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DELAWARE REVERSES ITS TREND IN GOING-PRIVATE TRANSACTIONS: THE FORGOTTEN MAJORITY

I. INTRODUCTION

Going-private transactions have become increasingly popular as corporations weary of wearing public smiles have sought the relative seclusion of private corporate existence. Basically, reversion to private status is accomplished by reducing the number of shareholders in the corporation to less than 300, thereby enabling the corporation to deregister with the Securities and Exchange Commission (SEC) under section 12 of the Securities Exchange Act of 1934 (the Exchange Act).[1] Because the going-private transaction necessarily involves elimination of the minority shareholders from the corporation, its rise in popularity has been accompanied by a growing judicial concern for the rights of the ousted minority shareholders.[2]

Two divergent approaches have emerged to provide protection for the eliminated minority shareholders. The valuation approach,[3] embodied in the appraisal statutes,[4] maintains that the shareholder's right in going-private transactions lies exclusively in the value of his investment. The second approach is rising in popularity. Based on a property conception of shareholder rights,[5] this approach gives the shareholder the right to remain within the corporation.[6] The right to remain within the corporation, however, is not considered absolute and may be overridden under certain conditions, for instance, if the majority can demonstrate either a valid business purpose for the transaction or the entire fairness of the transaction.

1. Securities Exchange Act of 1934 § 12(g)(4), 15 U.S.C. § 78*l*(g)(4) (1970).

2. *See, e.g.*, Berkowitz v. Power/Mate Corp., 135 N.J. Super. 35, 342 A.2d 566 (Super. Ct. 1975); Tanzer Economic Assocs. v. Universal Food Specialities, Inc., 87 Misc. 2d 167, 383 N.Y.S.2d 472 (1976). *See also* note 67 *infra*.

3. The term "valuation approach" is used here for convenience. Cases utilizing the valuation approach include: Grimes v. Donaldson, Lufkin & Jenrette, Inc., 392 F. Supp. 1393 (N.D. Fla. 1974) (applying Delaware law); David J. Greene & Co. v. Schenley Indus., 281 A.2d 30 (Del. Ch. 1971); Stauffer v. Standard Brands, Inc., 178 A.2d 311 (Del. Ch.), *aff'd*, 187 A.2d 78 (Del. 1962).

4. *See, e.g.*, DEL. CODE tit. 8, § 262 (Supp. 1976).

5. *See* notes 214-34 *infra* and accompanying text.

6. *Id.*

Delaware has recently joined in this trend toward the development of minority shareholder protections which extend beyond providing fair value for the minority's shares and which may be termed "extra-valuation protections." In *Singer v. Magnavox Co.*[7] the Delaware Supreme Court adopted a business purpose test and a fairness hearing for going-private transactions.

Extra-valuation protections in going-private transactions allow the minority shareholder to enjoin or void the transaction which, if consummated, would result in his elimination from the on-going enterprise.[8] In effect, such protections give the shareholder a contingent right of continued participation within the corporation.[9] The recognition of a right of continued participation necessarily results in an increase in shareholder litigation,[10] a delay in the consummation of business transactions requiring expedition,[11] and an impairment of the majority shareholders' voting rights.[12] Thus, the validity of extra-valuation protections warrants careful examination. It should be noted at the outset that although extra-valuation protections are intended to achieve a balance between the competing interests of the minority and majority shareholders,[13] such a balance is very difficult to achieve. Either the majority vote approving the transaction is given effect immediately or it is subject to judicial scrutiny. Conversely, either the minority must abide by the decision approved by the majority[14] and authorized by statute[15] or the minority is given the power to at least delay[16] and at most veto[17] the transaction.

In the rush to protect the over-powered minority, the majority shareholder's rights have been neglected. Should the minority prevail in obtaining injunctive relief, the corporation must remain public. The

7. 380 A.2d 69 (Del. 1977).

8. *See, e.g.*, Bryan v. Brock & Blevins Co., 490 F.2d 563 (5th Cir.), *cert. denied*, 419 U.S. 844 (1974); Albright v. Bergendahl, 391 F. Supp. 754 (D.C. Utah 1974); Singer v. Magnavox Co., 380 A.2d 969 (Del. 1977); Berkowitz v. Power/Mate Corp., 135 N.J. Super. 35, 342 A.2d 566 (Super. Ct. 1975).

9. *See* note 208 *infra* and accompanying text.

10. *See, e.g.*, text accompanying note 185 *infra*.

11. Gibson, *How Fixed Are Class Shareholder Rights?*, 23 L. & CONTEMP. PROB. 283, 285 (1958).

12. *See* notes 236-41 *infra* and accompanying text.

13. *See* Comment, *The Second Circuit Adopts a Business Purpose Test for Going Private: Marshel v. AFW Fabric Corp. and Green v. Santa Fe Industries, Inc.*, 64 CALIF. L. REV. 1184, 1208 (1976) [hereinafter cited as *Second Circuit*].

14. *See* notes 238-39 *infra* and accompanying text.

15. *Id.*

16. The minority may delay the consummation of the transaction simply by bringing suit.

17. If the minority prevails in obtaining an injunction or voidance of the merger, they have effectively overridden the majority's vote.

majority shareholder would thus be bound by a judicially imposed "business judgment" which may be questionable. Moreover, the option of withdrawing his investment from the corporation may be fraught with difficulties. For unless his stock is sold in one transaction, the inundation of the market with his large holdings may deflate the value of his shares. Nor may this deflation in market price be alleviated through an appraisal proceeding, since this remedy, which assures fair value to disgruntled minority shareholders in merger transactions, is not available to the majority shareholder whose merger transaction has been thwarted.[18] Even if the majority shareholder is able to sell his holdings for a satisfactory price, he may find himself liable under the insider trading provisions of section 16(b) of the Exchange Act.[19]

Aside from the failure to take into account these undesirable consequences, the critical flaw in the reasoning behind extra-valuation protections is that the nature of the shareholder's interest to be terminated is essentially economic[20] and, as such, may be compensated by fair valuation. Thus, there is simply no justification for the provision of injunctive relief.

Following an examination of the methods and motivations for the current prevalence of going-private transactions, this comment will focus critically on the recent rejection of the valuation approach and the concomitant adoption of extra-valuation protection for minority shareholders by the Delaware Supreme Court in *Singer*. The emphasis will be on the circular reasoning used by the *Singer* court in order to adopt extra-valuation protections which are inconsistent with legislative intent, case precedents, and policy considerations, as well as the factual uniquities of the case. Finally, it will be argued that because extra-valuation protections (1) do not reflect the nature of the shareholder's interest in the corporation, (2) infringe upon shareholder democracy tenets, and (3) impede corporate flexibility, they should be rejected. Instead, the remedy for the eliminated minority shareholders in going-private transactions should be limited to fair valuation of their stock.

II. METHODS AND MOTIVATION

A. *Going-Private Transactions Utilizing the Merger Technique*

Mergers which result in the involuntary elimination of the minority shareholders' interests in the corporation are characterized as freeze-outs

18. *See, e.g.*, DEL. CODE tit. 8, § 262 (Supp. 1976).
19. 15 U.S.C. § 78p (1970).
20. *See* notes 224-26 *infra* and accompanying text.

or squeeze-outs.[21] They are typically accomplished in the following manner: first, the majority shareholders transfer all of their stock in the target company[22] to a "shell" corporation[23] in exchange for 100% of the "shell" corporation's stock; second, the target company is merged into the shell corporation with the remaining public shareholders of the target company receiving cash or newly created debt securities[24] in exchange for their interest in the merged company.

Frequently, the merger is preceded by a tender offer through which the majority shareholders acquire a substantial percentage of the outstanding shares of the target company. Although all mergers require approval by the board of directors,[25] the necessity of shareholder approval is dependent upon the percentage of outstanding shares the majority shareholders have acquired. In Delaware, the short-form merger dispenses with the requirement of shareholder approval where the majority shareholders have acquired ninety percent or more of the target company's outstanding stock.[26] Absent ninety percent ownership, the Delaware long-form merger statute requires approval by a majority of the outstanding shares.[27] Thus, if the majority shareholders have acquired more than a majority but less than ninety percent of the outstanding shares, as a practical matter they may assure the success of the long-form merger by simply casting their votes in its favor.

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21. Squeeze-outs and freeze-outs are, of course, pejorative terms which bespeak wrongful exclusion. The taint associated with them is reinforced in the going-private area by the notions that there is something wrong in reversing direction when one already has enjoyed the fruits of public funding and that it is particularly invidious to use the equity attributable to the public to repurchase the public's shares for the benefit of those in control.

Borden, *Going Private—Old Tort, New Tort or No Tort?*, 49 N.Y.U.L. REV. 987, 988-89 (1974) [hereinafter cited as Borden].

22. The target company is the company whose existence terminates upon consummation of the merger, *i.e.*, the company from which the minority is eliminated.

23. For purposes of this comment, a "shell" corporation is a corporation which is created solely for effectuating the merger transaction.

24. For example, Delaware permits cash or securities of another company to be issued in exchange for shares of the target company in both the long-form and the short-form merger. DEL. CODE tit. 8, §§ 251, 253 (1974 & Supp. 1977).

25. *Id.*

26. *Id.* § 253. The Delaware short-form merger statute provides that if 90% of the outstanding stock is owned by the majority, the merger may be effectuated simply by a resolution of the board of directors.

27. *Id.* § 251. The Delaware long-form merger statute requires approval by the majority of shareholders as well as approval by the board of directors. One commentator noted that where cash is authorized under both the long-form and the short-form merger statute (as in Delaware, *see* note 24 *supra* and accompanying text) the primary distinction between the two merger statutes is merely that the long-form merger statute requires observance of "more cumbersome procedural formalities." Fillman, *Cash and Property as Consideration in a Merger or Consolidation*, 62 NW. U.L. REV. 837, 852 (1968).

