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Short-Form Merger in Missouri: Potential Problems for Minority Shareholders

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SHORT-FORM MERGER IN MISSOURI: POTENTIAL PROBLEMS FOR MINORITY SHAREHOLDERS?

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I. INTRODUCTION TO SHORT-FORM MERGERS

A. *New Missouri Act*

In mid-1977 the Missouri General Assembly enacted a statute authorizing so-called "short-form" mergers.¹ This provision allows a parent corporation owning 90% or more of the outstanding stock of a subsidiary corporation to merge the subsidiary into the parent by resolution of the parent's board of directors; no vote of the shareholders of either corporation, nor of the subsidiary's board of directors is required.² Thus, the acquiring corporation is enabled to bypass the procedural requirements

1. 1977 Mo. Laws 524, § 351.447 (codified at RSMO § 351.447 (Cum. Supp. 1980)).

2. RSMO § 351.447.1 (Cum. Supp. 1980). As used in this Comment, a "short-form merger" statute is one which allows a parent corporation holding less than 100% of the stock of the subsidiary corporation to effect a merger of the two corporations.

normally imposed upon mergers by Missouri's "long-form" merger provisions,³ and the merger transaction is expedited and simplified.

Although perhaps not yet widely recognized in Missouri, the short-form merger has implications much more significant and complex than this brief description of its general premise implies. In the states having similar legislation,⁴ short-form mergers have proven to be a potent weapon for the acquiring corporation in several different contexts.⁵ This same potency, however, also has created hazards in using short-form merger. It has increased the possibility of injury to the interests of the minority shareholders in the acquired corporation,⁶ interests which courts are beginning to recognize and protect.

This Comment will examine the workings of short-form merger statutes, particularly the newly enacted statute in Missouri. It also will attempt to illustrate some of the contexts in which short-form mergers may be used to advantage, and to explore some of the hazards which such transactions may involve. Finally, it will consider what remedies may be available to the minority shareholders in the corporation being acquired, should they be disgruntled with the terms of the transaction. Although emphasis will be placed on Missouri's short-form merger provision, it will be necessary to rely largely on materials from other jurisdictions since the Missouri courts have not had the opportunity to develop this area of corporate law. Particular attention will be paid to the law of Delaware. Several reasons prompt this: Delaware's short-form merger statute⁷ has been the subject of much litigation; the large number of national companies incorporated there⁸ gives its law a significant impact throughout the country;⁹ recent decisions there indicate a significant change in attitude toward the rights of minority shareholders in a merger transaction;¹⁰ and Missouri clearly modeled its short-form merger statute on that of Delaware,¹¹ making judicial interpretations of the latter especially noteworthy.

3. A corporation using the "long-form merger" provisions must secure the approval of the board of directors of the subsidiary corporation as required by RSMO § 351.410 (Cum. Supp. 1980), and submit the merger plan to a vote of the shareholders as required under RSMO §§ 351.420-.425 (1978).

4. See statutes cited note 31 *infra*.

5. See notes 58-76 and accompanying text *infra*.

6. See notes 77-89 and accompanying text *infra*.

7. DEL. CODE ANN. tit. 8, § 253 (1974 & Cum. Supp. 1978).

8. Nearly half of the corporations listed on the New York Stock Exchange are incorporated in Delaware. Folk, *State Statutes: Their Role in Prescribing Norms of Responsible Management Conduct*, 31 BUS. LAW. 1031, 1037 (1976).

9. See Lynch, *A Concern for the Interest of Minority Shareholders Under Modern Corporation Laws*, 3 J. CORP. L. 19, 27 (1977).

10. See notes 149-80 and accompanying text *infra*.

11. Compare RSMO § 351.447 (Cum. Supp. 1980) with DEL. CODE ANN. tit. 8, § 253 (1974 & Cum. Supp. 1978). Of the four subsections of the Missouri

B. *Background of Short-Form Mergers*

Before examining the specific provisions and applications of short-form merger statutes, the origins and development of such statutes will be traced. The genesis of the short-form merger occurred in 1896, when New York added a *pro forma* merger provision to its Stock Corporation Law.¹² Properly characterized as being "as insubstantial in substance as it was comprehensive in application,"¹³ the sweeping terms of this law merely allowed a parent corporation owning *all* the stock of another corporation to effect a merger by resolution of the parent's board.

Not until the 1936 amendment to the New York statute¹⁴ did the possibility of a conflict with minority shareholders arise. In that year, responding to the serious threat that the sprawling New York utility empires which had expanded through the use of numerous subsidiaries would collapse during the Depression, the New York legislature inserted a special provision applying to utility companies. To allow the financially troubled utilities to integrate and simplify their operations, without the obstruction of tenacious minority shareholders,¹⁵ the stock ownership requirement of the statute was lowered from 100% to 95%. This provision, however, was strictly limited, applying only to certain regulated utilities¹⁶ and requiring that the state's utility regulatory commission approve the merger.¹⁷ Even after the Depression, this short-form merger provision remained on the books until 1949, when the 95% ownership requirement was extended to business corporations generally,¹⁸ for reasons which are unclear.

statute, the first three correspond almost verbatim with subsections (a), (b), and (d) of the Delaware Act as it stood before its amendment in 1975 by 60 Del. Laws ch. 371, § 2 (1975) (simplifying subsection (d), regarding appraisal rights).

12. 1896 N.Y. Laws ch. 932, § 1 (current version at N.Y. BUS. CORP. LAW § 905 (McKinney 1963 & Cum. Supp. 1979-1980)).

13. Freedland, *Merger and Consolidation of New York Business Corporations: History of Enabling Legislation, 1776-1956*, 25 FORDHAM L. REV. 672, 689 (1956-1957).

14. 1936 N.Y. Laws ch. 778, § 1 (current version at N.Y. BUS. CORP. LAW § 905 (McKinney 1963 & Cum. Supp. 1979-1980)).

15. *See* *Beloff v. Consolidated Edison Co.*, 300 N.Y. 11, 20, 87 N.E. 561, 565 (1949) (referring to minority blocking attempts as an "evil").

16. In 1936 only domestic gas, electric, or gas and electric corporations were listed in the statute. 1936 N.Y. Laws ch. 778, § 1 (current version at N.Y. BUS. CORP. LAW § 905 (McKinney 1963 & Cum. Supp. 1979-1980)). In 1937 holdings in district steam corporations were included. 1937 N.Y. Laws ch. 815, § 1 (current version at N.Y. BUS. CORP. LAW § 905 (McKinney 1963 & Cum. Supp. 1979-1980)).

17. 1936 N.Y. Laws ch. 778, § 1 (current version at N.Y. BUS. CORP. LAW § 905 (McKinney 1963 & Cum. Supp. 1979-1980)).

18. 1949 N.Y. Laws ch. 762, § 85 (current version at N.Y. BUS. CORP. LAW § 905(a) (McKinney 1963 & Cum. Supp. 1979-1980)).

In 1957 Delaware laid the foundation of its present short-form merger statute¹⁹ by amending²⁰ its original *pro forma* merger provision.²¹ The amended Delaware statute was significant in two respects. First, it reduced the ownership requirement from 100% to 90%,²² thereby surpassing New York's liberality. Second, it expressly authorized the use of cash as consideration for the minority's shares,²³ thus opening the way for the direct elimination of minority shareholders through a "cash buyout" of their shares by the acquiring corporation.²⁴

In 1959 the American Law Institute's Model Business Corporation Act for the first time included a short-form merger provision.²⁵ Here, too, cash was allowed as consideration.²⁶ Although originally a 95% ownership requirement was imposed,²⁷ this was reduced to 90% in 1969,²⁸ the comment to the section indicating this was done "to provide more flexibility."²⁹ Both the Delaware and the Model Act provisions have had a significant impact on other states.³⁰ Short-form merger statutes have been enacted in forty-three states.³¹ All these acts now provide for cash buyouts of the

19. DEL. CODE ANN. tit. 8, § 253 (1974 & Cum. Supp. 1978).

20. 51 Del. Laws ch. 121, § 6 (1957) (current version at DEL. CODE ANN. tit. 8, § 253 (1974 & Cum. Supp. 1978)).

21. 50 Del. Laws ch. 131 (1937) (current version at DEL. CODE ANN. tit. 8, § 253 (1974 & Cum. Supp. 1978)).

22. 51 Del. Laws ch. 121, § 6 (1957) (current version at DEL. CODE ANN. tit. 8, § 253 (1974 & Cum. Supp. 1978)).

23. *Id.*

24. See F. O'NEAL, "SQUEEZE OUTS" OF MINORITY SHAREHOLDERS § 5.14 (1975 & Cum. Supp. 1980). In the "cash buyout," the majority shareholder simply provides in the plan of merger that the minority shareholders will receive cash, rather than some sort of security which would give the minority shareholders a continuing interest in the enterprise. Thus, the minority interest is completely eliminated. *Id.*

25. Lynch, *supra* note 9, at 31. See 2 MODEL BUS. CORP. ACT ANN. § 68A, ¶ 1 (1960) (offered as an optional section).

26. The section provides that the board of directors of a qualifying corporation must include in the plan of merger the "manner and basis of converting the shares of the subsidiary corporation into shares or other securities or obligations of the surviving corporation or the cash or other consideration to be paid . . . upon surrender of each share of the subsidiary corporation." 2 MODEL BUS. CORP. ACT ANN. § 68A, ¶ 1 (1960) (emphasis added).

27. *Id.*

28. ABA-ALI MODEL BUS. CORP. ACT § 75 (1969).

29. 2 MODEL BUS. CORP. ACT ANN. § 75, ¶ 2 (2d ed. 1971).

30. Lynch, *supra* note 9, at 27.

31. See ARIZ. REV. STAT. ANN. § 10-075 (1956) (90%); ARK. STAT. ANN. § 64-709 (1966) (95%); CAL. CORP. CODE § 1110 (West Cum. Supp. 1980) (90%); COLO. REV. STAT. § 7-7-106 (1973 & Cum. Supp. 1979) (90%); CONN. GEN. STAT. ANN. § 33-370 (West Cum. Supp. 1980) (90%); DEL. CODE ANN. tit. 8, § 253 (1974 & Cum. Supp. 1978) (90%); FLA. STAT. ANN. § 607.227 (West 1977)

minority's interest, and the vast majority impose a lesser ownership requirement than New York's 95%.³²

C. Statutory Provisions

Almost a verbatim copy of Delaware's short-form merger statute, Missouri Revised Statutes section 351.447 provides a good example of the types of procedures and requirements common to such statutes. The parent corporation must own at least 90%³³ of each class of the outstanding stock of the other corporation before the statute may be used.³⁴ If this requirement is met, the board of directors of the parent may, by resolution, approve a plan of merger.³⁵ If the merger is an "upstream" merger,

