. Therefore, the merger was deemed a scheme or

Associates, Inc. v. Universal Food Specialties, Inc.,⁸⁵ a corporation owning a majority of the shares of an independent corporation engaged in similar business activities, proposed a short-form merger to complete its acquisition of the target corporation.⁸⁶ Although the acquiring corporation strictly complied with statutory merger requirements,⁸⁷ the court examined the transaction to determine whether there was fraud, breach of the majority's fiduciary obligation, or lack of business purpose.⁸⁸ An analysis of the facts surrounding the merger revealed that the merger was not a typical one-step going private transaction,⁸⁹ but the culmination of a well planned acquisition of an unaffiliated corporation for the purpose of promoting the synergistic savings and advantages of combined operations.⁹⁰ In addition to finding valid business justifications for the merger,⁹¹ the court reasoned that throughout the take-over the acquiring corporation afforded frequent financial assistance to the target corporation and was not promoting a sham transaction for the purposes of unjustly enriching itself at the expense of the merged corporation.⁹² Consequently, the merger was upheld.⁹³

artifice to defraud minority shareholders despite full disclosure by the majority. 371 N.Y.S.2d at 554. *Concord* resulted in a novel interpretation of the Blue Sky statute since the statutory language clearly requires deception, misrepresentation, or concealment. *People v. Concord Fabrics, Inc.*, 50 A.D.2d 787, 377 N.Y.S.2d 84, 86 (1975) (Lane, J., dissenting); *Federal and State Remedies*, *supra* note 28, at 809-10. Moreover, the broad interpretation of the statute was unnecessary in view of the ready applicability of the long-established fiduciary doctrine. 44 *FORDHAM L. REV.* 796, 816 (1976). *See also* *Schulwolf v. Cerro Corp.*, 86 Misc.2d 292, 380 N.Y.S.2d 957 (Sup. Ct. 1976).

⁸⁵ 87 Misc.2d 167, 383 N.Y.S.2d 472 (Sup. Ct. 1976).

⁸⁶ Between 1960 and 1975 Nestle Alimentana S.A. (Nestle), a publicly held Swiss corporation, and its affiliates including a Delaware subsidiary, Universal Food Specialties (U.F.S.), acquired approximately ninety-two percent of the outstanding common stock of Libby, McNeil & Libby (Libby), a Maine corporation, by means of open market purchases and a tender offer. *Id.* at 169, 383 N.Y.S.2d at 474-75. Both Nestle and Libby were in the food processing business. The board of directors of Libby and U.F.S. approved a cash out merger between Libby and U.F.S. pursuant to short-form merger statutes of Maine, *ME. REV. STAT. tit. 13-A, § 904* (1974), and Delaware, *DEL. CODE ANN. tit. 8, § 253* (1974). Plaintiff, a minority shareholder in Libby, sought monetary damages on the ground of inadequate exchange price and an injunction against the merger on the grounds that the merger was "unjust, fraudulent, a breach of defendants' fiduciary obligations, and without proper business purpose." 87 Misc.2d at 171, 383 N.Y.S.2d at 476.

⁸⁷ 87 Misc.2d at 171, 383 N.Y.S.2d at 476.

⁸⁸ *Id.* at 175, 383 N.Y.S.2d at 479. The court was particularly sensitive to the dangers of going private and the possibility of overreaching on the part of the majority. *Id.* at 172-75, 383 N.Y.S.2d at 477-79.

⁸⁹ *Id.* at 177, 383 N.Y.S.2d at 480. *Tanzer Economic Associates* did not involve an attempt by insiders to repurchase at a low price shares sold earlier to the public at higher prices. *Id.*

⁹⁰ The merger promised to provide substantial increases in the efficiency and profitability of Libby. These gains would result from improved management and planning, economies resulting from centralized procurement of raw materials, greater diversity of products, and decreased reliance on outside financing. *Id.* at 180-82, 383 N.Y.S.2d at 482-83.

⁹¹ *See* note 90 *supra*.