B. *Reasons for Going Private*

The most apparent benefits inuring to those corporations which revert to a privately held status flow directly from the elimination of the minority shareholders. By reducing the number of shareholders to less than 300,[28] and delisting from a stock exchange,[29] the corporation is no longer subject to the reporting and disclosure obligations of sections 12[30] and 13(a)-(c)[31] of the Exchange Act. Compliance with subsections 13(d) and (e), requiring the registration of beneficial owners of five percent or more of the issuer's stock, is no longer mandated.[32] Similarly, the insider trading and reporting restrictions of section 16[33] as well as the proxy and tender offer requirements of section 14[34] are avoided.[35]

The corporation's benefits from circumventing compliance with the federal provisions are three-fold: (1) exemption from the expense of compliance;[36] (2) freedom from disclosure of previously confidential information; and (3) reduced exposure to protracted litigation. However, the benefits derived from the reduction of federal controls have been criticized as not justifying a decision to go private.[37] It has been argued that the expense-saving factor lacks merit since Congress in enacting these controls deemed public investor protection more important than the cost of compliance.[38] Still, it seems clear that Congress not only limited the initial imposition of the federal controls to companies with more than 500 shareholders,[39] but also contemplated that those companies might

28. Securities Exchange Act of 1934 § 12(g)(4), 15 U.S.C. § 78*l*(g)(4) (1970).

29. *Id.* § 12(d), 15 U.S.C. § 78*l*(d).

The New York Stock Exchange provides for delisting if the corporation has fewer than 600,000 publicly held shares, less than 1200 shareholders with blocks of 100 or more shares, or a total market value of publicly held shares below $5,000,000. NYSE Rule 499, 2 NYSE GUIDE (CCH) 4235-36 (1976).

30. 15 U.S.C. § 78*l* (1970).

31. *Id.* § 78m(a)-(c).

32. *Id.* § 78m(d), (e).

33. *Id.* § 78p.

34. *Id.* § 78n.

35. It should be noted that section 10(b) of the Exchange Act is still applicable to private corporations. *Id.* § 78j(b).

36. One commentator estimated that a company may save as much as $100,000 per year by eliminating disclosure costs. Hershman, *"Going Private"—Or How to Squeeze Investors*, DUN'S REV., Jan. 1975, at 37.

37. *Second Circuit, supra* note 13, at 1211; Comment, *"Going Private": Establishing Federal Standards for the Forced Elimination of Public Investors*, 1975 U. ILL. L.F. 638, 658 [hereinafter cited as *Establishing Federal Standards*].

38. *Second Circuit, supra* note 13, at 1211.

39. Securities Exchange Act of 1934 § 12(a), 15 U.S.C. § 78*l* (1970) requires registration if the issuer has "total assets exceeding $1,000,000 and a class of equity security . . . held

subsequently avoid compliance with the federal provisions by reducing the number of shareholders to less than 300.[40] The loss of a public market for the companies' stock when there are less than 300 shareholders diminishes the national interest in regulating these corporations.[41]

A similar criticism is that any benefit derived from reduced exposure to litigation does not flow to the corporation, but to the directors who "may mulct the corporation unhampered by outside review."[42] Such reasoning, however, ignores the fact that the directors of private corporations are still accountable for their actions under state law for breach of fiduciary duty.[43] Additionally, insofar as the corporation usually indemnifies its officers and directors for liabilities incurred in non-derivative suits arising from the good faith performance of their corporate duties, the benefit of reduced exposure to litigation does directly accrue to the corporation. Moreover, the ever-expanding sphere of liability of the modern corporation,[44] along with the growing litigiousness of shareholders,[45] has augmented the corporation's need to limit the risk of litigation.

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of record by five hundred or more . . . persons," *id.*, or has a security which is traded on a national exchange, *id.* § 12(g)(1), 15 U.S.C. § 78*l*(g)(1).

40. *Id.* § 12(g)(4), 15 U.S.C. § 78*l*(g)(4).

41. Section 2 of the Exchange Act provides:

> [T]ransactions in securities as commonly conducted upon securities exchanges and over-the-counter markets are affected with a national public interest which makes it necessary to provide for regulation . . . of such transactions . . . in order to protect interstate commerce . . . and to insure the maintenance in such transactions . . . .

Id. § 78b (1970 & Supp. V 1975).

42. *Second Circuit, supra* note 13, at 1209 n.105.

43. *See, e.g.*, Jones v. H.F. Ahmanson & Co., 1 Cal. 3d 93, 108-09, 460 P.2d 464, 471-72, 81 Cal. Rptr. 592, 599-600 (1969).

44. Borden notes:

> It is easy enough to dismiss these fears on the ground that all management must do to avoid liability is to obey the law. However, it is terribly difficult to know what the law is and even more difficult to predict what it will be at the time the propriety of a particular transaction may be adjudicated.

Borden, *supra* note 21, at 1014 (footnote omitted).

45. Although no reader of the *Wall Street Journal* could be unaware of the enormous number and amount of such claims, it is not surprising, in view of the magnitude of the claims and reasonable desire of plaintiff's counsel to achieve a prudent risk-reward ratio, that few cases have gone to judgment. Borden, *supra* note 21, at 1012 n.121. One court recognized the desirability of eliminating potential plaintiffs from the corporation:

> Possibly statutory provision should be made whereby very small corporate minorities could be bought out at a fair price fixed by appraisal, arbitration or court finding, so that shakedown or strike suits could be avoided, and potentially troublesome small shareholders could be properly compensated for their holdings and the majority enabled thereby to remove the present handicap to free exercise of judgment in management.

Cathedral Estates v. Taft Realty Corp., 157 F. Supp. 895, 897 (D. Conn. 1954), *aff'd*, 228 F.2d 85 (2d Cir. 1955).

In contrast, disclosure requirements are by now so routine that they have obtained a deceptively innocuous aura. Yet, as Arthur Borden has observed:

> The mandated disclosure of such straitened circumstances as "decreased flow of collections from sales to customers, the availability or lack of availability of credit from suppliers, banks, and other financial institutions, and the inability to meet maturing obligations when they fall due" may not have a significant market impact if, as is usually the case, the security is already severely depressed. However, it could well convert a voyage on rough but navigable economic seas into a Poseidon adventure by its impact on vendors, customers and creditors.[46]

For some companies the decision to go private reflects a desire to sever the company's business decisions and performance from the public market indices of success.[47] With the elimination of the public shareholders, the company need not be concerned with raising its earnings per share to instill investor confidence. Instead, the company is freer to make long-range growth decisions.[48]

Of course, the degree of the company's dependence upon future outside capital may be dispositive in determining whether the company should go private.[49] It has been suggested that only corporations which are small or medium in size can realistically consider going-private, as the large corporation is far too dependent upon public financing.[50]

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46. Borden, *supra* note 21, at 1011 (quoting SEC Securities Act Release No. 5092 [1970-1971 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 77,915 (Oct. 15, 1970)).

47. Solomon, *Going Private: Business Practices, Legal Mechanics, Judicial Standards and Proposals for Reform*, 25 BUFFALO L. REV. 141, 145 (1975) [hereinafter cited as Solomon].

48. As one commentator concluded: "[T]he company's management and owners spare themselves from bothersome shareholders. Their salaries and perquisites no longer are a matter of public concern. They end the pressure to squeeze out quarter-to-quarter earnings gains and can focus instead on long-range plans." Freeman, *Going Private*, Wall St. J., Oct. 18, 1974, at 21, col. 3. *See also* Borden, *supra* note 21, at 1007; *Establishing Federal Standards, supra* note 37, at 640.

49. Solomon, *supra* note 47, at 142.

50. Borden, *supra* note 21, at 1002-03. Borden concludes that the smaller companies should be allowed to go private since no public benefit is derived by prohibiting such companies from doing so. *Id.* Another commentator typified the companies which go private as follows:

> Moreover, those involved were generally among the smallest of our public corporations, and the liquidity of the public markets for their securities generally ranged from meager to almost nonexistent, undermining the reliability of those markets as pricing mechanisms. In many cases there was little likelihood, at any time in the near future, of being able to further take advantage of the public markets to fill financing needs, and the costs of remaining public sometimes equalled substantial fractions of net profits, seriously affecting securities values.

To some extent the trend toward going private is undoubtedly attributable to depressed stock market conditions.[51] The depressed price of stock has not only made reacquisition of an issuer's outstanding shares a relatively inexpensive proposition,[52] but has also deflated the currency value[53] of stock. Many companies went public during the 1960's when issues selling at 50, 60, or 100 times earnings[54] resulted in a supercurrency valuation of stock which make the use of such stock for employee stock option programs and corporate acquisitions more appealing. In contrast, two-thirds of the new issues marketed during the last four years are selling for less than their initial offering price, and many issues are currently selling for as low as six, seven, or eight times earnings.[55] This decline in the stock market, with the accompanying devaluation of stock, has made a market-centered valuation of stock less attractive.[56] Moreover, the option of going private, with the concomitant availability of book

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SEC. REG. & L. REP. (BNA) No. 389, at B-4 (Feb. 9, 1977). *See also* Solomon, *supra* note 47, at 174-75.

51. By the end of 1977, the Dow Jones average had fallen 19% below its 1976 New Year's Eve level. TIME, Dec. 19, 1977, at 82. Not surprisingly, inflation is the most frequently enunciated cause of the market's slump. *Id. See also id.*, Aug. 29, 1977, at 45. A comparison of the Dow Jones average of about 850 in August, with the August's average discounted for inflation of 443, illuminates the effect of inflation on the market. *Id.* at 44-45. The extent of the market's malaise is further exemplified by the decline in the percentage of total dollars attributable to individual trading on the New York Stock Exchange, which fell from 46.1% in 1961 to 23.1% in 1977. *Id.* at 45.