(90%); GA. CODE ANN. § 22-1005 (1977) (90%); HAWAII REV. STAT. § 417-42 (1976) (90%); IDAHO CODE § 30-1-75 (1980) (90%); ILL. ANN. STAT. ch. 32, § 157.66a (Smith-Hurd Cum. Supp. 1980-1981) (99%); IND. CODE ANN. § 23-1-5-8 (Burns 1972) (95%); IOWA CODE § 496A.72 (1979) (90%); KAN. STAT. ANN. § 17-6703 (1974) (90%); KY. REV. STAT. § 271A.375 (Cum. Supp. 1980) (90%); LA. REV. STAT. ANN. § 12:112H (West Cum. Supp. 1980) (90%); ME. REV. STAT. ANN. tit. 13-A, § 904 (1964) (90%); MD. CORP. & ASS'NS CODE ANN. § 3-106 (1975 & Cum. Supp. 1980) (90%); MASS. GEN. LAWS ANN. ch. 156B, § 82 (West 1970) (90%); MICH. COMP. LAWS ANN. § 450.1711 (1973) (90%); MISS. CODE ANN. § 79-3-149 (1972) (95%); RSMO § 351.447 (Cum. Supp. 1980) (90%); MONT. REV. CODES ANN. § 15-2268 (1947) (95%); NEB. REV. STAT. § 21-2074 (1943) (80%); NEV. REV. STAT. § 78.486 (1979) (90%); N.J. STAT. ANN. § 14A:10-5 (West Cum. Supp. 1980-1981) (90%); N.M. STAT. ANN. § 51-27-5 (Supp. 1975) (90%); N.Y. BUS. CORP. LAW § 905 (McKinney 1963 & Cum. Supp. 1979-1980) (95%); N.D. CENT. CODE § 10-20-05 (1976) (95%); OHIO REV. CODE ANN. § 1701.80 (Page 1978) (90%); OR. REV. STAT. § 57.495 (1979-1980) (90%); PA. STAT. ANN. tit. 15, § 1902.1 (Purdon Cum. Supp. 1980-1981) (90%); R.I. GEN. LAWS § 7-1.1-68.1 (Cum. Supp. 1979) (90%); S.C. CODE § 33-17-50 (1976) (95%); TENN. CODE ANN. § 48-904 (1979) (90%); TEX. BUS. CORP. ACT ANN. art. 5.16 (Vernon 1980) (90%); UTAH CODE ANN. § 16-10-70 (1953) (90%); VT. STAT. ANN. tit. 11, § 1955 (1973) (95%); VA. CODE § 13.1-76 (1950) (90%); WASH. REV. CODE ANN. § 23A.20.050 (Cum. Supp. 1980-1981) (95%); W. VA. CODE § 31-1-119 (1975) (90%); WIS. STAT. ANN. § 180.685 (West Cum. Supp. 1980-1981) (90%); WYO. STAT. § 17-1-404.1 (Cum. Supp. 1980) (90%).

Three jurisdictions have similar statutes. These laws require, however, the subsidiary to be wholly owned by the parent corporation. D.C. CODE ANN. § 29-927h (1968); MINN. STAT. ANN. § 301.421 (West 1969); N.C. GEN. STAT. § 55-108.1 (1975).

32. See statutes cited note 31 *supra*, for required percentage of share ownership in each state having a short-form merger act.

33. The percentage of ownership required in other states varies from a low of 80% in Nebraska to a high of 99% in Illinois. See statutes cited note 31 *supra*.

34. RSMO § 351.447.1 (Cum. Supp. 1980).

35. *Id.*

leaving the parent corporation as the surviving corporation,³⁶ it is unnecessary for the shareholders of either corporation to vote on the merger.³⁷ The articles of merger³⁸ must be filed with the Secretary of State and must contain the following: a statement that the plan of merger was adopted under section 351.447; the resolution of the parent's board of directors approving the plan of merger; the date the resolution was adopted; and a statement that the parent presently meets the 90% ownership requirement and will continue to do so until the Secretary of State issues the certificate of merger.³⁹ In addition, if the parent does not own all the outstanding shares of the subsidiary corporation, the articles of merger also must state what "securities, *cash*, property, or rights [are] to be issued . . . by the surviving corporation upon surrender of each share of the subsidiary corporation."⁴⁰

In the event that a minority shareholder is not satisfied with what the parent proposes to issue in exchange for his shares in the subsidiary corporation, he is granted the right to seek statutory appraisal. Thus, the Missouri statute provides that within ten days after the effective date of the merger,⁴¹ the surviving corporation must notify any shareholders of the subsidiary of the occurrence of the merger.⁴² Any of these shareholders within twenty days after the mailing of such notice may demand, in writing, payment by the surviving corporation of the value of his shares. This value is that "immediately prior to the merger exclusive of any element of value arising from the expectation or accomplishment of the

36. See S. CROSS, CORPORATION LAW IN CONNECTICUT 414 n.38 (1972) (discussing "upstream" merger).

37. RSMO § 351.447.1 (Cum. Supp. 1980).

38. See RSMO § 351.430 (1978) (stating the requirements for articles of merger in Missouri).

39. RSMO § 351.447.1 (Cum. Supp. 1980). The Model Business Corporation Act sets forth somewhat different requirements, providing that the articles of merger must set forth: the plan of merger; the number of outstanding shares of each class of the subsidiary; the number of these shares owned by the surviving corporation; and the date on which the plan of merger was mailed to the shareholders of the subsidiary. ABA-ALI MODEL BUS. CORP. ACT § 75 (1978).

40. RSMO § 351.447.1 (Cum. Supp. 1980) (emphasis added). The Model Business Corporation Act contains a similar provision, requiring the parent corporation's board of directors to set forth in the resolution approving the plan of merger, the "manner and basis of converting the shares of the subsidiary corporation into shares, obligations or other securities of the surviving corporation or of any other corporation or . . . into cash or other property." ABA-ALI MODEL BUS. CORP. ACT § 75 (1978).

41. In Missouri, the merger becomes effective upon the Secretary of State's issuance of the certificate of merger. RSMO § 351.440 (1978).

42. RSMO § 351.447.3 (Cum. Supp. 1980). This section requires, however, that the notice "be sent by certified or registered mail, return receipt requested, addressed to the shareholder at his address as it appears on the records of the corporation." *Id.*

merger."⁴³ If, in the thirty days following the twenty-day demand period, the dissenting shareholders and the surviving corporation cannot agree on the value of the shares, statutory appraisal applies and a court will determine the value of the shares.⁴⁴

The statute makes no distinction between closely held and publicly held corporations, and the statute also provides that short-form mergers may involve foreign corporations.⁴⁵ In Missouri the only requirement made is that "the laws of the jurisdictions of their [the foreign corporations'] incorporation permit a corporation of that jurisdiction to merge with a corporation of another jurisdiction,"⁴⁶ thereby differing from the requirements of several other states.⁴⁷

Missouri's Act also contains a few somewhat unusual provisions, borrowed from Delaware's short-form merger statute. First, express provision is made for the possibility that more than two corporations might be involved in a short-form merger.⁴⁸ Thus, it is possible for a parent to merge two or more subsidiaries into itself in one merger transaction should it so desire, provided the other statutory requirements are met. Also, both the Missouri and Delaware statutes contain specific limitations on "downstream" mergers,⁴⁹ in which the parent is merged into the subsidiary, leaving the latter as the surviving corporation. While providing for the possibility of such a transaction,⁵⁰ the statutes first provide that the holders of

43. *Id.*

44. *Id.* See *id.* § 351.455.3 (1978). For a discussion of the appraisal process in Missouri, see note 214 *infra*.

45. RSMO § 351.447.1 (Cum. Supp. 1980).

46. *Id.* Delaware's statute has a similar provision, requiring that "the laws of the other state or states . . . permit a corporation of such jurisdiction to merge with a corporation of another jurisdiction." DEL. CODE ANN. tit. 8, § 253(a) (1974).

47. See, e.g., CAL. CORP. CODE § 1110(h) (West Cum. Supp. 1980), which provides that a foreign corporation may not be a party to a short-form merger under the California statute "unless the laws of the state or place of its incorporation permit such action." Thus, while statutes like Missouri's would require only that the other jurisdiction allow mergers between foreign and domestic corporations, apparently statutes such as California's would require, in addition, that the other jurisdiction allow short-form mergers. See Comment, *Jurisdiction of the California Corporations Commissioners Over Delaware Short Form Mergers*, 52 CALIF. L. REV. 1016, 1016 n.4 (1964) (discussing a former Delaware provision similar to California's present provision).

48. Both the Missouri and Delaware statutes provide that a corporation meeting the other requirements of the acts "may either merge the other corporation or corporations into itself . . . , or merge itself, or itself and one or more of the other corporations, into one of the other corporations." RSMO § 351.447.1 (Cum. Supp. 1980). See DEL. CODE ANN. tit. 8, § 253(a) (1974).

49. See S. CROSS, *supra* note 36, at 414 n.38.

50. DEL. CODE ANN. tit. 8, § 253(a) (1974); RSMO § 351.447.1 (Cum. Supp. 1980). See note 48 *supra*, for the relevant statutory language.

the parent's stock must receive a pro rata amount of the stock of the surviving corporation;⁵¹ cash distributions are not allowed. The second limitation is that the shareholders of the parent corporation must vote to approve the merger at a shareholder meeting duly called and held.⁵² These limits effectively prevent a downstream merger from being employed to freeze out the minority shareholders of the parent.

D. *Significance of the Provisions*

The principal advantage offered by a short-form merger statute is the power to quickly, directly, and completely dispose of the interests of minority shareholders. While other advantages have been suggested in support of the short-form merger, such as saving the expense of calling a shareholders' meeting, they appear to be less significant.⁵³ Under the short-form merger statutes, the acquiring corporation has only to wait until the certificate of merger is issued by the appropriate state official to have an effective merger.⁵⁴ The minority shareholders of the acquired corporation need not be given a chance to present any objections, and in fact need not be told anything until after the merger is completed.

Furthermore, the statutes expressly authorize the acquiring corporation to offer cash in exchange for the shareholders' interests.⁵⁵ If a shareholder accepts such an offer, he loses whatever equity interest he held in the company. While it is possible to use other devices to accomplish the same result,⁵⁶ the short-form merger statutes' terms are simple, easy to

51. RSMO § 351.447.1 (Cum. Supp. 1980), provides "that if the parent corporation is not the surviving corporation, the plan of merger shall include provision for the pro rata issuance of shares of the surviving corporation to the holders of the shares of the parent corporation." The slightly different wording in DEL. CODE ANN. tit. 8, § 253(a) (1974), is of no significance.

52. RSMO § 351.447.1 (Cum. Supp. 1980) states "that if the parent corporation is not the surviving corporation, . . . the articles of merger shall state that the proposed merger has been approved by receiving the affirmative vote of the holders of at least two-thirds of the outstanding shares of the parent corporation," at a shareholder meeting "duly called and held." Delaware requires the approval of only a simple majority of the parent corporation's shares. DEL. CODE ANN. tit. 8, § 253(a) (1974).

53. See Comment, *The Short Merger Statute*, 32 U. CHI. L. REV. 596, 602-03 (1965).

54. See, e.g., RSMO § 351.440 (1978), providing that "[u]pon the issuance of the certificate of merger . . . by the secretary of state, the merger . . . shall be effected."

55. See note 40 and accompanying text *supra*.

56. Other methods which may be used by the majority shareholders to freeze-out the minority shareholders include: (1) using the regular long-form merger procedure to effect a merger with a corporation owned solely by the majority; (2) causing sale of the corporate assets to a corporation owned solely by the

comply with, and explicit. Even if the shareholder does not accept the cash offer, the only remedy specified by the statutes is appraisal in which the shareholder would only receive cash anyway.⁵⁷

II. USE OF SHORT-FORM MERGERS

A. *Types of Transactions*

In light of the attractions offered by short-form merger statutes, it becomes apparent why there are several situations in which such a merger device has proven quite popular. Although somewhat imprecise, broad categories of such situations would include: (1) "retrieval" by a parent corporation of one of its long-term subsidiaries; (2) acquisition by a corporation of a previously unrelated corporation through a two-step transaction; (3) elimination of the minority shareholders by the majority in a closely held corporation; and (4) elimination of the public shareholders in a publicly held corporation—*i.e.*, "going private."