⁹² 87 Misc.2d at 176-82, 383 N.Y.S.2d at 480-84. Nestle, as the principal stockholder in Libby, had provided needed capital to Libby at times when bank loans were unavailable. Furthermore, the merger was funded in such a manner as to assure the financial strength and

Although a business purpose was clearly articulated in *Tanzer Economic Associates*,⁹⁴ a later New York case, *Clark v. Pattern Analysis & Recognition Corp.*,⁹⁵ suggests that the business purpose test may not always easily be satisfied in freeze out transactions. In *Clark*, the majority shareholders of a corporation attempted to freeze out certain minority shareholders in the corporation by means of a reverse stock split followed by cash redemption of the minority shareholders' fractional shares.⁹⁶ The proposed recapitalization was not justified by the potential for enhanced operating economies. Furthermore, the majority did not contend that the minority hindered corporate activity or stifled managerial efficiency.⁹⁷ The

integrity of the U.F.S.-Libby merged corporation. *Id.* Finally, the court found no evidence of fraud in terms of the defendants' offer for the plaintiff's stock. *Id.* at 177-79, 383 N.Y.S.2d at 480-81.

⁹⁴ *Id.* at 184, 383 N.Y.S.2d at 484. In upholding the merger the court noted compliance by the controlling parties with the fiduciary duty rule of *Kavanaugh v. Kavanaugh*, 226 N.Y. 185, 123 N.E. 148 (1919). 87 Misc.2d at 176-84, 383 N.Y.S.2d at 479-84. In *Kavanaugh*, a New York court invalidated a freeze out dissolution. 226 N.Y. at 198, 123 N.E. at 153. The *Kavanaugh* court concluded that the majority had breached its fiduciary duties by ordering the dissolution of a highly profitable corporation without regard to the welfare of the corporation in order to free the corporation's business from the interference or participation of the plaintiff minority shareholder. *Id.* at 192-97, 123 N.E. at 149-51. It has been suggested, however, that the *Kavanaugh* merger would have been upheld had an appraisal statute been in effect, Vorenberg, *supra* note 2, at 1198 n.32. Moreover, New York cases subsequent to *Kavanaugh* and the passage of the appraisal statute have endorsed strongly freeze outs when an appraisal has been available. See *Rubel v. Rubel Corp.*, 206 N.Y.S.2d 396, 399 (Sup. Ct. 1960)(rights of minority shareholders surrendered subject only to fair and just compensation); *Blumenthal v. Roosevelt Hotel, Inc.*, 202 Misc.2d 988, 993, 115 N.Y.S.2d 52, 57 (1952); *Beloff v. Consolidated Edison Co.*, 300 N.Y. 11, 19, 87 N.E.2d 561, 565 (1949)(appraisal exclusive remedy; minority shareholder has no right to shares in new corporation or to enjoy corporation's future benefits). *But see Schulwolf v. Cerro Corp.*, 86 Misc.2d 292, 380 N.Y.S.2d 957, 962 (Sup. Ct. 1976)(merger upheld since there was valid purpose, review of transaction by independent board, and offer of continued equity interest to minority, but court noted the likelihood of a breach of the majority's fiduciary duty in long-form merger if there is fraud, illegality, price manipulation, unfair price or lack of corporate purpose); *People v. Concord Fabrics, Inc.*, 83 Misc.2d 120, 371 N.Y.S.2d 550, 553 (Sup. Ct. 1975)(*see note 84 supra*).

The U.F.S.-Libby merger also was upheld in federal court against a challenge based on Rule 10b-5 on the ground that the merger was not designed to promote a legitimate corporate purpose. *Merrit v. Libby, McNeil & Libby*, 533 F.2d 1310 (2d Cir. 1976).

⁹⁴ 87 Misc.2d 167, 182, 383 N.Y.S.2d 472, 483 (1976); Small, *supra* note 60, at 51-52.

⁹⁵ 87 Misc.2d 385, 384 N.Y.S.2d 660 (1976).