52. This prospect of buying the public shareholders out when the market price is low has been severely criticized. One commentator noted: "To allow the corporation to regain at the expense of public investors what it voluntarily sold on the market is to give the corporation a 'no lose' option—go public when the market is up, and if it goes down, freeze out at a bargain price." *Second Circuit, supra* note 13, at 1214. While none of the critics has suggested banning going-private transactions when the market is low and allowing them when the market is high, the fear seems to be that if going-private transactions are not subject to careful scrutiny by the courts, going-public/going-private transactions will become mere echoes of vacillating stock market conditions at the expense of public shareholders. In response to this possibility one commentator suggested offering "warrants" to the eliminated public shareholders. These warrants would enable these shareholders to buy back into the corporation for the same price at which they were eliminated, should the corporation decide to re-enter the public market within a specified period of time. Note, *Going Private*, 84 YALE L.J. 903, 929 (1975) [hereinafter cited as *Going Private*].

Although the possibility of speculative abuse does exist, it is important to realize that the companies that went public during the 1960's were not trying to capitalize on the subsequent bear market, but instead, believed that the market growth existing at the time would perpetuate itself. TIME, Aug. 29, 1977, at 45.

53. Stock may be used as currency by corporations for acquisitions and as an aid in the retention of key employees through stock option programs. *Going Private, supra* note 52, at 908-09.

54. TIME, Dec. 19, 1977, at 82.

55. *Id.*

56. Solomon, *supra* note 47, at 143-45; *Going Private, supra* note 52, at 908-09.

value rather than market value as an index of stock valuation,[57] becomes more enticing when the depressed stock value is accompanied by an increase in the company's book value.[58] With the currency value of the company's stock rejuvenated, stock option programs provide greater incentive,[59] corporate acquisitions using stock as consideration become more feasible,[60] and creditor skepticism induced by declining stock market prices is dispelled.[61]

Finally, it is important to note that the depressed stock prices create ideal conditions for the acquisition of such stock by both the issuer and outside raiders.[62] A corporation can most effectively thwart such takeover threats by using its available liquid assets to acquire another smaller company[63] or by going private.[64]

III. JUDICIAL RESPONSE

Issues of substantive fairness, clearly involved in going-private transactions, have traditionally been governed by state law.[65] Indeed, the full disclosure policy reflected in the federal securities laws was thought "ill-equipped to reach the problem of substantive fairness raised by going private."[66] Nevertheless, going-private litigation did gain access to the federal courts[67] through judicial expansion of section 10(b)[68] and rule

57. *Going Private, supra* note 52, at 908-09.

58. *See* Solomon, *supra* note 47, at 147 n.19. Indeed, if the market price were lower than the book value, reacquisition at a depressed price would increase the company's book value. *Going Private, supra* note 52, at 908. This situation is not at all uncommon. Thus, during 1977 while stock market prices were dropping, corporate profits and dividends were rising. TIME, Dec. 19, 1977, at 82. General Motors provides a useful example of the relative independence of market and book value. In 1965, General Motors stock reached almost $114 per share. Although its profits have doubled since 1965, it sold for approximately $65 a share in August. TIME, Aug. 29, 1977, at 44.

59. *Going Private, supra* note 52, at 908.

60. *Id.* at 909.

61. Borden, *supra* note 21, at 1008 n.105.

62. *Id.* at 1014; TIME, Aug. 29, 1977, at 50.

63. TIME, Aug. 29, 1977, at 54.

64. Borden, *supra* note 21, at 1014.

65. Generally, regulation of internal corporate affairs is regarded as being within the purview of state law: "Corporations are creatures of state law, and investors commit their funds to corporate directors on the understanding that except where federal law expressly requires certain responsibilities of directors with respect to stockholders, state law will govern the internal affairs of the corporation." Cort v. Ash, 422 U.S. 66, 84 (1975). *See also* Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 478 (1977). *See, e.g.*, DEL CODE tit. 8, §§ 251, 253 (1974 & Supp. 1977).

66. *Going Private, supra* note 52, at 912. *See* Popkin v. Bishop, 464 F.2d 714, 720 (2d Cir. 1972).

67. *See* Vine v. Beneficial Fin. Co., 374 F.2d 627 (2d Cir.), *cert. denied*, 389 U.S. 970 (1967); Bryan v. Brock & Blevins Co., 343 F. Supp. 1062 (N.D. Ga. 1972), *aff'd on other grounds*, 490 F.2d 563 (5th Cir.), *cert. denied*, 419 U.S. 844 (1974).

68. 15 U.S.C. § 78j(b) (1970).

10b-5[69] of the Exchange Act.

The emergence of a federal forum for going-private litigants received favorable response.[70] Moreover, it was contended that federal regulation of going-private transactions was warranted since liberal state corporate laws provided inadequate protection for minority shareholders.[71] Much of the criticism of the absence of effective state regulation was directed at Delaware: "The combination of Delaware law and the trend towards liberalization of corporate codes in other states makes it clear that there is virtually no likelihood of increased protection for minority shareholders at the state level."[72] In addition to the judicial response, the SEC also acknowledged the apparent need for federal regulation and proposed rules governing the substantive area of going-private transactions.[73]

Santa Fe Industries, Inc. v. Green[74] arose in the wake of this surge toward the development of federal causes of action. Once again the

69. 17 C.F.R. § 240.10b-5 (1977).

70. *Second Circuit, supra* note 13, at 1196-97; *Establishing Federal Standards, supra* note 37, at 658-59.

71. *Id.*

72. *Second Circuit, supra* note 13, at 1199 (footnote omitted).

73. *See* SEC Proposed Rules 13e-3A, 13e-3B, Securities Act Release No. 5567 (Feb. 6, 1975), *reprinted in* [1974-1975 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 80,104. Basically, rule 13e-3A would have imposed certain disclosure requirements and required that the consideration for the public shareholders' stock be determined by "two qualified independent persons." *Id.* Rule 13e-3B would have established a valid business purpose test for all going-private transactions. The continued viability of these proposed rules was doubtful in view of Santa Fe Indus., Inc. v. Green, 430 U.S. 462 (1977). *See* text accompanying notes 78-79 *infra*. The proposed rules had been criticized, and it was suggested that the SEC lacked authority to issue rule 13e-3B. Note, *SEC Rulemaking Authority and the Protection of Investors: A Comment on the Proposed "Going Private" Rules*, 51 IND. L. REV. 433, 446 (1976). Another criticism was that the rules would invade an area of law traditionally governed by the developing common law and statutes of the states. Greene, *Corporation Freeze-Out Mergers: A Proposed Analysis*, 28 STAN. L. REV. 487, 507 (1971) [hereinafter cited as Greene]. Moreover, it was believed that the rules had been "abandoned". Note, *Going Private: Who Shall Provide The Remedies?*, 51 ST. JOHN'S L. REV. 131, 146 (1976).

Nevertheless, the SEC recently revived and modified the proposed rules. SEC Proposed Rule 13e-3, Securities Act Release No. 33-5884 (Nov. 17, 1977), *reprinted in* SEC. REG. & L. REP. (BNA) No. 429, at E-1. Proposed Rule 13e-3 would prohibit a § 12 issuer from purchasing "directly or indirectly, any such security if such 13e-3 transaction is unfair to unaffiliated security holders." *Id.* at E-18. Ten factors are listed to aid in determining the transaction's fairness. *Id.* at E-18-19.

The Commission contends that the validity of the new proposed rule is not affected by *Green*. *Id.* at E-7. Still, the Commission's view that the *Green* rationale is limited to § 10b and rule 10b-5 is questionable in light of the recent extension of the *Green* principles to §§ 13 and 14 of the Exchange Act by the United States District Court for the Southern District of New York. SEC. REG. & L. REP. (BNA) No. 432, at A-9 (Dec. 14, 1977) (referring to Marshel v. AFW Fabric Corp. and Swift v. AFW Fabric Corp., S.D.N.Y., Dec. 1, 1977).

74. 430 U.S. 462 (1977).

adequacy of Delaware law was at issue. The insiders had utilized Delaware's short-form merger statute to eliminate a five percent minority interest in the corporation. Plaintiffs brought an action under rule 10b-5, contending among other things that the merger transaction was fraudulent since it was accomplished without a valid business purpose.[75] Although the district court dismissed the complaint for failure to state a cause of action,[76] the Second Circuit reversed.[77] The United States Supreme Court, in accordance with its policy of narrowing the scope of rule 10b-5,[78] held that absent deception, misrepresentation, or non-disclosure, rule 10b-5 did not apply to going-private transactions.[79]

Shortly after *Green*, the Delaware Supreme Court adopted a business purpose test for going-private transactions in *Singer v. Magnavox Co.*[80]

75. 391 F. Supp. 849, 852 (S.D.N.Y. 1975).

76. *Id.* at 849.

77. 533 F.2d 1283 (2d Cir. 1976).

78. *See, e.g.*, Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975).

79. 430 U.S. 462, 476 (1977).

80. 380 A.2d 969 (Del. 1977). The *Singer* decision is significant because of both the large number of companies incorporated in Delaware and the influence the Delaware courts have on other states. Shakin, *Going Private: Court Rulings Have Sharply Raised the Ante*, Barron's, Oct. 10, 1977, at 26, col. 2.

The impact of *Singer* on California courts, however, will probably be slight since California's new General Corporations Law effectively resolves many of the issues confronting the *Singer* court. *See* CAL. CORP. CODE §§ 407(c), 1101(e), 1110(b), 1312(c) (West 1977). Significantly, elimination of a greater than 10% minority interest in California is critically hampered by two restrictions. First, discrimination against minority shareholders with respect to the type of consideration offered for their shares is prohibited since "[e]ach share of the same class or series of any constituent company . . . shall . . . be treated equally with respect to any distribution of cash, property, rights or securities." *Id.* § 1101(e). Second, when one of the parties to the transaction owns 50% or more of the other party's voting power, the "nonredeemable common shares of a constituent corporation may be converted only into nonredeemable common shares of the surviving corporation." *Id.* Neither restriction applies to short-form mergers authorized under § 1110 or to treatment of fractional shares as provided by § 407(c).