The "retrieval" merger is the simplest and most obvious application of the short-form merger. Here, the board of directors of the existing parent decides that an existing subsidiary corporation could be operated more effectively under their direct and exclusive control, and vote to turn the subsidiary into a part of the parent corporation via the short-form merger. This, in fact, is apparently the sort of transaction that the New York legislature had in mind when it enacted the first short-form merger statute.⁵⁸ Nevertheless, even this situation has generated litigation by minority shareholders of the subsidiary corporation.⁵⁹

The use of the short-form merger in a two-step acquisition⁶⁰ is a more complex matter. The first step of the acquiring corporation is the purchase

majority; (3) forcing dissolution of the corporation, followed by distribution to the minority of their share of the proceeds and subsequent reorganization of the same enterprise by the former majority shareholders; and (4) using a massive reverse stock split to leave the minority shareholders with only fractional shares, followed by a cash purchase of the fractional shares. *See Note, Freezing Out Minority Shareholders*, 74 HARV. L. REV. 1630, 1630-33 (1961). *See generally* F. O'NEAL, *supra* note 24, §§ 5.01- .32.

57. F. O'NEAL, *supra* note 24, § 5.14.

58. The New York statute was originally intended to assist utility companies in operating more efficiently by making it easier for the parent utilities to absorb their subsidiaries. *See* text accompanying notes 14-18 *supra*.

59. *See* Beloff v. Consolidated Edison Co., 300 N.Y. 11, 87 N.E.2d 561 (1949); Alpren v. Consolidated Edison Co., 168 Misc. 381, 5 N.Y.S.2d 254 (Sup. Ct. 1938).

60. *See generally* Brudney & Chirelstein, *Fair Shares in Corporate Mergers and Takeovers*, 88 HARV. L. REV. 297, 330-44 (1974) (discussion of problems of fairness involved in two-step acquisitions). They define integrated mergers as

of a large amount of the outstanding stock of the target company. This would usually be done by means of a tender offer,⁶¹ but in a few cases it might still be accomplished by direct negotiation with the holder of a large block of stock.⁶² If a quantity of stock sufficient to satisfy the ownership requirement of the statute is acquired in this first step,⁶³ then the second step of the acquisition can take place as a short-form merger of the target company into the acquiring corporation,⁶⁴ or into a corporation established by the acquiring corporation for this purpose.⁶⁵ The acquiring corporation may then buy out the equity interest of the remaining shareholders.⁶⁶

Because the statute makes no distinction between publicly held and close corporations, the short-form merger also lends itself to use within close corporations as a means of "squeezing-out"⁶⁷ minority shareholders under certain conditions. Even though only one "real" corporation is involved, if the majority holds more than 90% of the outstanding stock,⁶⁸ the majority block may eliminate minority shareholders from the company.⁶⁹ In the first step the majority forms a "shell" corporation, capitalizing it by means of their shares in the original corporation.⁷⁰ Thus, the majority

"mergers which follow immediately or very shortly after the purchase of a controlling stock interest in the target company." *Id.* at 330.

61. *Id.* at 330-31.

62. *Id.* at 331.

63. For other devices which might be used to cause a freeze-out in the event not enough shares were obtained to meet the ownership requirement necessary to use short-form merger, see note 56 *supra*.

64. See *Stauffer v. Standard Brands, Inc.*, 41 Del. Ch. 7, 187 A.2d 78 (1962) (acquisition short-form merger of Planters of Delaware into Standard Brands); *Willcox v. Stern*, 18 N.Y.2d 195, 219 N.E.2d 401, 273 N.Y.S.2d 38 (1966) (acquisition short-form merger between insurance companies).

65. See *Tanzer Economic Assocs., Inc. v. Universal Food Specialties, Inc.*, 87 Misc.2d 167, 168-69, 383 N.Y.S.2d 472, 475 (Sup. Ct. 1976) (Nestle sought to merge the Libby food processing company into UFS, the Nestle affiliate holding the Libby shares).

66. See text accompanying notes 55-57 *supra*.

67. "Squeeze-out" as used here follows O'Neal's definition, referring to "use by some of the owners or participants in a business enterprise of strategic position, inside information, or powers of control, or the utilization of some legal device or technique, to eliminate from the enterprise one or more of its owners or participants." F. O'NEAL, *supra* note 24, § 1.01.

68. Even if the majority's holdings of the stock are initially less than the amount required by the short-form merger statute, the majority may be able to cause the corporation to issue them enough additional stock to bring their holdings up to the necessary level. *Id.* § 5.14.

69. See *Bryan v. Brock & Blevins Co.*, 343 F. Supp. 1062, 1063-66 (N.D. Ga. 1972) (although involving a long-form merger, case provides a good example of the freeze-out technique under consideration), *aff'd on other grounds*, 490 F.2d 563 (5th Cir.), *cert. denied*, 419 U.S. 880 (1974).

70. See F. O'NEAL, *supra* note 24, § 5.14.

shareholders in the original corporation become the sole shareholders of a dummy corporation whose assets consist of 90% or more of the stock of the original corporation. Then, all the majority need do is cause the board of directors of the shell to effect a short-form merger of the real corporation into the shell corporation.⁷¹ The minority shareholders will, of course, lose their equity interest as a result.⁷²

The fourth situation, "going private," was fairly common in the early 1970s and has elicited a great deal of comment.⁷³ In this case, the control group or management of a closely held corporation that had gone public decides to return to the closely held form by eliminating the public shareholders.⁷⁴ Although other devices may be used to attain this result,⁷⁵ the short-form merger may be used quite effectively. If the "insiders" do not have a large enough block of stock to effect an immediate short-form merger, it will be necessary for them to acquire more stock. This acquisition will probably be accomplished by a "parent" corporation, established by the insiders and holding their stock in the "subsidiary," making a tender offer for additional shares.⁷⁶ If a sufficient quantity of stock is obtained by the tender offer then a short-form merger may be accomplished. The public shareholders can then be effectively frozen out, forced to surrender their equity interest for cash.

B. *Possible Injury to Minority Shareholders*

The minority shareholders are obviously given little choice in such transactions. In fact, they may be injured in several ways in the course of a

71. *Id.*

72. See text accompanying notes 55-57 *supra*.

73. *E.g.*, Borden, *Going Private—Old Tort, New Tort, or No Tort?*, 49 N.Y.U.L. REV. 987 (1974); Brudney, *A Note on "Going Private,"* 61 VA. L. REV. 1019 (1975); Greene, *Corporate Freeze-Out Mergers: A Proposed Analysis*, 28 STAN. L. REV. 487 (1976); Moore, *Going Private: Techniques and Problems of Eliminating the Public Shareholder*, 1 J. CORP. L. 321 (1976); Swanson, *The Elimination of Public Shareholders: Going Private*, 7 CONN. L. REV. 609 (1975); Note, *Going Private: An Analysis of Federal and State Remedies*, 44 FORDHAM L. REV. 796 (1976); Note, *Going Private*, 84 YALE L.J. 903 (1975).

74. The impetus for this trend appears to have been the large decline in the market value of publicly traded stocks in relation to the intrinsic value of these stocks. In many instances this imbalance made it attractive and feasible for the management or controlling shareholders of certain corporations to buy the publicly held stock at an unusually low price, and thereby obtain complete control of the corporation. See Note, *Going Private*, 84 YALE L.J. 903, 903-05 (1975).

75. See note 56 *supra*.

76. Alternatively, the insiders could cause the corporation itself to buy back a quantity of publicly held stock to make their own holdings sufficient to meet the requirements of the short-form merger statute. Their new parent corporation could then cause the freeze-out merger. *Cf.* F. O'NEAL, *supra* note 24, § 5.32

short-form merger. First, the minority shareholders are forced to accept a change in the form of their holdings. Originally the holders of equity securities, they are left holding cash or debt instruments after the merger.⁷⁷ While it may be true that shareholders no longer regard their equity investment as a proprietary interest in a unique corporation,⁷⁸ they may well have an interest in the *form* of the investments they hold since cash, debt, and equity have distinctly different characteristics.⁷⁹

Second, even assuming that cash is an acceptable substitute for an equity interest, the shareholders may be compelled to accept a price for their shares which is not equal to the value of the shares. A disturbing possibility is that the acquiring corporation may offer an inadequate price.⁸⁰ Although the minority shareholder is supposedly assured of receiving a fair price by the right of statutory appraisal, it is well known that an appraisal proceeding can be costly, protracted, and uncertain for the dissenter.⁸¹ These disadvantages, coupled with uncertainty whether the resulting judgment will be any higher than the merger terms, encourage the minority shareholders to accept the proposed price, even if felt to be too low.⁸²

Third, assuming that the price offered does represent the value of the stock, the minority shareholders are still burdened by various costs not reflected in this "value." The shareholders must search for a new investment, possibly holding their money idle for some length of time during the search,⁸³ with no assurance that the present economic situation even holds

(suggesting that the majority shareholders might cause the corporation to repurchase its public stock to go private).

77. See text accompanying notes 55-57 *supra*.

78. See Comment, *Going Private—Juggling Shareholder Protection With Corporate Flexibility: Will the States Drop the Ball?*, 1978 WIS. L. REV. 797, 813-14.

79. See *Singer v. Magnavox Co.*, 380 A.2d 969, 977-78 (Del. 1977). See also *Outwater v. Public Serv. Corp.*, 103 N.J. Eq. 461, 465-66, 143 A. 729, 731 (Ch. 1928), *aff'd per curiam*, 104 N.J. Eq. 490, 146 A. 916 (N.J. 1929).

80. One commentator has noted that it is so difficult to demonstrate an inadequate consideration "that it is impossible for the majority stockholders not to be tempted to undercompensate those they displace, and improbable that they will not yield to the temptation." Brudney, *supra* note 73, at 1025.

81. See, e.g., Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L.J. 223, 233 (1962).

82. See Brudney, *supra* note 73, at 1025 (noting that the difficulties of appraisal preclude "challenges to all but the most outrageous discrimination among stockholders"). See also Eisenberg, *The Legal Roles of Shareholders and Management in Modern Corporate Decisionmaking*, 57 CALIF. L. REV. 1, 85 (1969).