⁹⁶ *Pattern Analysis & Recognition Corp. (PAR)* devised a plan of recapitalization which was designed to eliminate the plaintiffs as minority shareholders. *Id.* at 386-87, 384 N.Y.S.2d at 661-62. The plan, executed in strict conformity with N.Y. Bus. Corp. Law §§ 801(a), (b)(11) & 803(a)(McKinney 1963) called for a 4000 to 1 reverse stock split to be followed by a cash out of the resulting fractional shares as authorized by N.Y. Bus. Corp. Law §§ 509 & 513 (McKinney 1963). Since the plaintiffs, former employees of PAR, held less than 4000 shares of PAR, they would have been deprived of an equity interest in the corporation as a result of the plan. 87 Misc.2d at 386, 384 N.Y.S.2d at 662.

⁹⁷ *Id.* at 386-91, 384 N.Y.S.2d at 662-65. It is generally recognized that obstructionist minority shareholders motivated by greed alone should not be permitted to foil the legitimate business interests of the majority. See *Tanzer Economic Assocs., Inc. v. Universal Food Specialties, Inc.*, 87 Misc.2d 167, 383 N.Y.S.2d 472, 479 (1976); O'NEAL, *supra* note 5, at §

majority conceded that the sole purpose of the reorganization was to further corporate policies of maintaining only active employee shareholders and to assure the confidentiality of financial reports.⁹⁸ In reaffirming that minority shareholders should not be relegated to an appraisal remedy, the court enjoined the transaction on the ground that there was no "strong and compelling corporate purpose" for the freeze out.⁹⁹ Whether the *Clark* court intended that a "strong and compelling" corporate purpose test be more difficult to satisfy than a "valid" business purpose test is not clear. *Clark* does suggest, however, that the necessity of a freeze out will not be proved merely by pleading a business purpose.¹⁰⁰

In *Gabhart v. Gabhart*,¹⁰¹ Indiana also adopted a business purpose requirement for freezing out minority shareholders by means of a merger. Furthermore, the court has made available to dissenting minority shareholders the infrequently utilized remedy of involuntary dissolution.¹⁰² In

211; Kutcher, *Freeze Outs of Minority Shareholders in Closely-Held Corporations*, 25 LA. B.J. 123, 124, 130 (1977); Winter, *supra* note 4, at 281.

⁹⁸ 87 Misc.2d at 391, 384 N.Y.S.2d at 665. The court questioned the legitimacy of the corporation's motives and noted that notwithstanding the reverse stock split, some non-employees would remain shareholders. *Id.* Another court also has held that the majority's desire to limit stock ownership to active employees does not justify a freeze out. See *Bryan v. Brock & Blevins Co.*, 490 F.2d 563 (5th Cir. 1974).

⁹⁹ 87 Misc.2d at 391, 384 N.Y.S.2d at 665. The court's holding was premised on the rule that controlling shareholders are bound by their fiduciary obligation not to act in bad faith or in a manner financially detrimental to the minority. *Id.* at 387-91, 384 N.Y.S.2d at 663-65. In *Clark*, the plaintiffs were exposed to irreparable damage due to the potential loss of their entire investment. *Id.* at 386, 384 N.Y.S.2d at 661-62.

¹⁰⁰ There is considerable lack of agreement among courts and commentators concerning what constitutes a valid business reason for eliminating minority shareholders. See text accompanying note 115 *infra*.

¹⁰¹ 370 N.E.2d 345 (Ind. 1977). *Gabhart* was certified to the Indiana Supreme Court by the Court of Appeals for the Seventh Circuit. 545 F.2d 877 (7th Cir. 1977).

¹⁰² Courts of equity have long had the discretionary power to order the dissolution of a corporation, but have exercised the power with great restraint. Note, *Dissolution of the Close Corporation*, 41 ST. JOHNS L. REV. 239, 248 (1966)[hereinafter cited as *Dissolution*]. See generally Comment, *A Remedy for Corporate Abuse—Judicial Power to Wind up a Corporation at the Suit of a Minority Shareholder*, 40 COLUM. L. REV. 220 (1940) [hereinafter cited as *Remedy for Corporate Abuse*]. In the leading involuntary dissolution case, *Miner v. Belle Isle Ice Co.*, 93 Mich. 97, 53 N.W. 218 (1892), a corporation was ordered dissolved upon a showing by a minority shareholder that the majority shareholders had breached their trust obligations by failing to pursue the corporate purpose of profit maximization for all investors. 53 N.W. at 224. Generally, the remedy of involuntary dissolution has been utilized only when there is an abandonment of corporate function, a failure of corporate purpose, as in *Miner*, or a deadlock among shareholders or management. *Dissolution*, *supra* at 248-49.