Additionally, both restrictions provided in § 1101(e) may be waived only by a unanimous vote of all the shareholders of the affected class. *Id.* Insofar as one member of the affected class may prevent the majority of the minority shareholders from accepting alternate types of consideration, the statute has been criticized. Barton, *Business Combinations and the New General Corporation Law*, 9 LOY. L.A.L. REV. 738, 768 (1976).

Barton notes that elimination of the minority interest may be accomplished by either a short-form merger or a reverse stock split with cash consideration offered in exchange for the fractional shares. *Id.* at 766 n.104. Neither method, however, may be used to eliminate a minority interest of greater than 10%. CAL. CORP. CODE §§ 1110(b), 407(c) (West 1977).

Nevertheless, the business purpose test enunciated in *Singer* could have some impact on going-private transactions in California. Section 1312(c) of the General Corporation Law shifts the burden of proving that the transaction is just and reasonable to the surviving corporation when it has direct or indirect control over the constituent corporation. *See* note 154 *infra*. Conceivably, a business purpose test could be read into the just and reasonable standard.

In a companion case, *Tanzer v. International General Industries, Inc.*,[81] the court clarified the business purpose standard adopted in *Singer*. The timing of the *Singer* decision was critical. Although in *Green* the Supreme Court had refused to create a federal forum for going-private transactions by expanding the judicial interpretation of rule 10b-5, the threat of federal intervention under the proposed SEC rules still existed.[82] The court in *Singer* was clearly influenced by this prospect of federal intervention.[83] Indeed, according to Arthur Borden the strongest message implicit in the *Singer* opinion "is that Delaware enforces the highest standard of fiduciary obligations and there is consequently no reason for any form of federal corporation statute."[84]

81. 379 A.2d 1121 (1977).

82. A footnote in *Green* states: "Because we are concerned here only with § 10(b), we intimate no view as to the Commission's authority to promulgate such rules under other sections of the Act." Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 473 n.12 (1977). *See* note 73 *supra* for a discussion of the proposed SEC rules.

83. It is important to realize that the possibility of federal regulation of going-private transactions inherent in the Second Circuit's decision in *Green* as well as the proposed SEC rules (*see* note 73 *supra*) poses the threat of federal intervention in other areas of corporate law traditionally governed by state law. As one commentator observed: "*Green v. Santa Fe Industries, Inc.* and *Marshel v. AFW Fabric Corp.* may be precursers of a major body of judicially formulated federal corporate law." Barton, *Business Combinations and the New General Corporation Law*, 9 LOY. L.A.L. REV. 738, 819 (1976) (footnotes omitted). Moreover, federal intervention necessarily imposes a uniformity over state law which negates the motivation for incorporating within a particular state. Such uniformity would, of course, result in a substantial loss of incorporating revenues to those states which have obtained a competitive advantage by virtue of their liberal corporate statutes. *See* text accompanying note 84 *infra*. The threat of federal intervention in any area of corporate law has serious economic consequences for Delaware. "Low taxes in the state, combined with easy incorporation laws, have combined to make legal work one of the main industries there." Shakin, *Going Private: Court Rulings Have Sharply Raised the Ante*, Barron's, Oct. 10, 1977, at 26, col. 2. The policy exhibited in Delaware's corporation laws is to promote the flexibility of the management and, thus, hopefully entice greater incorporation within the state. *See* Folk, *Some Reflections of a Corporation Law Draftsman*, 42 CONN. B.J. 409, 410 (1968). Moreover, this approach has been successful:

> The extent to which Delaware has preempted state corporation law applicable to our largest industrial corporations is a matter of statistics; 40 percent of the companies listed on the New York Stock Exchange are Delaware corporations. And it has been estimated that over 200 of the Fortune 500 largest industrial corporations are also incorporated in Delaware.

Jennings, *Federalization of Corporate Law: Part Way or All the Way*, 31 BUS. LAW. 991, 992-93 (1976) (footnote omitted). The ability of the revenue-seeking states to adequately protect non-management interests has been questioned. Folk, *Some Reflections of a Corporation Law Draftsman*, 42 CONN. B.J. 409, 416-17 (1968). Its notoriously liberal corporate statutes thus not only made Delaware particularly demonstrative of the need for federal regulation, but also made the threat of federal intervention financially unpalatable for the state.

84. Borden, *Some Comments on Singer v. Magnavox*, 178 N.Y.L.J. 66, at 1, col. 4 (1977).

Singer involved an attempt by North American Philips Corporation (North American) to acquire Magnavox Company (Magnavox). In August of 1974, North American Philips Development Corporation (Development), a wholly owned subsidiary of North American, tendered for Magnavox's shares at eight dollars per share. Two days later, the board of directors of Magnavox notified the Magnavox shareholders of its decision to oppose Development's offer on the ground that, in view of the eleven dollar per share book value, eight dollars per share was inadequate.[85]

In September, the managements of North American, Development, and Magnavox negotiated a compromise whereby Development increased the tender offer price to nine dollars per share and Magnavox withdrew its opposition to the offer.[86] The tender offer yielded Development eighty-four percent of Magnavox's outstanding shares. In May, Development incorporated T.M.C. Development Corporation (T.M.C.) for the purpose of merging T.M.C. into Magnavox. The terms of the merger provided that the holders of Magnavox's untendered shares would receive nine dollars per share.[87] The merger was unanimously approved by Magnavox's board of directors.[88] At a special stockholders' meeting in July, with Development voting its shares in favor thereof, the merger was approved and consummated.[89] Plaintiffs brought an action on behalf of all non-tendering minority shareholders of Magnavox seeking damages and nullification of the merger, alleging that the merger was both fraudulent and a breach of fiduciary duty on the part of the majority shareholders.[90]

Plaintiffs' contention that the merger was fraudulent because it was designed solely to eliminate the minority shareholders and served no valid business purpose was rejected by the court of chancery.[91] The court went on to note that since the central issue of the complaint was inadequacy of the consideration offered for untendered shares, appraisal[92]

85. Singer v. Magnavox Co., 367 A.2d 1349, 1352 (Del. Ch. 1976).

86. As part of the compromise agreement sixteen of Magnavox's officers entered into two-year employment contracts with North American and Development at their then current salaries. 380 A.2d at 971.

87. *See* note 128 *infra* and accompanying text.

88. 380 A.2d at 972. Of the nine-man board, four were also directors of North American and three others had entered into two-year employment contracts with North American and Development. *Id.* The *Singer* court, however, did not deal with the issue of a breach of fiduciary duty on the part of the directors.

89. *Id.*

90. 367 A.2d at 1353.

91. *Id.* at 1349.

92. *See* note 129 *infra*.

rather than nullification of the merger was the appropriate remedy and granted defendant's motion to dismiss for failure to state a cause of action.[93]

The Delaware Supreme Court reversed,[94] observing that although defendant's full compliance with the merger statute[95] was uncontroverted, "Delaware case law clearly teaches that even complete compliance with the mandate of a statute does not, in every case, make the action valid in law."[96] The court noted that Development, as the majority shareholder of Magnavox, owned a fiduciary duty to the minority shareholders.[97] Development had not satsified that duty by offering fair value for minority's shares.[98]

The court went on to hold that in the absence of a valid business purpose "a § 251 merger, made for the sole purpose of freezing out minority stockholders, is an abuse of the corporate process . . . and [a] violation of a fiduciary duty."[99] Finally, because Development stood on both sides of the transaction, the court imposed the burden enunciated in *Sterling v. Mayflower Hotel Corp.*[100] of "establishing [the merger's] entire fairness" and "pass[ing] the test of careful scrutiny by the courts."[101] Thus, under *Singer* any corporation attempting a merger transaction which will result in the elimination of the public shareholders is subject to a "fairness hearing" and must be able to demonstrate a valid business purpose for the transaction.

The *Singer* case represents an unexpected turning point in Delaware corporate law. In *Singer*, the policy of protecting minority shareholders prevailed over the policy of promoting corporate flexibility.[102] Undoubtedly, the language of *Singer* will reverberate from the keyboards of many commentators.[103] Moreover, the *Singer* opinion has serious ramifi-

93. 367 A.2d at 1361-62.
94. 380 A.2d at 980.
95. DEL. CODE tit. 8, § 1251 (1974 & Supp. 1977).
96. 380 A.2d at 975.
97. *Id.* at 976.
98. *Id.*
99. *Id.* at 980.
100. 93 A.2d 107 (Del. 1952).
101. *Id.* at 110 (cited in *Singer*, 380 A.2d at 976).
102. The policy of promoting corporate flexibility is regarded as a major reason for the initial enactment of the Delaware merger statutes. Salt Dome Oil Corp. v. Schenck, 41 A.2d 583, 587 (Del. 1945), *quoted in* E. FOLK, THE DELAWARE GENERAL CORPORATION LAW § 251, at 332 (1972). Folk notes that "[t]he 1967 revision of the statute, in particular, reflects the 'continuing legislative approval' of mergers and the avoidance of their disruption by protesting stockholders." *Id.* (quoting Bastian v. Bourns, Inc., 256 A.2d 680, 684 (Del. Ch. 1969), *aff'd per curiam*, 278 A.2d 467 (Del. 1970)).
103. The case quickly roused a response from Arthur Borden. Borden, *Some Comments on Singer v. Magnavox*, 178 N.Y.L.J. 66, at 1, col. 2 (1977).

cations for companies incorporated within Delaware.[104] The adoption of extra-valuation protections for minority shareholders by Delaware, which has traditionally been considered the most pro-corporation state in the country,[105] will serve as an influential guide to other states grappling with the going-private phenomenon.[106] Thus, the superficiality of the court's reasoning is rather disturbing and warrants careful scrutiny.

The reasoning in the *Singer* opinion is flawed in that it was grounded neither on the factual uniquities of the case, policy considerations, nor established precedent, and, in fact, ran contrary to the legislative scheme in Delaware. These flaws in the court's analysis render the case of questionable precedential value since it does not provide any substantial basis for predicting the outcome of future going-private transactions. Moreover, because the imposition of protections which extend beyond fair valuation was inconsistent with both the legislative intent and established precedent, the court in *Singer* was obligated to lead the reader down a path of obfuscated reasoning to reach its desired result. Still, the court did not explain why the valuation approach was rejected, and this rejection becomes particularly questionable when the certainty of the standard for determining the fair value of the public shareholders' stock is contrasted with the nebulousness of the business purpose or "entire fairness" standard enunciated by the court.