83. See *Outwater v. Public Serv. Corp.*, 103 N.J. Eq. 461, 466-67, 143 A. 729, 731 (Ch. 1928), *aff'd per curiam*, 104 N.J. Eq. 490, 146 A. 916 (N.J. 1929).

equivalent investment opportunities.⁸⁴ In addition, the minority shareholders may be involuntarily exposed to tax burdens.⁸⁵ Although the merger is compelled by the majority shareholder, the receipt of cash by the minority shareholders in exchange for their shares will be treated as a sale, forcing them to recognize gain or loss on the transaction.⁸⁶ This fact gives the acquiring corporation leverage over the minority shareholders since the threat of immediate tax consequences may cause the shareholders to accept less than the fair value of their stock in return for deferred tax treatment.⁸⁷

Fourth, a short-form merger transaction inevitably involves self-dealing. While in a regular merger it is possible for a third party with no prior interest in the corporation to bring about a merger which equally affects the interests of both the majority and the minority shareholders of the acquired company, in the short-form merger the acquiring corporation must already be the majority shareholder in the corporation being acquired.⁸⁸ This situation raises the question of unequal treatment of majority and minority shareholders, because the majority retains perforce an equity interest in the merged corporation, while the minority almost certainly does not. Under these circumstances, the acquiring corporation, which is also the majority shareholder, is placed in a position from which it may profit at the expense of the minority.⁸⁹

III. PROBLEMS PRESENTED BY SHORT-FORM MERGERS

A. *Business Purpose Test*

1. Early Cases

Because there is such a large potential for the majority shareholder to cause damage to the minority through a short-form merger transaction, it is necessary to consider what limits may be placed on such mergers. The statutes, beyond setting forth the simple formal details, provide no guidance in determining what constitutes a valid purpose for using the stat-

84. See F. O'NEAL, *supra* note 24, § 5.28; Brudney, *supra* note 73, at 1023-25.

85. See Vorenberg, *Exclusiveness of the Dissenting Stockholder's Appraisal Right*, 77 HARV. L. REV. 1189, 1203-04 (1964).

86. See I.R.C. § 354.

87. F. O'NEAL, *supra* note 24, § 5.14.

88. See Lynch, *supra* note 9, at 43-44. See also Brudney & Chirelstein, *supra* note 60, at 297-98.

89. Lynch, *supra* note 9, at 43-44.

ute.⁹⁰ No mention is made of any duty owed by an acquiring company to the minority shareholders, or of any evaluation of the motives of the majority. Nor can it be said that a legislative intent with regard to the minority interests can be clearly discerned.⁹¹

It might be anticipated that courts would approach short-form mergers from the standpoint of fiduciary duty, since it is now widely accepted that controlling shareholders stand in such a position of power as to owe a fiduciary duty to the minority shareholders.⁹² In fact, it has been said that this duty should be scrutinized with particular care in situations where the majority shareholder stands on both sides of a transaction,⁹³ where it uses its voting power to obtain some advantage not enjoyed by the minority,⁹⁴ or where it may profit at the minority's expense.⁹⁵ These are exactly the types of problems which may arise under short-form mergers.⁹⁶

Instead, the first cases to consider short-form merger transactions approached the question from the perspective of the literal statutory language, thereby strongly favoring the controlling shareholders. In the first case to consider New York's statute,⁹⁷ a minority shareholder in Consolidated Edison sought an injunction against the short-form merger of a steam company into Consolidated Edison,⁹⁸ alleging that the statute was

90. See Kessler, *Elimination of Minority Interests by Cash Merger: Two Recent Cases*, 30 BUS. LAW. 699, 710 (1975).

91. For instance, while it appears that the New York legislature wanted to prevent minority interests from blocking much needed mergers of utility companies, the legislature's rationale for extending short-form merger privileges to business corporations is unclear. See text accompanying notes 14-18 *supra*.

92. See, e.g., *Pepper v. Litton*, 308 U.S. 295, 306-07 (1939); *Lebold v. Inland Steel Co.*, 125 F.2d 369, 372-73 (7th Cir. 1941) (citing *Pepper*), cert. denied, 316 U.S. 675 (1942); *Jones v. H.F. Ahmanson & Co.*, 1 Cal. 3d 93, 108, 460 P.2d 464, 471, 81 Cal. Rptr. 592, 599 (1969).

93. See, e.g., *Zahn v. Transamerica Corp.*, 162 F.2d 36, 42 (3d Cir. 1947); *Outwater v. Public Serv. Corp.*, 103 N.J. Eq. 461, 464, 143 A. 729, 730 (Ch. 1928), *aff'd per curiam*, 104 N.J. Eq. 490, 146 A. 916 (N.J. 1929).

94. See, e.g., *David J. Greene & Co. v. Dunhill Int'l, Inc.*, 249 A.2d 427, 431 (Del. Ch. 1968); *Sterling v. Mayflower Hotel Corp.*, 33 Del. Ch. 293, 298, 93 A.2d 107, 110 (1952).

95. See, e.g., *Lebold v. Inland Steel Co.*, 125 F.2d 369, 373 (7th Cir. 1941), cert. denied, 316 U.S. 675 (1942); *Fix v. Fix Material Co.*, 538 S.W.2d 351, 358 (Mo. App., St. L. 1976).

96. See text accompanying notes 88 & 89 *supra*.

97. *Alpren v. Consolidated Edison Co.*, 168 Misc. 381, 5 N.Y.S.2d 254 (Sup. Ct. 1938).

98. *Id.* at 382-83, 5 N.Y.S.2d at 255-56. Apparently, the Consolidated Edison stockholder bringing the suit feared that the acquisition of the steam company might bring about a fundamental change in Consolidated Edison, which until then had been supplying only gas and electricity. *Id.* at 382-83, 5 N.Y.S.2d at 255.

an unconstitutional interference with her vested property rights as a stockholder. The court upheld the statute as dealing solely with a matter of public policy within the legislature's discretion.⁹⁹ In *Beloff v. Consolidated Edison Co.*,¹⁰⁰ a minority shareholder eliminated by a short-form merger of utility companies¹⁰¹ again raised the constitutional issue. Again the court upheld the statute, this time adding that appraisal was the shareholder's exclusive remedy:

In short, the merged corporation's shareholder has only one real right; to have the value of his holding protected, and that protection is given him by his right to appraisal. . . . He has no right to stay in the picture, to go along into the merger, or to share in its future benefits.¹⁰²

This view of the exclusivity of the appraisal remedy in the short-form merger context was restated in a subsequent case,¹⁰³ in which the court noted bluntly that the statute "clearly anticipates . . . [that] minority shareholders may be frozen out of continued participation in the merged corporation."¹⁰⁴

The approach taken by the Delaware courts was virtually indistinguishable from New York's. Soon after the 1957 amendments to Delaware's short-form merger statute,¹⁰⁵ a minority shareholder in Park & Tilford Distillers Corporation brought suit¹⁰⁶ to enjoin the short-form merger of Park & Tilford into Schenley Industries, alleging that the statute

99. The court reasoned that "[a] shareholder is not entitled to the continued protection of a statute requiring the merging corporation to own every outstanding share of the stock of the merged corporation," since the amended statute was only a "slight modification" of the preceding 100% ownership requirement, not sufficient to affect any of the shareholder's vested rights. *Id.* at 383-84, 5 N.Y.S.2d at 256.

100. 300 N.Y. 11, 87 N.E.2d 561 (1949).

101. In this case, Consolidated Edison was taking over Brooklyn Edison, in which it held about 99.6% of the latter's common stock. Plaintiffs were shareholders of Brooklyn Edison, owning only 59 shares, about 1/200 of 1% of the outstanding common stock. *Id.* at 17, 87 N.E.2d at 563.

102. *Id.* at 19, 87 N.E.2d at 564.

103. *Willcox v. Stern*, 18 N.Y.2d 195, 219 N.E.2d 401, 273 N.Y.S.2d 38 (1966). In this case, American Surety Company of New York had been merged into Transamerica Insurance Company, which held 97% of the common stock of American. Attacking the approval of the merger by the state Superintendent of Insurance, the plaintiff, owning less than 1/10 of 1% of American's common stock, sought to have the merger set aside. *Id.* at 199-200, 219 N.E.2d at 402-03, 273 N.Y.S.2d at 41-42.

104. *Id.* at 201, 219 N.E.2d at 404, 273 N.Y.S.2d at 43.

105. For discussion of the 1957 Delaware amendments, see text accompanying notes 19-24 *supra*.

106. *Coyne v. Park & Tilford Distillers Corp.*, 37 Del. Ch. 558, 146 A.2d 785 (1958), *aff'd*, 38 Del. Ch. 514, 154 A.2d 893 (Del. 1959).

was unconstitutional. The court of chancery upheld the constitutionality of the statute. In *Stauffer v. Standard Brands, Inc.*,¹⁰⁷ however, the validity of another Delaware short-form merger was attacked on the grounds of constructive fraud.¹⁰⁸ In dismissing the plaintiff's claim for equitable relief because the dispute was only as to value, the court noted:

Indeed it is difficult to imagine a case under the short merger statute in which there could be such actual fraud as would entitle a minority to set aside the merger. This is so because the very purpose of the statute is to provide the parent corporation with a means of eliminating the minority shareholder's interest in the enterprise This power of the parent corporation to eliminate the minority is a complete answer to plaintiff's charge of breach of trust¹⁰⁹

Thus, the Delaware court appears to have considered the statutory authorization for short-form merger and the availability of appraisal as sufficient to overcome nearly any charge of breach of the majority shareholder's fiduciary duty. This acceptability of "cashing out" the minority interests by giving them no option other than to receive cash, either by accepting the terms of the merger or by seeking appraisal, was reaffirmed in a later case.¹¹⁰

Although there were some suggestions in both New York¹¹¹ and Delaware¹¹² that majority fraud or illegality might result in equitable review of a short-form merger transaction, these remarks have been characterized as "hairline fractures" in the pro-majority shareholder approach of the courts.¹¹³ Indeed, this series of short-form merger cases would seem to indicate that the minority shareholders will be denied equitable relief and

107. 41 Del. Ch. 7, 187 A.2d 78 (1962).

108. Plaintiff's claim was that the cash offered by the acquiring corporation for each share of the subsidiary's stock was "so grossly inadequate as to constitute a constructive fraud upon the minority." *Id.* at 9, 187 A.2d at 80.

109. *Id.* at 10-11, 187 A.2d at 80. This was so even though in this case statutory appraisal was not available to the plaintiff because he had been absent from the country during the 20 day period in which he could have demanded appraisal. *Id.* at 9, 187 A.2d at 79.

110. *Carl Marks & Co. v. Universal City Studios, Inc.*, 43 Del. Ch. 391, 233 A.2d 63 (1967). This was the result even though plaintiff had lost the appraisal remedy by objecting incorrectly to the merger. *Id.* at 393, 233 A.2d at 64.

111. The court in *Willcox v. Stern*, 18 N.Y.2d 195, 204, 219 N.E.2d 401, 405-06, 273 N.Y.S.2d 38, 45 (1966) noted the general judicial principle that equity will act where there is illegality or fraud, but stated that the petition attacking the merger contained no factual support of fraud and did not consider the point further.

112. In *Stauffer v. Standard Brands, Inc.*, 41 Del. Ch. 7, 11, 187 A.2d 78, 80 (1962), the court noted that it was "unnecessary to hold that under no conceivable circumstances could a minority stockholder obtain relief for fraud."

113. *Lynch*, *supra* note 9, at 40.

limited strictly to their remedy of appraisal so long as the majority shareholder has complied with the literal statutory requirements in effecting the merger.