In addition to the inherent power of a court of equity to order dissolution, almost all states now provide some statutory basis for involuntary dissolution patterned after ABA-ALI MODEL BUS. CORP. ACT § 9 (1953). Comment, *Oppression as a Statutory Ground for Corporate Dissolution*, 1965 DUKE L. REV. 128 (1965)[hereinafter cited as *Oppression as Ground for Dissolution*]. These statutes generally provide for dissolution upon proof that the majority stockholders are engaged in conduct oppressive to the interests of minority shareholders. See, e.g., PA. STAT. ANN. tit. 15 § 2107 (Purdon 1967); VA. CODE § 13.1-94 (1973). Although no clear standard has evolved for determining the scope of oppressive conduct, see *Oppression as Ground for Dissolution*, *supra* at 135-38; Comment, *Corporate Dissolution for Illegal, Oppres-*

Gabhart, majority shareholders in a close corporation, unable to negotiate a contract for the purchase of the interest of a minority shareholder, created a shell corporation in order to eliminate the uncooperative shareholder through a long-form merger.¹⁰³ Although the merger statute did not expressly require a business purpose for a merger, the Indiana Supreme Court interpreted the statute as implicitly containing such a requirement.¹⁰⁴ The court further noted that the Indiana dissolution statute neither expressly nor impliedly incorporated a business purpose requirement.¹⁰⁵ Consequently, the court concluded that a merger which promotes a legitimate business purpose will be upheld and that dissenting shareholders will be relegated to an appraisal remedy.¹⁰⁶ The court held, however, that a merger that did not advance corporate interests would be treated as a dissolution, and objecting minority shareholders would be

sive or Fraudulent Acts: The Maryland Solution, 28 MD. L. REV. 360, 368, 372 (1968)[hereinafter cited as *Maryland Solution*], courts have treated as oppressive corporate actions devoid of corporate purpose or designed to provide disproportionate benefit to majority shareholders. *Oppression as Ground for Dissolution*, *supra* at 130-32. Indiana has no direct statutory authority permitting dissolution for oppressive majority conduct. Note, *Remedies for Oppression in Close Corporations in Indiana*, 41 IND. L.J. 256, 273 (1966) [hereinafter cited as *Remedies in Indiana*]. Therefore, the *Gabhart* court apparently relied on its inherent equity power in permitting the merger to be challenged as a dissolution.

¹⁰³ The corporate defendant, Washington Nursing Center, Inc., was a close corporation controlled by four shareholder directors, each with 100 shares. The remaining one-fifth interest was owned by the plaintiff, a former director. Unable to enter a contract for the purchase of the plaintiff's interest, the majority shareholders transferred their shares to a newly-formed corporation and affected a long form merger pursuant to IND. CODE ANN. §§ 23-1-5-1 to 23-1-5-6 (Burns 1972). Under the terms of the merger, the plaintiff was required to surrender his equity interest in the old corporation for debentures in the new corporation. 370 N.E.2d at 349. The plaintiff challenged the validity of the merger on the grounds of fraudulent misrepresentation and lack of business purpose. *Id.* at 349-50.