Significantly, the court's opinion is completely devoid of factual analysis, and the circumstances of the case do not appear to be the most appropriate vehicle for its opinion.[107] *Singer* was not a true going-private transaction in which the insiders simply transfer their shares to a newly formed corporation created to effectuate the merger.[108] The result of a true going-private transaction is, in actuality, merely an internal reorganization of the same corporation. In such transactions, the public shareholders are clearly not afforded the benefit of an arms-length negotiation since the terms of the transaction are unilaterally set by the insiders.[109]

Instead, *Singer* involved an acquisition merger.[110] The terms of the merger were not unilaterally set by the insiders of Magnavox, but rather a

104. *See* note 83 *supra*.
105. *Id.*
106. *See* note 80 *supra*.
107. Borden suggests that the case may be more applicable to true going-private transactions than to the acquisition merger involved in the case. Borden, *Some Comments on Singer v. Magnavox*, 178 N.Y.L.J. 66, at 1, col. 3 (1977).
108. *See* Greene, *supra* note 73, at 495.
109. *Id.* at 487.
110. 367 A.2d at 1349. The chancery court found this distinction significant. *Id.*

third party, North American,[111] acquired the controlling interest in Magnavox through a successful tender offer. The presence of the third party in the merger transaction gives the public shareholder the benefit of negotiated merger terms.[112] Thus, *Singer* did not involve any of the more blatant forms of abuse typically associated with going-private transactions. The shareholder equity of Magnavox was not used to acquire the minority interest, nor did the case involve a corporation which had recently gone public at a considerable profit only to go private when the stock market was low.[113] And, while the acquiring corporation "may, for a variety of reasons, desire not to inherit . . . any of its stockholders,"[114] the primary motivation for the merger, as the name implies, is the acquisition of another corporation. Consequently, the *Singer* court should never have reached the issue of a "merger, made for the *sole* purpose of freezing out minority stockholders."[115]

If the factual analysis in the case is weak, the court exacerbated this inadequacy by its failure to provide any public policy analysis. The policy of promoting corporate flexibility is much stronger in the acquisition merger than in the true going-private transaction.[116] The acquisition merger generally results in an increased efficiency within the corporation due to amelioration of conflicts of interest between and the achievement of economics of operation for corporations competing in the same industry.[117] Moreover, it may be the only expedient method of revitalizing or replacing ineffective management. These policy considerations certainly outweigh the relatively minor inconvenience to the displaced minority shareholders who are compelled to seek a new investment,[118] and should have persuaded the court to limit the plaintiffs' remedy to an appraisal of their shares.

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111. North American was the actual acquiring company. Development and T.M.C. were created by North American to effectuate the acquisition. *See* text accompanying notes 86-88 *supra*.

112. Brudney, *A Note on "Going Private"*, 61 VA. L. REV. 1019, 1029 (1975).

113. 367 A.2d at 1358.

114. Brudney, *A Note on "Going Private"*, 61 VA. L. REV. 1019, 1026 n.28. (1975).

115. 380 A.2d at 980 (emphasis added). The court was forced to back off from the *Singer* holding with respect to acquisition merger in Tanzer v. International Gen. Indus., Inc., 379 A.2d 1121 (Del. 1977), discussed in text accompanying notes 168-81 *infra*. *But see* Young v. Valhi, Inc., No. 5430 (Del. Ch. Feb. 22, 1978), discussed in text accompanying notes 184-91 *infra*.

116. Brudney, *A Note on "Going Private"*, 61 VA. L. REV. 1019, 1028-29 (1975); Greene, *supra* note 73, at 494.

117. *See* note 185 *infra* and accompanying text.

118. *See* notes 228-30 *infra* and accompanying text.

A. *Utilization of Cases*

In its use of case authorities, the *Singer* court seemed clearly to be sculpting the available precedents to meet the needs of the court's new position on going-private transactions. The court relied upon cases which are clearly distinguishable from the *Singer* facts, while rejecting precedents which are more factually analogous. As one commentator has observed:

> The reader will certainly note that the Court consistently employs the technique of distinguishing cases implicit with contrary propositions by claiming that either on their facts or in the contentions made they were not quite the same as the case in point, while relying on other cases, less pertinent on their facts, because their language is deemed more appropriate to the desired result, with untidy ends said to be "overruled".[119]

By summarily distinguishing or overruling inconsistent cases,[120] the court failed to address the controversial issues in the case. Similarly, by failing to explore the factual distinctions between *Singer* and the cases relied upon to support its holding, the court conveyed a false sense of precedential consistency.

The majority of cases cited by the court in support of its holding do not even involve merger transactions.[121] This sparsity of merger precedent in *Singer* is significant since Delaware courts have held that the individual corporate statutory provisions "have independent legal significance."[122] Thus, "a result prohibited . . . under one section of the law may be entirely permissible . . . through the authorization of another section."[123]

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119. Borden, *Some Comments on Singer v. Magnavox*, 178 N.Y.L.J. 66, at 3, col. 1 (1977) (footnote omitted).

120. *See* note 132 *infra*.

121. Schell v. Chris-Craft Indus., Inc., 285 A.2d 437 (Del. 1971) (advancing the date of annual meeting to thwart proxy fight); Kaplan v. Fenton, 278 A.2d 834 (Del. 1971) (misappropriation of corporate opportunity); Dolese Bros. Co. v. Brown, 157 A.2d 784 (Del. 1960) (misappropriation of corporate opportunity); Johnston v. Greene, 121 A.2d 919 (Del. 1956) (misappropriation of corporate opportunity); Italo-Petroleum Corp. v. Hannigan, 14 A.2d 401 (Del. 1940) (execution of notes not authorized by board of directors); Guth v. Loft, Inc., 5 A.2d 503 (Del. 1939) (misappropriation of corporate opportunity); Condec Corp. v. Lunkenheimer Co., 230 A.2d 769 (Del. Ch. 1967) (issuance of additional shares to thwart tender offer); Craig v. Graphic Arts Studio, Inc., 166 A.2d 444 (Del. Ch. 1960) (misappropriation of corporate opportunity); Bennett v. Breuil Petroleum Corp., 99 A.2d 236 (Del. Ch. 1953) (cancellation of shares and issuance of new shares to freeze out minority shareholders); Brophy v. Cities Serv. Co., 70 A.2d 5 (Del. Ch. 1949) (reacquisition of corporate stock using inside information); Yasik v. Wachtel, 17 A.2d 309 (Del. Ch. 1941) (issuance of additional shares to acquire control).

122. 367 A.2d at 1354 (citation omitted).

123. *Id.* *See* note 130 *infra* for an example of a result achievable only through a merger.

The factual dissimilarities between the cases cited in support of the court's holding and the case before the court are significant. For instance, *Condec Corp. v. Lunkenheimer Co.*[124] was cited for the proposition that "corporate machinery may not be manipulated so as to injure minority shareholders."[125] However, *Condec* was not even technically a minority oppression case. The plaintiff was a tender offeror who had acquired slightly more than fifty percent of the target's outstanding common stock.[126] In an effort to foil the tender offer, the director of the target caused the corporation to issue previously authorized but unissued stock. The plaintiff tender offeror claimed that the new issue resulted in an equitable dilution of its interest in the target, effected with the sole purpose of defeating the tender offer. The court held that in issuing such stock the directors had breached a fiduciary duty and ordered cancellation of the shares.[127]

In *Singer*, however, the minority's interest was not diluted. Instead, the minority's interest in the corporation was terminated with the plaintiffs receiving a sum higher than the market value of their stock in exchange.[128] Additionally, the remedy of appraisal, available only when corporations merge,[129] was not available to the plaintiffs in *Condec*.[130]

124. 230 A.2d 769 (Del. Ch. 1967).

125. 380 A.2d at 979 (quoting Condec Corp. v. Lunkenheimer Co., 230 A.2d 769, 775 (Del. Ch. 1967)).

126. 230 A.2d at 772.

127. *Id.* at 777.

128. The tender offer as well as the cash-out-price was $9 per share. The market value of Magnavox's stock on the day preceding the tender offer was approximately $4 per share. Standard & Poor, 3 DAILY STOCK PRICE RECORD, NYSE 235 (1974). Book value as of March 31, 1975 was $10.16. Brief for Appellee at 26, Singer v. Magnavox Co., 380 A.2d 969 (Del. 1977).

129. DEL. CODE tit. 8, § 262 (1974 & Supp. 1977) provides that the appraisal remedy is available only in merger transactions. California, on the other hand, extends dissenter's rights to all shareholders whose approval is required for any form of reorganization. CAL. CORP. CODE § 1300(a) (West 1977).

Generally, the appraisal statutes give the dissenting shareholders in merger transactions the right to compel the corporation to buy them out at an appraised value. The appraisal remedy "is regarded as assuring substantial equivalence between the continued participation afforded to the insider and the cash or altered participation paid to the outsider." Brudney, *A Note on "Going Private"*, 61 VA. L. REV. 1019, 1027 n.33 (1975) (citations omitted).

Under the Delaware appraisal remedy, the shareholder is entitled to "the intrinsic value of [his] shares determined on a going concern basis." Application of Delaware Racing Ass'n, 213 A.2d 203, 209 (Del. 1965). The factors utilized to ascertain the "intrinsic" value have been weighted as follows: assets, 25%; market value, 40%; earnings value, 25%; and dividend value, 10%. *Id.* at 214. The remedy has been criticized as presenting the dissenting shareholder with "an unattractive and complex procedural obstacle course—supervised by a judiciary which, if not hostile, is disposed to present its stern Jehovan

Possibly, it is the court's failure to attach any significance to these distinctions which leaves answered but unexplored the critical issue in the case—whether the utilization of a merger transaction to eliminate the public shareholders is an abuse of corporate process and a manipulation of corporate machinery. A corporate process can only be abused or manipulated to the extent that it is used in a manner inconsistent with the legislature's intent in authorizing that process. Therefore, without an examination of the legislative intent behind the long-form merger statute, the court's conclusion that the "use of corporate power to *eliminate* the minority is a violation of [a fiduciary duty]"[131] if done without a valid business purpose, can only be regarded as tenuous.