In large part, this seeming bias toward the majority shareholder's interest in these first short-form merger cases can be seen as reflecting the trend of corporate law in general over the past decades.¹¹⁴ Commentators have noted that state corporation codes generally have been made increasingly liberal toward the interests of controlling shareholders, gradually reducing the statutory protection offered the minority.¹¹⁵ The most prominent example is the degree to which the minority's power to prevent fundamental corporate changes, such as merger or amendment of corporate articles, has been diluted by lowering of voting requirements necessary for approval.¹¹⁶ In addition, the adoption of appraisal statutes has further deprived minority interests of protection they once enjoyed.¹¹⁷ It has not been unusual for courts as well to adopt a similar liberality toward management and controlling shareholders, especially through deferring to their "business judgment."¹¹⁸

In recent years there has been criticism voiced against "majority bias," with Delaware in particular being criticized for the increasing liberalism of its corporate code.¹¹⁹ The growing concern with fairness to the minority shareholders appears to be due in large part to the increase in minority eliminations in the 1970s, including the "going private" phenomenon which began in the early 1970s.¹²⁰ These factors appear to have prepared the way for a reconsideration of the rights of minority shareholders in freeze-out situations, and the courts have demonstrated concern over the growing problem of elimination of minority shareholders' interests.¹²¹

114. See Greene, *supra* note 73, at 489 n.7.

115. See, e.g., Eisenberg, *supra* note 82; Lynch, *supra* note 9. But see F. O'NEAL, *supra* note 24, § 7.08 (discussing significant restrictions still imposed by the California Corporate Code).

116. Lynch, *supra* note 9, at 24-25.

117. A number of cases have blocked judicial review of the fairness of corporate transactions because of the availability of appraisal. See, e.g., Blumenthal v. Roosevelt Hotel, Inc., 202 Misc. 988, 115 N.Y.S.2d 52 (Sup. Ct. 1952).

118. See, e.g., Meyerson v. El Paso Natural Gas Co., 246 A.2d 789, 794 (Del. Ch. 1967); Cheff v. Mathes, 41 Del. Ch. 494, 508, 199 A.2d 548, 556-57 (1964). See also Missouri cases cited note 190 *infra*.

119. See Carey, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663 (1974); Murdock, *Delaware: The Race to the Bottom—Is an End in Sight?*, 9 LOY. CHI. L.J. 643 (1978); Comment, *Law for Sale: A Study of the Delaware Corporation Law of 1967*, 117 U. PA. L. REV. 861 (1969).

120. See notes 73-76 and accompanying text *supra*.

121. See, e.g., Jones v. H.F. Ahmanson & Co., 1 Cal. 3d 93, 460 P.2d 464, 81 Cal. Rptr. 592 (1969); David J. Greene & Co. v. Schenley Indus., Inc., 281 A.2d 30 (Del. Ch. 1971).

Since the mid-1970s a number of cases have gradually developed an approach to these situations which promises to have a significant effect on the judicial evaluation of short-form mergers. Although a few earlier cases had examined the business reasons alleged for transactions affecting the minority shareholders,¹²² and respected comment had advocated such an approach to restrain majority abuse of corporate powers,¹²³ it was not until recently that many courts began to adopt a "business purpose test" in the merger context.¹²⁴

2. Recent Cases

Federal courts appear to have been quicker to recognize the threats posed to minority shareholders in merger situations, and to look to the business purposes involved in the transaction.¹²⁵ Although a series of cases involved questions of federal securities laws violations,¹²⁶ in the 1974 case

122. See, e.g., *Paine v. Saulsbury*, 200 Mich. 58, 166 N.W. 1036 (1918); *Matteson v. Ziebarth*, 40 Wash. 2d 286, 242 P.2d 1025 (1952); *Theis v. Spokane Falls Gas Light Co.*, 34 Wash. 23, 74 P. 1004 (1904).

123. See generally *Vorenberg*, *supra* note 85.

124. Courts had examined the business purpose of other types of transactions well before the 1970s, however. See, e.g., *Gregory v. Helvering*, 293 U.S. 465 (1935) (examining business purpose of a corporate reorganization).

125. *Lynch*, *supra* note 9, at 44.

126. See, e.g., *Green v. Sante Fe Indus., Inc.*, 533 F.2d 1283 (2d Cir. 1976), *rev'd*, 430 U.S. 462 (1977); *Marshel v. AFW Fabric Corp.*, 533 F.2d 1277 (2d Cir.), *vacated*, 429 U.S. 881 (1976); *Albright v. Bergendahl*, 391 F. Supp. 754 (D. Utah 1974). The significance of these cases lies in their interpretation of "fraud" under the Securities Exchange Act § 10(b), 15 U.S.C. § 78j(b) (1976), and Securities and Exchange Commission Rule 10b-5, 17 C.F.R. § 240.10b-5 (1980). *Sante Fe Industries* is illustrative in this regard. There the holders of about 95% of the stock of Kirby Lumber Company sought to eliminate the minority stockholders by causing a Delaware short-form merger of Kirby with a corporation which the majority shareholders had recently created. 533 F.2d at 1287-89. The minority shareholders brought suit, claiming that the short-form merger had no business purpose and constituted a breach of the majority shareholders' fiduciary duty to the minority. *Id.* at 1285. After examining the transaction, the Second Circuit agreed and held that the breach of fiduciary duty amounted to fraud under 10b-5. *Id.* at 1290.

The Supreme Court's hostile response to this line of reasoning appears, however, to have foreclosed the further use of such securities law attacks on short-form mergers. In *Sante Fe Indus., Inc. v. Green*, 430 U.S. 462 (1977), the Court held that a cause of action was stated under rule 10b-5 *only* if the majority's conduct amounted to manipulation or deception within the strict traditional meaning of these terms in the securities case law, and that breach of fiduciary duty by majority shareholders, absent any deception, misrepresentation, or non-disclosure, was *not* violative of rule 10b-5. *Id.* at 474-77.

of *Bryan v. Brock & Blevins Co.*,¹²⁷ the United States Court of Appeals for the Fifth Circuit interpreted a state merger statute in a squeeze-out dispute involving a closely held corporation. The 85% majority shareholders, unable to convince the recalcitrant 15% minority shareholder to sell out to them, attempted to squeeze him out through use of Georgia's long-form merger statute.¹²⁸ The majority first created a new corporation, Power Erectors, capitalizing it with their Brock & Blevins stock and taking 100% of the Power Erectors stock in exchange. Through their control of Power Erectors they then attempted to cause the merger of Brock & Blevins into Power Erectors. The terms of the merger would have left the minority stockholder with cash but no interest in the business.¹²⁹

The court of appeals sustained the district court's injunction against the merger.¹³⁰ Although the transaction complied fully with the terms of the Georgia statute, the court concluded that the merger statute must be read to imply the requirement of a proper business purpose before the statute could be utilized.¹³¹ Hence, the creation of a new corporation, "having no business purpose of its own and no pre-existing viability of any kind, solely for the purpose of effecting a 'freeze-out'"¹³² was not a valid use of the statute.

In the state courts, several cases indicate a similar willingness to at least inquire into the purpose for elimination of the minority shareholders by the majority. Most of these cases, however, fail to make it clear whether lack of a business purpose by the majority is enough, alone, to allow the court to grant equitable relief, or whether the added presence of evidence of other breaches of fiduciary duty is necessary. In 1975 a New Jersey court granted a temporary injunction against a proposed going-private merger in *Berkowitz v. Power/Mate Corp.*¹³³ Following a severe decline in the market price of Power/Mate stock, the "inside" majority shareholders had decided to eliminate the public shareholders through a merger with a shell corporation owned by themselves.¹³⁴ Despite findings of the major-

127. 490 F.2d 563 (5th Cir.), *cert. denied*, 419 U.S. 844 (1974).

128. GA. CODE ANN. § 22-1001 (1977) (amended 1977).

129. 490 F.2d at 567.

130. The district court granted an injunction against the merger on the theory that the defendants' use of the Georgia merger statute to freeze-out the plaintiff constituted a scheme to defraud and therefore violated federal securities law. *Bryan v. Brock & Blevins Co.*, 343 F. Supp. 1062, 1070 (N.D. Ga. 1972), *aff'd*, 490 F.2d 563 (5th Cir.), *cert. denied*, 419 U.S. 844 (1974). Thus, at the district court level, *Bryan* was one of the first of a series of federal cases using fiduciary standards to establish fraud in securities cases. See note 126 *supra*.

131. 490 F.2d at 570.

132. *Id.*

133. 135 N.J. Super. 36, 342 A.2d 556 (Ch. Div. 1975).

134. In 1968 Power/Mate had gone public with an issue of 110,000 shares priced at \$5 each. In that year, the price of the stock ranged between a high ask-

ity's disclosure of its plans, and full compliance with New Jersey's merger statute, the court went on to inquire into the fairness of the transaction to the minority stockholders.¹³⁵ Though finding it unnecessary to hold that the lack of a valid business purpose alone could invalidate a merger, the court clearly thought an injunction warranted when the lack was coupled with evidence of other breaches of fiduciary duty.¹³⁶

A series of cases in New York indicates that there as well the courts will examine the business purpose of a freeze-out transaction. In *People v. Concord Fabrics, Inc.*,¹³⁷ the Attorney General of New York sought a temporary injunction against a proposed going-private merger.¹³⁸ As in *Berkowitz*, there was evidence of other breaches of fiduciary duty,¹³⁹ but the "fact that no real corporate purpose has been demonstrated"¹⁴⁰ was one of the factors considered in granting the injunction. The 1976 case of *Clark v. Pattern Analysis & Recognition Corp.*¹⁴¹ involved an attempt by the majority shareholders of a close corporation to squeeze-out the minor-

ing price of \$21 per share, and a low bid of \$9; during 1975 the comparable figures were \$2.50 and \$.75. In 1975 the majority shareholders and directors of Power/Mate, who had retained control of about 69% of its stock, formed a new corporation, General, and contributed all their Power/Mate stock to it. They then proposed to merge Power/Mate into General for the admitted purpose of eliminating the public shareholders. *Id.* at 39-42, 342 A.2d at 568-70.

135. The court rejected the defendants' argument that any price in excess of the market price is fair and reasonable, noting that "there really is no market for the public stock, and hence the 'market price' may only be . . . an altogether fictitious concept." *Id.* at 49, 342 A.2d at 574.

136. The court noted that the majority admitted they intended to acquire the public stock at a price advantageous to themselves, that the timing of the merger suggested that the majority sought to obtain the stock at an unusually low price, and that the majority had clearly engaged in self-dealing transactions in effecting its plans. *Id.* at 48-49, 342 A.2d at 573-74.

137. 83 Misc. 2d 120, 371 N.Y.S.2d 550 (Sup. Ct.), *aff'd mem.*, 50 A.D.2d 787, 377 N.Y.S.2d 84 (1975).

138. *Concord Fabrics, Inc.*, had made public stock issues in 1968 and 1969 worth \$4,500,000 and \$4,000,000, respectively. The book value of the shares at offering was about \$7. By 1974, however, the market price had declined from a high of \$25 per share to \$1. In that year the controlling shareholders decided to regain full control of the company by merging it into a newly formed corporation and cashing-out the public shareholders at \$3 per share. The state then sought a temporary injunction against this merger on grounds of state securities law violations. *Id.*

139. The court noted that the shareholders directing the reacquisition were "the very ones who made the company public originally," that they had controlled the appraisal of the stock, and that the credit of the public corporation was to be used to finance the merger benefiting the control group. *Id.* at 125, 371 N.Y.S.2d at 554.