¹⁰⁴ 370 N.E.2d at 355. The application of a business purpose requirement resulted from the court's conclusion that the principles of contract and agency apply in a merger setting. *Id.* at 354-55. Under contract principles, a shareholder is assumed to have notice at the time of purchase that the terms of his investment may be altered unilaterally by the majority in accordance with the state merger statute which is incorporated into the corporation's charter. *Norton v. Union Traction Co. of Indiana*, 110 N.E. 113, 118-19 (Ind. 1915); see David J. Greene & Co. v. Schenley Indus. Inc., 281 A.2d 30, 35 (Del. Ch. 1971); Comment, *Corporate Freeze-Outs Effected by Merger: The Search for a Rule*, 37 U. PITT. L. REV. 115, 120 (1975). The right of the majority to institute corporate reorganization is tempered, however, by principles of agency which impose a fiduciary duty on controlling shareholders in their dealings with the minority. 370 N.E.2d at 355, citing *Lebold v. Inland Steel Co.*, 125 F.2d 369 (7th Cir. 1941). Previous Indiana cases have not required that mergers promote a corporate purpose. See, e.g., *Apartment Prop., Inc. v. Luley*, 252 Ind. 205, 247 N.E.2d 74 (1969); *Raff v. Darrow*, 111 N.E. 189, 191 (Ind. 1916).

¹⁰⁵ 370 N.E.2d at 355, citing IND. CODE ANN. 23-1-7-1 (Burns 1972). Both the merger and dissolution statutes expressly require only a majority shareholder vote. Since majority shareholders are always bound by their duty to the minority and since both mergers and dissolutions may result in unfair treatment of minority shareholders, see note 113 *infra*, there seems to be no justification for the court's reasoning that the merger statute impliedly required a business purpose and the dissolution statute did not. *Id.*

¹⁰⁶ 370 N.E.2d at 356. The *Gabhart* court provided no criteria for determining when a merger advances corporate interests.

entitled to all the benefits of the dissolution statute.¹⁰⁷ In effect, the *Gabhart* court has afforded a dissenting minority shareholder the right to demand the involuntary dissolution of a corporation merged without a business purpose and to obtain his pro rata share of the liquidated value of the corporation.¹⁰⁸ Although the *Gabhart* approach¹⁰⁹ seems to assure the equal treatment of shareholders, *Gabhart* does not afford minority shareholders the protection of the Delaware approach.¹¹⁰ Under *Gabhart*, once a business purpose is shown, an Indiana court need not inquire into the "entire fairness" of the transaction.¹¹¹ Furthermore, under the *Singer* rule, Delaware courts will enjoin a merger designed solely to eliminate a minority shareholder thereby protecting the shareholder's equity interest.¹¹² Under similar circumstances, however, Indiana courts presumably will permit the freeze out in order to promote corporate flexibility, but will grant dissenting minority shareholders the protection of a dissolution remedy.¹¹³

¹⁰⁷ *Id.* The court reasoned that a frozen out minority shareholder has greater rights under the dissolution statute than under the appraisal statute since all principles of equity may be applied in a dissolution proceeding to assure the equal treatment of shareholders. *Id.*

¹⁰⁸ Since the *Gabhart* court assumed that an appraisal proceeding provides a shareholder the fair value of his investment, the court in permitting the remedy of involuntary dissolution indicated that where there is no corporate purpose for a freeze out merger, a minority shareholder is entitled to all the protection of a dissolution remedy and not just the value of his investment. The court ignored, however, the possibility that a shareholder may be better off with an appraisal since the shareholder may suffer a loss in the value of his investment as a result of a forced judicial sale of the corporation's assets. See *Oppression as Ground for Dissolution*, *supra* note 102, at 139; *Maryland Solution*, *supra* note 102, at 364. Furthermore, a dissolution may be very harmful to a great number of innocent shareholders especially in the case of a large prosperous corporation, *id.* at 373-74, and is subject to abuse. In addition, for a discussion of the problems involved in estimating the value of shares, see authorities cited at note 33 *supra*. See text accompanying note 113 *infra*. See generally *Remedy for Corporate Abuse*, *supra* note 102, at 236-50.

¹⁰⁹ The *Gabhart* court's use of involuntary dissolution as a means of contesting a merger is apparently unique. See sources at note 102, *supra*.

¹¹⁰ The *Gabhart* court expressly rejected the *Singer* rule on the basis that the "entire fairness" test required scrutiny of every proposed merger and entailed unnecessary judicial intervention into the corporate decision making process. 370 N.E.2d at 356.