To circumvent inconsistencies between *Singer* and established precedents, the court speciously distinguished all of the defendant's merger authorities on the basis that the minority shareholders were offered stock for their shares rather than cash as in *Singer*.[132] The court did not offer any justification for this distinction, nor does any justification exist. Although at one time the long-form merger statute in Delaware did not authorize a straight cash for stock conversion,[133] the statute was subsequently modified to provide for solely cash consideration.[134] Certainly the fact that the amendment was adopted without qualifying language

aspect." Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L.J. 223, 231 (1962) [hereinafter cited as Manning].

130. Delaware courts have found the availability of appraisal significant. *Compare* Keller v. Wilson & Co., 190 A. 115 (Del. 1936) *with* Federal United Corp. v. Havender, 11 A. 2d 331 (Del. 1940). In *Keller*, minority shareholders obtained an injunction against a charter amendment which would have altered the accrued dividends on their stock. In *Havender*, minority shareholders again sought to enjoin the alteration of their preferred stock. However, in *Havender*, the alteration of their interests was to take place through a merger. The court noted that in this merger case, unlike the *Keller* case, the appraisal remedy was available to the plaintiffs. Therefore, the court refused to issue the injunction. 11 A.2d at 339.

131. 380 A.2d at 980.

132. The Court stated: "But none of these decisions involved a merger in which the minority was totally expelled *via* a straight 'cash-for-stock' conversion in which the only purpose of the merger was . . . to eliminate the minority." 380 A.2d at 978. *See also* note 141 *infra*. The cases thus distinguished are: MacCrone v. American Capital Corp., 51 F. Supp. 462 (D. Del. 1943); Stauffer v. Standard Brands, Inc., 187 A.2d 78 (Del. 1962); Federal United Corp. v. Havender, 11 A.2d 331 (Del. 1940); David J. Greene & Co. v. Schenley Indus., Inc., 281 A.2d 30 (Del. Ch. 1971); Bruce v. E.L. Bruce Co., 174 A.2d 29 (Del. Ch. 1961). *Bruce* and *Schenley* were expressly overruled, while *Stauffer* was limited to short-form mergers.

133. In 1967 the statute permitted "cash or securities of any other corporation . . . in *addition* to the shares . . . of the surviving . . . corporation." 56 Del. Laws, ch. 50, § 251(b) (1967) (emphasis added).

134. A subsequent amendment in 1968 allows cash "in addition to or *in lieu of*" shares of the surviving corporation. 56 Del. Laws, ch. 186, § 16 (1968) (emphasis added) (current version at DEL. CODE tit. 8, § 251 (1974 & Supp. 1977)).

after the going-private phenomenon had received much public attention and debate[135] indicates that the legislature did not intend that any distinction be made. Nor can the distinction be justified on the basis that the possibilities for abuse in a cash-out merger are greater than those in a stock conversion merger since "debt securities or sinking fund preferred stocks . . . will inevitably be liquidated by cash payments."[136] In addition, it would appear to be to the minority's advantage to receive cash rather than securities of doubtful valuation or liquidity. The fictional nature of the cash-stock distinction is revealed by the fact that the distinction was applicable only to the cases relied upon by the defendants. If the distinction were applied uniformly, the cases relied upon by the court to support its holding would also be deemed unworthy of consideration.[137] It is this lack of uniformity in imposing the cash-stock distinction which suggests that it is a distinction without substance or meaning created solely as a method for disposing of cases inconsistent with the *Singer* holding.

The most important case to be felled by the cash-stock distinction was *David J. Greene & Co. v. Schenley Industries, Inc.*[138] *Schenley* was factually more similar to *Singer* than any other case cited in the court's opinion. There, the public shareholders sought to enjoin the proposed merger of the subsidiary into the parent. The parent owned eighty-six percent of the subsidiary's outstanding stock, and the displaced public shareholders were to be given cash and subordinated debentures in exchange for their equity interest in the subsidiary. The *Schenley* court noted that since the merger involved a cash and debenture rather than a stock conversion, the controversy essentially centered on whether the plaintiffs were receiving fair value for their equity interest.[139] Accordingly, the court concluded that appraisal was an adequate remedy for a value dispute.[140]

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135. *See, e.g.*, Vorenberg, *Exclusiveness of the Dissenting Stockholder's Appraisal Right*, 77 HARV. L. REV. 1189 (1964) [hereinafter cited as Vorenberg]. It is also worth noting that Stauffer v. Standard Brands, Inc., 178 A.2d 311 (Del. Ch. 1962), *aff'd*, 187 A.2d 78 (Del. 1962), had been decided five years prior to the amendment. There the court interpreted the short-form merger statute's cash consideration provision as an authorization for freeze-out mergers. *See* note 158 *infra*.

136. Fillman, *Cash and Property as Consideration in a Merger or Consolidation*, 62 NW. U.L. REV. 837, 851 (1968).

137. *See* note 121 *supra* and accompanying text. The few merger authorities cited by the court in support of its holding can be distinguished on the basis that they did not involve cash-for-stock conversions. *See* Sterling v. Mayflower Hotel Corp., 93 A.2d 107 (Del.1952); Bastian v. Bourns, 256 A.2d 680 (Del. Ch. 1969), *aff'd per curiam*, 278 A.2d 467 (Del. 1970); David J. Greene & Co. v. Dunhill Int'l, Inc., 249 A.2d 427 (Del. Ch. 1968).

138. 281 A.2d 30 (Del. Ch. 1971).

139. *Id.* at 33.

140. *Id.*

The *Singer* court reacted to *Schenley* in two manners. First, *Schenley* was distinguished on the basis that it did not involve a " 'cash-out merger,' the *sole* purpose of which was to eliminate minority stockholders."[141] This distinction is completely untenable since the utilization of subordinate debentures as partial consideration does not change the ultimate cashing out of the minority shareholders but merely postpones the time of its occurrence. Apparently recognizing the tenuousness of the distinction, the court also overruled *Schenley* insofar as it was inconsistent with *Singer*.[142] Clearly, if there had been any merit to the cash-stock distinction, this overruling would not have been necessary.

The overruling of *Schenley* coupled with the revitalization of *Sterling v. Mayflower Hotel Corp.*[143] indicates a distinct shift in the trend of Delaware case law. The radical nature of this shift is evidenced by the wide divergence of approach utilized in the two cases. Although both cases involved interested mergers,[144] in *Sterling* the burden of establishing the entire fairness of the transaction was imposed upon the defendants,[145] while in *Schenley* the plaintiffs carried the burden of demonstrating fraud, illegality or serious overreaching by the defendants.[146]

Despite the apparent irreconcilability of the two cases, it had been generally assumed that the *Schenley* approach would set the trend in situations where the dispute centered on share valuation.[147] The continued vitality of *Sterling* had been seriously questioned, with Professor Ernest L. Folk suggesting that the doctrine was in "grave jeopardy"[148] and would most likely "receive only lip service."[149] At any rate, a re-examination of the *Sterling* doctrine would have been appropriate in *Singer* since neither the burden of proof nor the standard of judicial review were contested by the *Sterling* defendants.[150] As Professor James Vorenberg noted, "[o]ne can only speculate as to why the defendants

141. 380 A.2d at 978.

It is not clear from the court's language whether it is the existence of a business purpose or the use of subordinated debentures as consideration which distinguishes *Schenley* from *Singer*. A post-trial analysis by the *Singer* court of a business purpose which the *Schenley* court did not deem dispositive, however, could only be regarded as presumptuous.

142. *Id.* at 980.

143. 93 A.2d 107 (Del. 1952).

144. Of course, all going-private transactions utilizing the merger technique are "interested mergers." *See* Note, *Going Private: An Analysis of Federal and State Remedies*, 44 FORDHAM L. REV. 796, 810-11 (1976).

145. 93 A.2d at 109-10.

146. 281 A.2d at 35.

147. E. FOLK, THE DELAWARE GENERAL CORPORATION LAW § 251, at 334-36 (1972).

148. *Id.* at 336.

149. *Id.* at 335.

150. 93 A.2d at 109-10.

made this concession rather than urging that the availability of appraisal shifted the burden to plaintiff."[151]

In some respects, however, the court's refusal to follow the *Schenley* approach is not surprising. Adherence to the *Schenley* approach would, to some extent, have required the court to accept the contention that the minority shareholder's right "is exclusively in the value of his investment, not its *form*"—a proposition the court flatly rejected.[152] Nevertheless, instead of rejecting *Schenley* because its holding was inconsistent with the adoption of the business purpose test, the court in *Singer* should have followed the valuation approach embodied in *Schenley* because it was consistent with established precedent.

The valuation rationale of *Schenley* should have and would have prevailed had the court abstained from broad generalizations and conducted a factual analysis of the case. If, as the court maintained, the value of the shareholder's investment did not govern his rights, it certainly formed the gravamen of the minority's complaint. It was not the termination of the minority's equity position in Magnavox, but the "forced removal of public minority shareholders . . . at a grossly inadequate price,"[153] which offended the plaintiffs. Thus, the issue presented to the court was not whether the public shareholders may be eliminated but, instead, at what price. Viewed in this light, neither the court's rejection of the valuation approach[154] nor its reference to a sentimental attachment to stock was responsive to the issues presented in *Singer*.

Moreover, the *Sterling* doctrine, placing the burden of establishing the "entire fairness" of the transaction upon the defendants, seems unduly

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151. Vorenberg, *supra* note 135, at 1212. In *Singer*, defendants also conceded the issues. Brief for Appellee at 16, Singer v. Magnavox Co., 380 A.2d 969 (Del. 1977).