140. *Id.*

141. 87 Misc. 2d 385, 384 N.Y.S.2d 660 (Sup. Ct. 1976).

ity by use of a 4,000 to 1 reverse stock split. The court granted a temporary injunction, stating:

A minority shareholder . . . should not be relegated to an appraisal right solely by reason of the fact that an appraisal right exists. Where there is an allegation of fraud, illegality or bad faith, coupled with a tenuous showing of legitimate . . . business purpose, fairness requires that a minority shareholder be afforded an opportunity to fully contest the actions of the majority¹⁴²

In another 1976 case, *Tanzer Economic Associates, Inc. v. Universal Food Specialties, Inc.*,¹⁴³ similar principles were applied to a short-form merger transaction. Here, the Swiss company, Nestle, had been acquiring shares in the Libby food processing corporation since 1960. In 1975 the Nestle subsidiary holding 61% of the Libby stock made a tender offer for the remaining shares, announcing an intention to merge Libby into it if 90% of the shares were obtained.¹⁴⁴ The plaintiff sought an injunction against the proposed merger. Acknowledging the influence of both the "flood" of going-private transactions and the recent cases in the area,¹⁴⁵ the court concluded that there could be a basis for equitable intervention in a proposed short-form merger if the plaintiff could show evidence of fraud or illegality, concealment or nondisclosure of material facts, the merger being merely a device to disadvantage the minority and having no proper business purpose, or breach of fiduciary responsibility.¹⁴⁶ Only after an exhaustive review of the facts in relation to each of these four categories, especially business purpose,¹⁴⁷ did the court deny the injunction, finding that the plaintiff had not shown a strong likelihood of success at trial.¹⁴⁸ Thus, in this case, the plaintiff was still required to shoulder the burden of showing that no valid business purpose existed before the merger would be enjoined. The court, however, clearly treated lack of business purpose for the merger either as a separate cause of action, or as a special kind of breach of fiduciary duty sufficient by itself to invalidate the transaction.

The most significant development in the application of the business purpose test to mergers came in 1977. In that year, the Delaware Supreme

142. *Id.* at 390, 384 N.Y.S.2d at 664-65. *But see* *Teschner v. Chicago Title & Trust Co.*, 59 Ill. 2d 452, 322 N.E.2d 54 (1974), *appeal dismissed*, 422 U.S. 1002 (1975), in which the Illinois Supreme Court upheld a similar reverse stock split transaction used to freeze-out a minority shareholder.

143. 87 Misc. 2d 167, 383 N.Y.S.2d 472 (Sup. Ct. 1976).

144. *Id.* at 168-69, 383 N.Y.S.2d at 474-75.

145. "It became manifest that in some instances, some persons were taking undue advantage of their manipulative powers, and in recoil the courts were called upon to expand the . . . available remedies." *Id.* at 172, 383 N.Y.S.2d at 477.

146. *Id.* at 176, 383 N.Y.S.2d at 479.

147. *Id.* at 180-83, 383 N.Y.S.2d at 482-84.

148. *Id.* at 183, 383 N.Y.S.2d at 483.

Court handed down its decision in *Singer v. Magnavox Co.*,¹⁴⁹ which involved an attempt by North American Philips to acquire full control of Magnavox. North American first incorporated a subsidiary, Development, for the purpose of making a tender offer for Magnavox shares. Although the directors of Magnavox initially opposed the tender offer on the grounds of inadequate price, a compromise was reached¹⁵⁰ and they withdrew their opposition. Development thereafter acquired more than 84% of the outstanding Magnavox common stock.¹⁵¹ The proposed next step consisted of acquiring 100% of the equity interest in Magnavox by causing it to merge under the Delaware long-form statute into T.M.C., a shell corporation created by Development especially for this purpose.¹⁵² The directors of Magnavox unanimously agreed to the proposed merger and scheduled a special stockholder meeting to vote on the plan.¹⁵³ The shareholders were advised that nine dollars would be offered for the shares, which had a book value of slightly over ten dollars. They also were advised that the holdings of Development alone were sufficient to meet the statutory majority required for approval of the merger.¹⁵⁴ At the meeting the merger was approved.

Suit was then brought by shareholders alleging that the merger was fraudulent because it served no business purpose beyond removing the minority shareholders, and that the defendants had breached their fiduciary duty to the minority by approving the merger at an offering price which they knew to be grossly inadequate.¹⁵⁵ The court of chancery dismissed the complaint, finding that the merger did not need a valid business purpose so long as it complied with the statute and, that in any event, the shareholders were entitled only to seek statutory appraisal.¹⁵⁶

The Delaware Supreme Court reversed on those points.¹⁵⁷ After considering the prior case law and the facts, the court concluded that a major-

149. 380 A.2d 969 (Del. 1977).

150. Although the book value of Magnavox shares exceeded \$11 per share, the original tender offer was \$8. The compromise reached by the managements of Magnavox, North American, and Philips increased the offer price to \$9 per share, and gave two-year employment contracts to 16 Magnavox officers. *Id.* at 971.

151. *Id.*

152. *Id.*

153. Four of the nine Magnavox directors were North American directors as well, and three of the remaining five had employment contracts with Magnavox and options to purchase North American common stock, effective on the merger date. *Id.* at 972.

154. *Id.*

155. *Id.*

156. *Singer v. Magnavox Co.*, 367 A.2d 1349 (Del. Ch. 1976), *aff'd in part and rev'd in part*, 380 A.2d 969 (Del. 1977).

157. The chancery court, however, was upheld on its dismissal of the claim that the merger had been accomplished in violation of the Delaware Securities

ity stockholder owed a fiduciary duty to the minority stockholders,¹⁵⁸ and held that this duty to the minority could not be met "simply by relegating them to a statutory appraisal proceeding,"¹⁵⁹ because the shareholders had rights in the form as well as in the value of their investment.¹⁶⁰ In addition, the court concluded that "use of corporate power solely to *eliminate* the minority is a violation of that [fiduciary] duty"¹⁶¹ and that the complaint therefore stated "a cause of action for violation of a fiduciary duty for which the Court may grant such equitable relief as it deems appropriate under the circumstances."¹⁶²

Significantly, it appears that under *Singer* the burden is placed upon the majority shareholder to show a valid business purpose does exist, rather than upon the minority shareholder to show the lack of any such purpose.¹⁶³ Further, the court held that "the fiduciary obligation of the majority to the minority stockholders remains and proof of a purpose, other than such freeze-out, without more, will not necessarily discharge it."¹⁶⁴ Thus, even if the majority shareholder satisfies the court that it does indeed have a valid business purpose for its action, the court still will proceed to examine the transaction for its "entire fairness."¹⁶⁵ Should a violation of entire fairness be found, the court stated that it "will grant such relief as equity may require."¹⁶⁶

A month later in *Tanzer v. International General Industries, Inc.*,¹⁶⁷ the Delaware Supreme Court examined another case in which a parent corporation had cashed-out the minority shareholders in a subsidiary through long-form merger.¹⁶⁸ Although finding that the parent had in-

Act by issuing false and misleading proxy statements, the Delaware Supreme Court agreeing that subject matter jurisdiction was not established. *Singer v. Magnavox Co.*, 380 A.2d 969, 981-82 (Del. 1977).

158. *Id.* at 976-77.

159. *Id.* at 977.

160. *Id.* at 977-78. The court observed that the defendants' argument "assumes . . . that a dissenting stockholder has no legally protected right in his shares . . . or his company beyond a right to be paid fair value when the majority is ready to do this." *Id.*

161. *Id.* at 980.

162. *Id.*

163. *Id.*

164. *Id.*

165. *Id.*

166. *Id.*

167. 379 A.2d 1121 (Del. 1977).

168. International General Industries (IGI) already owned 81% of the stock of Kliklok, when IGI formed KLK Corporation for the purpose of merging KLK into Kliklok and acquiring the entire interest in Kliklok. The minority shareholders of Kliklok sought to enjoin the merger, alleging that its sole purpose was to serve the interest of IGI. *Id.* at 1122.

deed demonstrated a bona fide business purpose for the transaction,¹⁶⁹ the court stressed that the parent's "interest must not be suspect as a subterfuge, the real purpose of which is to rid itself of unwanted minority shareholders,"¹⁷⁰ and remanded the case for a hearing on the "entire fairness" of the transaction as a whole.¹⁷¹

In the following year, the court of chancery followed *Singer* in granting a permanent injunction against a proposed long-form merger.¹⁷² Finding that the basic purpose of the transaction was to eliminate the minority shareholders,¹⁷³ the court declined to even consider the overall fairness of the transaction to the minority, suggesting that the price offered for the minority's shares was irrelevant.¹⁷⁴

The reasoning of *Singer* has been specifically applied in two Delaware cases dealing with short-form merger. In *Kemp v. Angel*,¹⁷⁵ the court of chancery granted a preliminary injunction against a proposed short-form merger, the chancellor observing that in light of the strict standards of fiduciary duty imposed upon the majority shareholder by *Singer* he could see no reason why a short-form merger should receive less scrutiny than one done under the long-form statute.¹⁷⁶ *Najjar v. Roland International Corp.*,¹⁷⁷ involving a motion to dismiss a complaint attacking the validity of a short-form merger, dealt more directly with the validity of *Stauffer v. Standard Brands, Inc.*¹⁷⁸ after *Singer*. Although the defendants contended that *Singer* applied solely to long-form mergers, the chancellor concluded that its principles applied to short-form mergers as well. In reaching this conclusion, he noted that the Delaware Supreme Court in *Singer* had not read *Stauffer* "'as approving a merger accomplished . . . [under the short-form statute] solely to freeze-out the minority without a valid business purpose,'"¹⁷⁹ and that *Singer* and *Tanzer* had been worded broadly, requiring entire fairness as well as a business purpose.¹⁸⁰

169. The only reason given for the merger was that the elimination of the minority shareholders would facilitate long-term debt financing by IGI. *Id.* at 1124-25.

170. *Id.* at 1124.

171. *Id.* at 1125.

172. *Young v. Valhi, Inc.*, 382 A.2d 1372 (Del. Ch. 1978).

173. *Id.* at 1378.

174. *Id.*

175. 381 A.2d 241 (Del. Ch. 1977).

176. *Id.* at 244.

177. 387 A.2d 709 (Del. Ch. 1978), *aff'd*, 407 A.2d 1032 (Del. 1979).

178. 41 Del. Ch. 7, 187 A.2d 78 (1962). See notes 107-09 and accompanying text *supra*, for discussion of *Stauffer*.

179. 387 A.2d at 712 (quoting *Singer v. Magnavox Co.*, 380 A.2d 969, 978 (Del. 1977)).

180. 387 A.2d at 712-13.

3. Application to Short-Form Mergers

Viewed together, this series of cases suggests a significant change in the approach taken by courts to the problem of transactions in which the minority shareholders are eliminated by the majority. All indicate that the majority shareholder's mere technical compliance with the corporate code is no longer sufficient to insulate the transaction from review, and that the availability of appraisal will not automatically bar equitable relief. Likewise, all indicate that in its review the court will be willing to examine closely the majority's business purpose in effecting the transaction, and the language of several cases¹⁸¹ would apparently allow the absence of a business purpose alone, without allegations of overreaching or other breaches of fiduciary duty, to invalidate the merger. The logic of *Singer* goes beyond this position and requires the majority to show that the whole transaction was fair to the minority shareholders, an astonishing change compared to *Stauffer* and the other early cases.