¹¹¹ *Id.*; see text accompanying note 71 *supra*.

¹¹² See text accompanying notes 48-58.

¹¹³ The freeze out of minority shareholders by means of a dissolution is just as objectionable as any other type of freeze out. See *Borden*, *supra* note 2, at 990-93, 1000. Freeze out dissolutions are particularly inequitable when controlling majority shareholders purchase the corporation's assets and continue the enterprise through a new corporation absent the participation of the ousted minority shareholders. Many courts have noted the potential inequities of a corporate dissolution. See, e.g., *Kellogg v. Georgia-Pacific Paper Corp.*, 227 F. Supp. 719, 723-24 (W.D. Ark. 1964)(dissolution statute does not permit majority to dissolve corporation, take over the corporate assets, and continue the business since the transaction deprives the minority of an interest in the business and the attendant possibility of growth and appreciation in value); *Kavanaugh v. Kavanaugh*, 226 N.Y. 185, 123 N.E. 148 (1919)(see note 93 *supra*); *Theis v. Spokane Falls Gaslight Co.*, 34 Wash. 23, 74 P. 1004 (1904)(freeze out dissolution followed by perpetuation of enterprise by majority impermissible under dissolution statute when there is no corporate reason for depriving minority of continued participation).

The recent decisions in Delaware, New York, Indiana, and other states¹¹⁴ demonstrate that there is increasing judicial concern for assuring fairness in corporate mergers and for providing minority shareholders remedies to supplement traditional appraisal rights. State courts often have overemphasized, however, the business purpose test which does not provide clear guidelines for measuring the propriety of a corporate reorganization.¹¹⁵ The proper focus of reviewing courts, as suggested in *Singer v. Magnavox Co.* and *Kemp v. Angel*, should be on the overall fairness of the merger and not merely the price offered the dissenting shareholders or the alleged purpose of the transaction.¹¹⁶ Unfortunately, the Delaware decisions do not specify methods for assuring fairness.¹¹⁷ Thus, Delaware courts must wrestle with fairness questions on a case by case basis.

As a result of the vagueness of judicial guidelines regulating going private transactions and other freeze outs, there is a need for clear statutory guidelines directing courts in their review of corporate reorganizations.¹¹⁸ Such a statute should enumerate indicia of fairness in transactions intended to eliminate shareholders. The factors bearing on the issue of fairness might include the purpose of the transaction,¹¹⁹ independent non-

¹¹⁴ See note 83 *supra*.

¹¹⁵ The business purpose test has received mixed reactions from commentators. In support of the rule, see Brudney, *supra* note 16, at 1026-39; Kerr, *supra* note 2, at 58-59; Vorenberg, *supra* note 2, at 1204-05. Criticism of the rule has been voiced by Borden, *supra* note 2, at 1022-23; Greene, *supra* note 2, at 500-02; Small, *supra* note 60, at 52; *Chicago Comment*, *supra* note 18, at 603-04. The basic problem regarding the use of the business purpose test involves the fact that there is insufficient agreement as to what constitutes a valid business justification for eliminating minority shareholders. Moreover, the criteria are easy to fabricate, 89 HARV. L. REV. 1917, 1932 (1976), and true corporate motives difficult to ascertain. Winter, *supra* note 5, at 281. Among the reasons advanced as business purposes are the attainment of more prudent management, *Business Purpose Test*, *supra* note 4, at 1210, increased corporate efficiency, *Schulwolf v. Cerro Corp.*, 86 Misc.2d 292, 380 N.Y.S.2d 957, 962 (Sup. Ct. 1976), reductions in taxes and financial reporting expenses, *id.*, the elimination of an obstructionist minority, Kessler, *Elimination of Minority Interests by Cash Merger: Two Recent Cases*, 30 BUS. LAW. 699, 710 (1975), and the avoidance of financial collapse. Polin v. Conduction Corp., 552 F.2d 797, 815-16 (8th Cir. 1977). Motives designated insufficient to amount to a corporate purpose for a merger include the elimination of managerial discord, Brudney, *supra* note 16, at 1032, the elimination of minority shareholders in order to go private, *id.*, and savings in SEC registration fees. *Berkowitz v. Power/Mate Corp.*, 132 N.J. Super. 35, 342 A.2d 566, 571 n.4 (Ch. Div. 1975). See text accompanying notes 12-14 *supra*.