152. 380 A.2d at 978. It should be noted that neither *Singer* nor *Sterling* discusses the relevance of the appraisal remedy.

153. *Id. See* Opening Brief for Appellant at 1, Singer v. Magnavox Co., 380 A.2d 969 (Del. 1977).

154. 380 A.2d at 977 n.8. The court is referring to an unreported California case, Jutkowitz v. Bourns, Los Angeles Super. Ct. Case No. CA000268 Memorandum of Decision (Nov. 19, 1975), *noted in* Barton, *Business Combinations and the New General Corporation Law*, 9 LOY. L.A.L. REV. 738, 776 n.149. In *Jutkowitz* a merger was utilized to eliminate a 10% minority interest. The court held that the majority shareholders' use of the merger technique to eliminate the public shareholders was a breach of their fiduciary duty to the latter and preliminarily enjoined consummation of the merger. The court's holding was based on Jones v. H.F. Ahmanson & Co., 1 Cal. 3d 93, 460 P.2d 464, 81 Cal. Rptr. 592 (1969). In *Jones* the court held that the majority shareholders had breached their fiduciary duty to the minority by excluding the minority shareholders from a profitable going-public transaction.

In *Singer*, however, the court's reliance on *Jutkowitz* to reject the valuation approach is questionable, particularly since *Jutkowitz* is not in accordance with the new California

harsh and extreme.[155] In *Singer*, the defendant's fiduciary duty as a majority stockholder arose solely as a result of a successful tender offer. And, while the voluntariness of shareholder response to tender offers has been questioned,[156] it nevertheless seems anomalous that the defendants are alleged to have breached a fiduciary duty because the owners of the majority of outstanding stock indicated their approval of the transaction by tender rather than by vote of their stock. Furthermore, if the standard of fairness is not completely subjective, it is logically inconsistent to maintain that an offer deemed fair by the owners of eighty-four percent of the outstanding stock may not be fair as to the owners of the remaining sixteen percent.[157]

The overruling of *Schenley* is also notable since the case offered a rare glimpse into Delaware's obscure legislative history.[158] A similar lack of

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General Corporation Law. *Jutkowitz* was decided on the basis of the merger statute then in effect which did not provide for a short-form merger procedure. Former CAL. CORP. CODE § 4124, ch. 997, § 29, 1949 Cal. Stats. 1840, *as amended by* ch. 2261, § 30, 1957 Cal. Stats. 3960 & ch. 1256, § 2, 1959 Cal. Stats. 3391 & ch. 789, § 4, 1968 Cal. Stats. 1533.

Subsequently, § 1110 of the General Corporation Law was enacted to allow a corporation to eliminate a 10% minority interest utilizing the short-form merger technique. CAL. CORP. CODE § 1110 (West 1977). *See* Barton, *Business Combinations and the New General Corporation Law*, 9 LOY. L.A. L. REV. 738, 777 (1976).

The minority shareholders thus displaced are entitled to an appraisal procedure under CAL. CORP. CODE § 1300 (West 1977). However, the dissenter's rights provision is not the shareholder's exclusive remedy when one of the parties is "directly or indirectly controlled by . . . another party to the reorganization." *Id.* § 1312(b). Thus, if the shareholder of the controlled corporation attacks the validity of the merger and does not elect the dissenter's remedy, § 1312(c) imposes the burden on the controlling party to prove that the transaction is just and reasonable. *Id.* § 1312(c).

155. *See* Vorenberg, *supra* note 135, at 1214.

156. *See* text accompanying notes 243-53 *infra*.

157. *See* Alcott v. Hyman, 16 Misc. 2d 192, 183 N.Y.S.2d 359 (Sup. Ct. 1958). Applying Delaware law to a sale of assets transaction, the court found such reasoning persuasive: "The shares sold or tendered . . . represent a very substantial majority of stockholders who have thus indicated their approval of the proposed transaction . . . . And it is the price which more than 80% of the stockholders have evidently deemed fair and reasonable." *Id.* at 193-94, 183 N.Y.S.2d at 362.

158. *See* E. FOLK, THE DELAWARE GENERAL CORPORATION LAW xviii (1972). Although in Stauffer v. Standard Brands, Inc., 178 A.2d 311 (Del. Ch.), *aff'd*, 187 A.2d 78 (Del. 1962), appraisal was held to be the exclusive remedy in a short-form cash-out merger, 178 A.2d at 314, the court also noted that its holding was not applicable to the long-form statute, which did not have a similar cash consideration provision. *See* note 133 *supra* and accompanying text. After *Stauffer*, the Delaware long-form statute, which had previously spoken only of securities, was amended to provide for cash consideration. *Id.* With the long-form merger statute thus amended, the court in *Schenley* adopted the *Stauffer* approach: "In short, I am of the opinion that the rights of the plaintiffs and of other minority shareholders of Schenley . . . are no greater under the . . . [long-form] Delaware merger statute . . . than under the so-called short-merger statute . . . ." 281 A.2d at 35. By overruling *Schenley* and limiting *Stauffer* to short-form mergers, *Singer* signifies a departure from corporate case law and is inconsistent with legislative intent.

concern with legislative intent is exhibited throughout the *Singer* opinion. Although the court cited in full the relevant provisions of both the long-form merger statute and the appraisal statute,[159] it did not discuss the legislative intent behind either of them.

Significantly, the case was brought in equity, yet the inadequacies of the legal remedy of appraisal were not analyzed. Examination of the inadequacies of the appraisal remedy would have been particularly relevant since appraisal proceedings had already commenced in connection with the merger.[160] However, the court's covert disapproval of appraisal as the only remedy was apparent: "In our view, defendants cannot meet their fiduciary obligations to plaintiffs simply by relegating them to a statutory appraisal proceeding."[161] Although the court did not elucidate its reason for rejecting the appraisal remedy, a footnote suggests that the rejection may in part have been predicated on the procedural difficulties with the remedy.[162] Regardless of the procedural difficulties, the legislature in adopting the appraisal statute considered the primary issue in merger transactions to be the value of the displaced shareholder's interest.[163]

Thus, while the court's rejection of the appraisal remedy was consistent with its rejection of the valuation approach, the result seems to be that internal consistency of the case was maintained at the expense of adherence to legislative intent. Moreover, the court's failure to consider the legislative intent behind the appraisal statute cannot be dismissed as an oversight. The issue was distinctly raised by the chancery court: "However, if a better method is to be found, it must be championed through the General Assembly and not through a complaint which asks this Court, in effect, to ignore the appraisal statute and the decisions of

159. 380 A.2d at 972-75 nn.3 & 4.

160. 367 A.2d 1349, 1362 (Del. Ch. 1976).

161. 380 A.2d at 977.

162. The court notes that the recently amended appraisal statute provides for plaintiff's attorney and expert fees and concludes: "Realistically, that may broaden the scope of the value inquiry in an appraisal proceeding but it is not significant here." *Id.* at 975 n.4. The plaintiffs contended that the appraisal remedy was inadequate for two reasons. First, the valuation focus of the remedy is not responsive to breaches of fiduciary duty. Second, the appraisal remedy presents procedural difficulties for the plaintiffs. Opening Brief for Appellants at 43-45, Singer v. Magnavox Co., 380 A.2d 969 (Del. 1977).

163. *See* Stauffer v. Standard Brands, Inc., 178 A.2d 311, 314 (Del. Ch.), *aff'd*, 187 A.2d 78 (Del. 1962). *See also* Grimes v. Donaldson, Lufkin & Jenrette, Inc., 392 F. Supp. 1393 (N.D. Fla. 1974) (applying Delaware law). There the court concluded: "It is clear that the Delaware legislature has determined that a stockholder has no absolute right to his interest in the corporation and may be forced to surrender his shares for a fair cash price." *Id.* at 1403 (citations omitted).

our Supreme Court which have held it to provide an adequate remedy."[164]

The legislative intent reasoning in *Federal United Corp. v. Havender*[165] received similar treatment from the *Singer* court. Although *Havender* involved the use of a merger to eliminate the cumulative dividends in arrears on its preferred stock, and thus is factually dissimilar to *Singer*, the importance of the case lies in the following statutory interpretation guidelines enunciated for merger: (1) where the language of the statute is clear the courts will "[add] nothing thereto and [take] nothing therefrom," (2) "where the Legislature ha[s] made no exception to the positive terms of a statute, the presumption is that it intended to make none, and it is not the province of the court to do so," and (3) "[i]t is for the Legislature not for the court, to declare the public policy of the state."[166]

Singer's adoption of a valid business purpose test stands in direct conflict with the principles enunciated in *Havender* and falls perilously close to judicial legislation. Again, however, the *Singer* court, employing a specious distinction, quickly dismissed the *Havender* reasoning on the basis that "the Merger Statute in effect at the time *Havender* was written did not authorize a pure cash-for-shares conversion."[167] In short, the court's consistent refusal to deal with any indications of legislative intent suggests the obvious—that *Singer* simply cannot be harmonized with Delaware's legislative scheme.

B. Modification of Singer: Tanzer

In adopting the business purpose test, the *Singer* court left many issues unresolved. Indeed, the court itself observed that one of the difficulties with the valid business purpose test lies in determining whether the business purpose looked to is that of the subsidiary or that of the parent.[168] The court noted that if the business purpose of the subsidiary was determinative, the result might well be academic or unrealistic since the minority shareholders had been cashed out of an enterprise which may have disappeared in the merger.[169] In contrast, if the purpose of the parent was determinative, the "minority shareholders of the subsidiary . . . may have undue difficulty in raising and maintaining the issue."[170]

164. 367 A.2d at 1362 (citation omitted).
165. 11 A.2d 331 (Del. 1940).
166. *Id.* at 337.
167. 380 A.2d at 979.
168. *Id.* at 976.
169. *Id.*
170. *Id.*

Finding neither possibility attractive, the court left the issue for another day.