It has been argued that this approach should not be applied to short-form merger cases.¹⁸² The main tenet of this argument is that the legislative intent of short-form merger statutes was to facilitate the freezing-out of the minority shareholders in a situation where the majority shareholder had the votes to approve the merger at a shareholders' meeting anyway. Indeed, short-form merger statutes do differ significantly from long-form merger statutes, requiring no advance notice, no shareholder vote, and no approval by the board of directors of the acquired corporation.¹⁸³ Viewing these differences as substantive rather than procedural, this line of reasoning concludes that:

these differences . . . evidence a legislative determination that when the percentage of ownership of a . . . corporation reaches 90 per cent or more, the law . . . [should] conclusively presume that the parent has a legitimate and proper purpose in obtaining a 100 per cent ownership by means of a merger, and that the fiduciary duty owed to the minority is satisfied so long as the minority shareholders receive fair value for their shares.¹⁸⁴

181. See, e.g., *Singer v. Magnavox Co.*, 380 A.2d 969 (Del. 1977); *Young v. Valhi, Inc.*, 382 A.2d 1372 (Del. Ch. 1978); *Tanzer Economic Assocs., Inc. v. Universal Food Specialties, Inc.*, 87 Misc. 2d 167, 383 N.Y.S.2d 472 (Sup. Ct. 1976).

182. See *Najjar v. Roland Int'l Corp.*, 387 A.2d 709, 711-12 (Del. Ch. 1978) (discussing the arguments made by the defendants), *aff'd*, 407 A.2d 1032 (Del. 1979).

183. Compare DEL. CODE ANN. tit. 8, § 251 (1974 & Cum. Supp. 1978) (Delaware's long-form merger statute) with DEL. CODE ANN. tit. 8, § 253 (1974 & Cum. Supp. 1978) (Delaware's short-form merger statute).

184. *Najjar v. Roland Int'l Corp.*, 387 A.2d 709, 711 (Del. Ch. 1978) (summarizing the defendants' arguments), *aff'd*, 407 A.2d 1032 (Del. 1979).

The argument in behalf of imposing fairness requirements in cases arising under short-form merger statutes stresses that prior to the enactment of such statutes, subsidiaries merged into parent corporations for business reasons, and that the use of mergers solely for the elimination of minority interests is not within the history of merger practices.¹⁸⁵ Thus, the purpose of short-form merger statutes is not to allow the unrestrained elimination of minority interests, but rather to allow corporations to alter the minority's interest only as a merger undertaken for good business reasons may require.¹⁸⁶ Further, the fact that control of a corporation is highly concentrated does not mean that problems of fiduciary duty are no longer present.

Whether the Missouri courts will adopt some form of the business purpose test in interpreting Missouri's short-form merger statute is mere speculation. Unlike some states,¹⁸⁷ Missouri's appraisal statutes,¹⁸⁸ like those of Delaware,¹⁸⁹ do not block the business purpose test by specifying that the appraisal remedy is exclusive in merger situations. Further, there appear to be no cases in related corporate areas which foreclose applying this test in statutory merger transactions. Although Missouri courts have deferred to business judgment in the past,¹⁹⁰ they also have recognized the

185. Lynch, *supra* note 9, at 38-39.

186. *Id.*

187. See, e.g., PA. STAT. ANN. tit. 15, § 1515.K (Purdon 1967), Pennsylvania's appraisal statute, which provides that "shareholders . . . dissenting shall have the rights and remedies herein provided, shall be limited to the rights and remedies prescribed under this section, and the rights and remedies prescribed by this section shall be exclusive." The court in *In re Jones & Laughlin Steel Corp.*, ___ Pa. Super. Ct. ___, ___, 398 A.2d 186, 193 (1979), held that in light of the statute's language, appraisal was the exclusive remedy for public shareholders frozen-out in a merger transaction.

188. RSMO § 351.405 (Cum. Supp. 1980) (regarding shareholders who dissent to a sale or exchange of corporate assets); RSMO § 351.455 (1978) (regarding shareholders who dissent to a merger).

189. DEL. CODE ANN. tit. 8, § 262 (Cum. Supp. 1978).

190. See *Brown v. Citizens' State Bank*, 345 Mo. 480, 488-89, 134 S.W.2d 116, 121 (1939) (indicating that equity will not review judgment of majority shareholders in the absence of a wanton or fraudulent injury to the rights of the minority shareholders); *Putnam v. Juvenile Shoe Corp.*, 307 Mo. 74, 92, 269 S.W. 593, 597 (En Banc 1925) ("Courts will not substitute their judgment for that of the [majority] stockholders as to what is good business policy, . . . absent evidence of fraud upon minority stockholders."); *Jackson v. St. Regis Apartments, Inc.*, 565 S.W.2d 178, 183 (Mo. App., St. L. 1978) (absent fraud or oppression, court should not substitute its judgment for that of those controlling the corporation); *Golden v. St. Joseph Milk Producers' Ass'n*, 420 S.W.2d 31, 33 (Mo. App., K.C. 1967); *Bates v. Werries*, 198 Mo. App. 209, 221, 199 S.W. 758, 762 (K.C. 1917).

applicability of fiduciary standards to majority shareholders.¹⁹¹

Even should Missouri choose to follow this line of cases, there are still key issues which a court would find not yet fully resolved. First, if a business purpose is required, it is not clear whether it is required merely for the merger itself, or for the freeze-out of the minority shareholders, or for both.¹⁹² Obviously, the minority shareholders would prefer that a business purpose had to be shown for the actual freeze-out, while the majority would rather only have to justify the basic merger transaction. Second, there remains the question of whether the business purpose the court is supposed to evaluate is that of the parent corporation or that of the subsidiary.

The analysis by the Delaware Supreme Court in *Tanzer v. International General Industries, Inc.*,¹⁹³ probably comes closest to addressing these problems. There, the court apparently directed its attention more closely to the justification for the freezing-out of the minority shareholders, rather than to the purpose of the merger per se, noting that the majority shareholder's "interest must not be suspect as a subterfuge, the real purpose of which is to rid itself of unwanted minority shareholders in the subsidiary."¹⁹⁴ This approach has much to recommend it, because in many cases it is not the merger which injures the minority, but only the freeze-out itself.¹⁹⁵ In addition, the court devoted a lengthy discussion to the interests of the parent corporation, attempting to resolve the question of whether the parent could cause the merger to be made solely for its own benefit.¹⁹⁶ In concluding that the parent corporation as majority stockholder could vote its stock in behalf of its own interests, provided they were bona fide interests,¹⁹⁷ the court endorsed implicitly the examination of the

191. Although the cases cited at note 190 *supra* deferred to the business judgment of the majority shareholders, they also recognized that the majority probably owed a fiduciary duty to the minority and that equity would examine the majority's conduct under some circumstances. See also *Fix v. Fix Material Co.*, 538 S.W.2d 351 (Mo. App., St. L. 1976). There the court stated that "[s]hareholders in control are under a fiduciary duty to refrain from using their control . . . to produce corporate action of any type that is designed to operate unfairly to the minority." *Id.* at 358.

192. See *Singer v. Magnavox Co.*, 380 A.2d 969, 980 n.11 (Del. 1977), where the Delaware Supreme Court noted the problem but declined to consider it because it was not central to the case.

193. 379 A.2d 1121 (Del. 1977).

194. *Id.* at 1124.

195. See, e.g., *Bryan v. Brock & Blevins Co.*, 490 F.2d 563 (5th Cir.), *cert. denied*, 419 U.S. 844 (1974), in which the merger of the original company into a shell corporation had no real effect upon the assets or operation of the enterprise, the plaintiff being injured only when he was required to give up his equity interest under the terms of the merger agreement.

196. 379 A.2d at 1124.

197. *Id.*

parent's business purposes rather than that of the subsidiary.

To date the cases have failed to resolve fully the problem of the burden of proof. While earlier cases indicated that the party challenging the merger bore the burden of showing that the majority's action was improper,¹⁹⁸ *Singer* seemed to indicate that once a fiduciary relationship was shown, the burden fell upon the majority to prove that their action was proper.¹⁹⁹ Although Missouri courts have not yet dealt with this question in relation to a short-form merger, several cases involving other conflicts between majority and minority shareholders strongly suggest that the minority will bear at least the initial burden of showing fiduciary misconduct.²⁰⁰

Another troublesome problem which still awaits resolution is the uncertainty as to what constitutes a valid business purpose.²⁰¹ Although judges have occasionally hypothesized what might be valid reasons for corporate mergers,²⁰² there are few actual holdings on this point. In *Tanzer Economic Associates, Inc. v. Universal Food Specialties, Inc.*,²⁰³ however, a New York lower court enumerated a lengthy list of business purposes the court considered as justifying the acquisition merger of two companies in related fields.²⁰⁴ These included: improved corporate planning, mutual availability of the management experience of each company, economic savings from centralized purchasing of raw materials, economic savings from joint distribution and advertising, avoidance of duplicative management functions, a stronger financial position for both companies with less dependence on outside financing, avoidance of possible conflicts of interest, and avoidance of possible charges by minority shareholders of overreaching in the future.²⁰⁵ The court, however, assigned no weight to any of the individual factors, making it difficult to predict their relative impor-

198. See *Tanzer Economic Assocs., Inc. v. Universal Food Specialties, Inc.*, 87 Misc. 2d 167, 176, 383 N.Y.S.2d 472, 479 (Sup. Ct. 1976).

199. See *Singer v. Magnavox Co.*, 380 A.2d 969, 980 (Del. 1977).

200. The cases in Missouri suggest that although the majority shareholders do assume the status of fiduciaries with regard to the minority shareholders, the minority is not relieved of the burden of proving that misconduct has occurred. See *Jarvis v. Boatmen's Nat'l Bank*, 478 S.W.2d 266, 273-74 (Mo. 1972); *Jackson v. St. Regis Apartments, Inc.*, 565 S.W.2d 178, 182 (Mo. App., St. L. 1978). This burden, however, may apparently be shifted to the majority to show no unfair profit was made, once the plaintiffs show the existence of a transaction between the corporation and the majority shareholders. See *Ramacciotti v. Joe Simpkins, Inc.*, 427 S.W.2d 425, 431-32 (Mo. 1968); *Yax v. DIT-MCO, Inc.*, 366 S.W.2d 363, 367 (Mo. 1963).

201. Greene, *supra* note 73, at 500.

202. See *Green v. Santa Fe Indus., Inc.*, 533 F.2d 1283, 1308 (2d Cir. 1976) (Moore, J., dissenting), *rev'd*, 430 U.S. 462 (1977).

203. 87 Misc. 2d 167, 383 N.Y.S.2d 472 (Sup. Ct. 1976).

204. *Id.* at 182, 383 N.Y.S.2d at 483.

205. *Id.*

tance. Two other state cases²⁰⁶ and a federal short-form merger case²⁰⁷ also have indicated that the economic benefits resulting from the merger of two corporations engaged in related lines of business constituted valid business reasons, on the facts before those courts.