¹¹⁶ See Chirlstein, Sargeant & Lipton, *supra* note 64, at 304.

¹¹⁷ See text accompanying notes 52-82 *supra*.

¹¹⁸ Wisconsin is the only state that has adopted specific going private regulations. See Wisc. ADM. CODE § 6.05, reprinted in BLUE SKY LAW RPTER. (CCH) ¶ 52,606 (1978) (promulgated pursuant to Wisc. STAT. ANN. § 551 (West 1977)). The Wisconsin regulation requires that a going private transaction be fair to all holders of equity securities. Fairness is presumed if the compensation is approved by independent appraisers, the transaction is approved by a majority of the unaffiliated shareholders, and the compensation afforded the shareholders is greater than the public offering price unless the latest public offering of securities was more than ten years prior to the transaction. See Bartell, *Minority Stockholder Freeze-outs Under Wisconsin Law*, 33 BUS. LAW. 1501 (1978).

¹¹⁹ See note 115 *supra*.

judicial scrutiny of the transaction,¹²⁰ approval of the transaction by impartial directors,¹²¹ acceptance of the reorganization plan by majority vote of public shareholders,¹²² an offer by the corporation to the minority shareholders of a continued equity interest,¹²³ and the availability of warrants entitling ousted shareholders to repurchase an interest in the corporation should the corporation reissue public shares in the future.¹²⁴ By providing courts with standards by which to measure corporate reorganizations, statutory guidelines will help avoid judicial overemphasis on dubious elements of corporate purpose and will promote greater certainty in the review of freeze out transactions.¹²⁵ Finally, state legislation may be desirable in order to avert the adoption of rules by the SEC governing going private transactions which would result in renewed federal intervention in the area of fairness litigation and the further proliferation of securities actions in federal courts.¹²⁶

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¹²⁰ See *Harriman v. E. I. DuPont de Nemours & Co.*, 411 F. Supp. 133, 142 (D. Del. 1971), in which the court viewed favorably the appointment of an independent negotiating committee to arrange merger terms. See generally Chirelstein, Sargeant & Lipton, *supra* note 64, at 299-302.

¹²¹ See *Puma v. Marriot*, 283 A.2d 693, 696 (Del. Ch. 1971) (court afforded great deference to the approval of a corporate transaction by outside, independent directors). See generally Small, *supra* note 60, at 64.

¹²² See Chirelstein, Sargeant, & Lipton, *supra* note 64, at 302. It also has been suggested that a parent corporation seeking to eliminate minority shareholders in a subsidiary has the duty to seek out third-party buyers who may offer the minority shareholders greater compensation for their investment. *Id.* at 290-91.

¹²³ See discussion of the new California statute at note 23 *supra*; note 26 *supra*.

¹²⁴ See *Going Private*, *supra* note 1, at 929-30. Two noteworthy commentators also have advocated giving ousted minority shareholders a share of the post-merger gains of a corporation attributable to the shareholders' interest in the pre-merger corporation. See Brudney & Chirelstein, *supra* note 18. The Brudney-Chirelstein approach has been criticized, however, as a "vast seedbed of litigation" due to the speculative nature of attempts to determine future corporate value. Chirelstein, Sargeant & Lipton, *supra* note 64, at 285-87.

¹²⁵ See note 115 *supra*.

¹²⁶ Since the Supreme Court in *Santa Fe* denied minority shareholders a federal fairness claim based on Rule 10b-5, see text accompanying notes 4-7 *supra*, there may be increased demands for major federal legislation governing the shareholder-corporation relationship. Winter, *supra* note 4, at 251; see discussion of proposed SEC Rule 13e-3 at note 6 *supra*.