Although expressing views differing somewhat from the preceding business reasons, commentators also have discussed a number of justifications alleged for allowing the elimination of minority shareholders in non-acquisition transactions, such as "going private." It has been said that these transactions may result in an increase of the value of the stock in the "new" enterprise,²⁰⁸ making it easier to use stock incentive plans to attract better management.²⁰⁹ In addition, if a formerly public corporation reduces the number of its shareholders below 300, it may be able to "de-register" from the reporting requirements of the Securities Exchange Act of 1934,²¹⁰ thereby eliminating the expense of periodic reports to the SEC.²¹¹ The corporation also may be able to avoid the disclosure requirements imposed by the federal securities laws, requirements which can result in the disclosure of business secrets and can impose extensive liability upon the corporation and its management.²¹²

IV. REMEDIES AVAILABLE TO MINORITY SHAREHOLDERS

A. *Appraisal*

If a minority shareholder in a corporation being acquired in a short-form merger refuses to accept the terms offered by the acquiring corporation, the shareholder's most obvious remedy is still statutory appraisal, even if equitable relief is available. Exclusively a creation of statute,²¹³ ap-

206. *Tanzer v. International Gen. Indus.*, 379 A.2d 1121, 1124-25 (Del. 1977) (court still remanded the case for a hearing on the fairness of the merger to the minority shareholders); *Schulwolf v. Cerro Corp.*, 86 Misc. 2d 292, 297-98, 380 N.Y.S.2d 957, 962 (Sup. Ct. 1976).

207. *Grimes v. Donaldson, Lufkin & Jenrette, Inc.*, 392 F. Supp. 1393, 1402 (N.D. Fla. 1974), *aff'd mem.*, 521 F.2d 812 (5th Cir. 1975).

208. Comment, *Protection of Minority Shareholders from Freezeouts Through Merger*, 22 WAYNE L. REV. 1421, 1444-45 (1976).

209. *Brudney*, *supra* note 73, at 1034.

210. The Securities Exchange Act of 1934, § 12(b), 15 U.S.C. § 78L(g)(1)(B) (1976), requires that corporations with total assets exceeding \$1,000,000 and having a class of equity securities held of record by more than 500 persons register with the SEC and comply with the reporting requirements of the 1934 Act. The Securities Exchange Act of 1934, § 12(b), 15 U.S.C. § 78L(g)(4) (1976), however, allows a reporting corporation to terminate this registration if the number of holders of its equity securities drops below 300.

211. See Comment, *supra* note 208, at 1439-40.

212. *Borden*, *supra* note 73, at 1008-13.

213. *Manning*, *supra* note 81, at 226.

praisal allows shareholders who comply with the statutory procedure to negotiate with the acquiring corporation over the price of their shares and, if agreement cannot be reached, to have a court decide the value of the shares.²¹⁴ These statutes were enacted apparently to protect minority shareholders and to compensate them for a diminished ability, under more liberal corporate codes, to halt mergers.²¹⁵

Since the appraisal right is for the minority shareholder's protection, should he ever forego relief under the statutes and pursue different remedies? Several commentators have suggested that the number of defects in the protection offered by appraisal statutes might justify alternative relief.²¹⁶ First, the intricate procedural requirements of the statutes make appraisal a complicated and technical remedy.²¹⁷ Indeed, the courts have been exceedingly strict in their interpretation of the appraisal procedure,²¹⁸ denying relief to dissenters who fail to observe the procedure precisely, even though without appraisal the shareholder would have no alternative but to accept the merger terms.²¹⁹ This technical emphasis has

214. In Missouri, the first steps of the appraisal process are dictated by the short-form merger statute itself, RSMO § 351.447.3 (Cum. Supp. 1980). Within 10 days after the merger has become effective, the surviving corporation must notify each shareholder of this event. Any of these shareholders is given only 20 days after the mailing of the notice to make a written demand upon the surviving corporation for payment of the value of his shares, if he does not wish to accept the proposed terms of the merger. The demand for value, however, must be "exclusive of any element of value arising from the expectation or accomplishment of the merger." After this 20-day demand period, the dissenting shareholders and the surviving corporation are given 30 days to agree upon a value for the shares. If they fail to reach an agreement, then RSMO § 351.455.3 (1978) applies. RSMO § 351.447.3 (Cum. Supp. 1980).

Under RSMO § 351.455.3 (1978), the dissenting shareholder has 60 days in which to file a petition for appraisal with the circuit court in the county in which the surviving corporation is registered. If he fails to file within the 60-day period, he will be bound by the terms of the merger. If a petition is timely filed, the shareholder will be entitled to a judgment against the surviving corporation for the fair value of the shares immediately before the merger. RSMO § 351.455.3 (1978). This judgment must exclude any element of value due to the merger. RSMO § 351.447.3 (Cum. Supp. 1980).

215. Lynch, *supra* note 9, at 53.

216. See generally Manning, *supra* note 81; Vorenberg, *supra* note 85; Note, *Valuation of Dissenters' Stock Under Appraisal Statutes*, 79 HARV. L. REV. 1453 (1966).

217. See note 214 *supra*. See also Manning, *supra* note 81, at 231.

218. See Manning, *supra* note 81, at 231.

219. See, e.g., *Carl Marks & Co. v. Universal City Studios, Inc.*, 43 Del. Ch. 391, 233 A.2d 63 (1967) (letter objecting to merger held not to constitute "demand for payment" necessary to invoke appraisal, plaintiff left to accept terms of short-form merger); *Stauffer v. Standard Brands, Inc.*, 41 Del. Ch. 7, 187 A.2d

caused the procedure to grow long and expensive,²²⁰ reducing the value of the shareholder's eventual recovery²²¹ and making appraisal "a remedy of desperation."²²²

Further, there is a very real question whether the courts can actually arrive at the value of the minority's shares. The appraisal statutes are vague as to just what "value" is,²²³ and the courts have resorted to a number of different valuation methods in judging the worth of stocks, such as calculating capitalized earnings, dissolution value, going-concern value, replacement cost of the particular corporation, or by comparing other corporations.²²⁴ Even if the minority shareholder were assured of receiving the exact cash value of his shares, he still would be forced to incur costs and expenses, which the majority does not incur, as the result of receiving a lump cash payment for his shares.²²⁵

In addition, Missouri's appraisal provisions explicitly foreclose the dissenting shareholders from recovering any element of value generated by the merger.²²⁶ Since the freeze-out itself may well increase the value of the corporation to the remaining shareholders,²²⁷ the ejected minority shareholders are further disadvantaged in comparison to the majority. It has been argued that the majority should be compelled to share this gain under fiduciary principles,²²⁸ but this is clearly not the object of an appraisal proceeding.²²⁹ It also has been noted that the appraisal statutes fail to recognize the possibility that the majority may purposely choose a time for the freeze-out transaction which they know from inside data will reflect

78 (1962) (plaintiff's failure to demand appraisal during 20-day appraisal period not excused by his absence from the country; plaintiff left to accept terms of short-form merger). *See also* Vorenberg, *supra* note 85, at 1201.

220. *See* Manning, *supra* note 81, at 231.

221. *See* Vorenberg, *supra* note 85, at 1201-04.

222. Eisenberg, *supra* note 82, at 85.

223. *See* Manning, *supra* note 81, at 231.

224. *Id.* at 232. It is not clear which valuation method would be used by Missouri courts. In *Dreiseszun v. FLM Indus., Inc.*, 577 S.W.2d 902 (Mo. App., W.D. 1979), the court stated that there was no single formula for determining the fair value of corporate stock and noted that "[e]ach case presents different elements of value and each must be viewed separately." *Id.* at 907. In this case, the court reversed the trial court's award of \$23 per share to the dissenting minority shareholders, the amount originally offered to the minority, and ordered the trial court to compute the pro rata value of the dissenters' stock based upon the actual amount offered for the majority shareholder's stock by the acquiring corporation. *Id.* at 910.

225. *See* notes 77-79 and accompanying text *supra*. *See also* Brudney, *supra* note 73, at 1023.

226. *See* text accompanying note 43 *supra*.

227. *See* Brudney, *supra* note 73, at 1025 n.24.

228. *See generally* Brudney & Chirelstein, *supra* note 60.

229. *Id.* at 305. *See also* text accompanying note 43 *supra*.

an unrealistically low valuation, thereby allowing the majority to use the limitations of appraisal to their own advantage.²³⁰

B. *Equitable Remedies*

In view of the drawbacks presented by the appraisal remedy, it is clear why minority shareholders might prefer the broad discretion which courts may exercise under equity principles. Although the area of equitable remedies in freeze-out cases has not been explored thoroughly, there would appear to be several potentially useful remedies for the minority shareholders to seek. A preliminary injunction preventing the merger from proceeding further until a court is able to consider the merits of the case has obvious advantages for the minority shareholders since it may be obtained before the merger has gone so far that the damage to the minority shareholders cannot be easily undone.²³¹ While the remedy of preliminary injunction against freeze-out mergers has been criticized for placing too large a burden on the acquiring corporation, and for producing more litigation than the appraisal remedy,²³² the analysis required in such cases does not seem to be much different than that required in other sorts of temporary injunction cases.²³³ A subsequent permanent injunction against the merger may benefit the minority shareholders in most cases because it leaves their interest as it was before the transaction which injured them.

An alternative to this injunctive relief would be to award the minority shareholders damages for any injury they suffered because of oppressive conduct by the majority shareholder.²³⁴ While damage suits have been criticized for raising the same problems of valuation and expense as statutory appraisal,²³⁵ such suits would apparently free the courts from the statutory requirement in appraisal proceedings that any increase in stock value resulting from the merger be ignored.²³⁶ Indeed, it has been strongly urged that courts require the majority shareholders to share such gains with the frozen-out minority shareholders,²³⁷ thereby removing much of the incentive for oppression of the minority. Other alternatives might be for the court to order that the minority shareholders be allowed to obtain

230. Brudney & Chirelstein, *supra* note 60, at 305-06.

231. *See* Kemp v. Angel, 381 A.2d 241 (Del. Ch. 1977) (granting preliminary injunction against proposed short-form merger).

232. Greene, *supra* note 73, at 506.

233. *See* Tanzer Economic Assocs., Inc. v. Universal Food Specialties, Inc., 87 Misc. 2d 167, 383 N.Y.S.2d 472 (Sup. Ct. 1976).

234. *See* Baker v. Commercial Body Builders, Inc., 264 Or. 614, 633, 507 P.2d 387, 396 (1973).

235. Greene, *supra* note 73, at 505.

236. *See* note 214 *supra*.

237. *See generally* Brudney & Chirelstein, *supra* note 60.

an equity interest in the merged corporation²³⁸ or that the majority stockholder purchase the stock at such a price and in such a manner as to prevent adverse tax consequences to the minority stockholders.²³⁹

V. CONCLUSION

It is too early to discern what approach Missouri courts will take when examining a challenged short-form merger. The trend in other states suggests that Missouri courts ought to be willing to examine the business purpose behind the transaction. This possibility should be explored both by majority shareholders planning to use the device of short-form merger as well as by minority shareholders exposed to it.

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238. This remedy would be similar to that of allowing an oppressed minority shareholder, whose stock holdings have been diluted by the majority's actions, to purchase additional stock in the corporation. See *Baker v. Commercial Body Builders, Inc.*, 264 Or. 614, 633, 507 P.2d 387, 396 (1973).

239. Courts have been willing in some cases of minority oppression to order a corporation or the majority of its shareholders to buy the minority's stock under conditions specified by the court. See *Hornstein, A Remedy for Corporate Abuse*, 40 COLUM. L. REV. 220, 237-38 (1940).