Similarly unresolved was the issue of whether the defendant's burden of proving the entire fairness of the transaction would be satisfied by indices of fair valuation.[171] Additionally, since the point in dispute before the court was the sufficiency of the complaint, the conditions that would satisfy the valid business purpose test were left unexplored.

Tanzer v. International General Industries, Inc.,[172] decided shortly after *Singer*, dealt with many of these issues. The case is factually similar to *Singer*. International General Industries, Inc. (IGI) owned eighty-one percent of Kliklok Corporation (Kliklok). IGI created a wholly owned subsidiary, KLK Corporation (KLK). Subsequently, Kliklok was merged into KLK with Kliklok's minority shareholders receiving cash in exchange for their equity interest in the subsidiary. Plaintiffs sought a preliminary injunction against the merger on the ground that it did not serve a valid purpose of Kliklok.

Defendants advanced the business purpose of the parent to support the transaction. *Tanzer* held that the parent's ability to obtain long term financing satisfied the business purpose test.[173] The court also noted that indices of fair valuation alone would not satisfy the *Sterling/Singer* doctrine, and remanded the case to the chancery court for a full fairness hearing.[174]

Tanzer employed a liberal construction of the business purpose test. As the court observed, the emphasis was on the majority shareholders' rights.[175] Thus the court conceded that the fiduciary duty of the majority did not abridge the majority's right to vote its shares[176] in its own interest and concluded that "[a]s a stockholder, IGI need not sacrifice its own interest in dealing with a subsidiary, but that interest must not be suspect as a subterfuge, the real purpose of which is to rid itself of unwanted minority shareholders."[177]

The importance of this conclusion is exemplified by a fact not mentioned in the court's opinion. Although the majority assured the merger's success by voting their shares in its favor, the merger was also approved by over ninety percent of the minority shares voting.[178] In declining the

171. *See* note 183 *infra*.
172. 379 A.2d 1121 (Del. 1977).
173. *Id.* at 1124-25.
174. *Id.* at 1125.
175. *Id.* at 1123-24.
176. *Id.* at 1124.
177. *Id.*
178. Letter Opinion and Order on Plaintiff's Application for a Preliminary Injunction by Chancellor William T. Quillen (Dec. 23, 1975), at 1.

enticing option of basing its holding on the approval by the minority shareholders, the court avoided entanglement with corporate democracy tenets. Moreover, the court apparently recognized that unless the majority is allowed to vote in its own interest the result would be to effectively eliminate the majority shareholder's role in merger transactions.[179]

Another issue raised by the plaintiffs, but again not mentioned in the court's opinion, may be important. Although an independent appraiser had determined the cash-out price, the plaintiffs contended that the price was nevertheless unfair since it did not reflect the economic benefit the parent derived from the transaction.[180] In light of the complexity surrounding this extra-valuation remedy issue, the *Tanzer* court's reluctance to deal with it is not surprising. *Singer* also neglected to explore the difficulties of fashioning an extra-valuation remedy.[181]

C. *Impact*

The imposition of a business purpose test in *Singer* will clearly serve as a deterrent to both the true going-private transactions and the merger acquisitions. This deterrence stems in part from the uncertainty of the obligation imposed on the majority shareholder. While it is clear that the test is two-pronged and the defendants must show both a valid business

179. The imposition of a valid business purpose standard restricts the majority's voting power in that the majority's vote will not be given effect unless it is accompanied by a valid business purpose.

180. Letter Opinion and Order on Plaintiff's Application for a Preliminary Injunction by Chancellor William T. Quillen (Dec. 23, 1975), at 3.

181. *See* note 152 *supra* and accompanying text. The court's evident willingness to enjoin going-private transactions is disturbing. If the transaction has already been consummated, it "can hardly be unscrambled, since it is inconceivable that many shareholders would be willing to disgorge their cash in return for their prior equity position." Borden, *Some Comments on Singer v. Magnavox*, 178 N.Y.L.J. 66, at 3, col. 3 (1977). Moreover, even if the transaction has not been consummated, many of the shareholders who voluntarily sold their shares to the majority may have similar misgivings about exchanging their cash for their equity interest. Enjoining the transaction may thus restore the dissenting shareholders' equity position in a corporation with limited market liquidity. *See* text accompanying notes 243-44 *infra*.

Additionally, it is difficult to see how the court could fashion a remedy which would restore the diminished liquidity of the corporation's stock. Clearly, the court cannot compel the shareholders who sold their stock to the majority to repurchase their equity positions. It seems equally inequitable to compel the majority to resell to the public the stock it purchased from the minority at a price substantially above the market value of the stock. *See* text accompanying notes 229-30 *infra*.

However, if the minority cannot be adequately restored within the corporation, the plaintiff's remedy would appear to be damages. But as Edward Greene observes, "the court will of necessity be required to establish a fair price in order to assess damages. That very process duplicates an appraisal proceeding created for the same purpose and may lead to different results." Greene, *supra* note 73, at 505.

purpose and the entire fairness of the transaction, the criteria necessary to satisfy either standard are vague.[182]

The *Tanzer* decision also indicated that indices of fair valuation[183] alone will not satisfy the entire fairness doctrine of *Sterling*. The court's unwillingess to elucidate those additional indices of fairness instills further uncertainty in going-private transactions. Moreover, since the judicial scrutiny of the merger is triggered solely by the elimination of the minority from an on-going enterprise regardless of the ultimate fairness of the terms of the merger, the *Singer* decision will result in both an increase in litigation and a corresponding delay in the consummation of such transactions. This injects an element of expense and delay into both the true going-private transaction and the acquisition merger.

Although the *Tanzer* opinion indicated that the business purpose test adopted in *Singer* would be liberally construed at least with respect to acquisition mergers, a recent chancery court decision, *Young v. Valhi, Inc.*,[184] suggests otherwise. In granting the plaintiffs' application for a permanent injunction against consummation of the proposed cash-out merger, the *Young* opinion appears to have significantly expanded the *Singer* rationale. Like *Tanzer, Young* also involved a takeover attempt with Contran Corporation and Farnham Corporation vying for control of Valhi. An injunction against Farnham enabled Contran to successfully acquire a fifty-five percent controlling interest in Valhi. Subsequent purchases resulted in Contran's owning approximately sixty-five percent of Valhi's outstanding stock at the time of the trial. Contran's plan to acquire the remaining interest of Valhi through a cash-out merger, however, was hindered by an anti-takeover provision in Valhi's charter

182. Judge Moore criticized the business purpose test as a "totally amorphous standard." Green v. Santa Fe Indus., Inc., 533 F.2d 1283, 1308 (2d Cir. 1976) (dissenting opinion), *rev'd*, 430 U.S. 462 (1977). Similarly, Professor Folk observed that "the issue still remains unsettled as to . . . how far, the courts will . . . scrutinize an 'interested merger' and determine its fairness." E. FOLK, THE DELAWARE GENERAL CORPORATION LAW § 251, at 334 (1972).

183. The cash-out price in *Tanzer* was determined by an independent expert investment banking firm. Letter Opinion and Order on Plaintiff's Application for a Preliminary Injunction by Chancellor William T. Quillen (Dec. 23, 1975), at 3. Although Chancellor Quillen found this fact persuasive, the Delaware Supreme Court did not attach any significance to it. Other indices of fairness include approval of the transaction by a majority of the minority and determination of the transaction by a committee of independent directors. All three indices of fairness tend to restore the negotiation process to an arms-length basis.

In *Tanzer*, the court refused to allow approval of the transaction by a majority of the minority shareholders to overshadow the majority's voting rights. This index should still be persuasive, however, in determining the fairness of the transaction.

184. No. 5430 (Del. Ch. Feb. 22, 1978) (consolidated with Bruno v. Contran Corp., No. 5428).

which required approval by the holders of eighty percent of Valhi's outstanding stock to effectuate a merger if the other party to the transaction owned a five percent or greater interest in Valhi. Another charter provision required only a majority vote if the proposed merger was between Valhi and one of its wholly owned subsidiaries. Thus, after several unsuccessful endeavors to obtain the requisite eighty percent vote, Contran attempted to eliminate the remaining shareholders by merging Valhi into its wholly owned subsidiary, VIS Corporation. The cash-out price to be paid to the eliminated minority shareholders was $22.50—twice the market value of Valhi's stock.

Plaintiffs sought to enjoin the consummation of the proposed merger, challenging both the validity of Contran's business purpose and the fairness of the transaction. Contran maintained that the elimination of potential conflict of interest claims as well as a $150,000 tax savings qualified as valid business purposes.[185] The court characterized both of the business purposes advanced by Contran as "contrived,"[186] observing that the number of conflict of interest claims in the past had been minimal and that the tax savings could be accomplished by other means.[187] Thus, the court apparently imposed an additional requirement on the valid business purpose test: the elimination of alternative means of achieving the resulting benefits. In so doing, the court clearly goes beyond the *Singer* holding, which merely required the existence of a valid business purpose.

The court also was not impressed by the fact that an independent investment banking firm had determined the cash-out price or that an independent director had found the "proposed merger to be fair, reasonable and equitable to the minority stockholders."[188] By refusing to regard the presence of the independent investment banking firm as significant, *Young* is consistent with *Tanzer's* holding that indices of fair valuation alone do not satisfy the entire fairness requirement. However, the court's failure to attach any significance to the presence of the independent director is disturbing. Since the fairness determination by the independent director was not limited to a determination of fair

185. *See* Grimes v. Donaldson, Lufkin & Jenrette, Inc., 392 F. Supp. 1393, 1402 (N.D. Fla. 1974) (applying Delaware law) (elimination of potential claims of conflict of interest and joint economy of operation constitute valid business reasons for freeze-out merger). Indeed, one of the harshest critics of going-private transactions concedes that "the elimination of a minority interest as the last step in a corporate amalgamation is a proper purpose." Kerr, *Going Private: Adopting a Corporate Purpose Standard*, 3 SEC. REG. L.J. 33, 60 (1975) (footnote omitted).

186. No. 5430, slip. op. at 12 (Del. Ch. Feb. 22, 1978).

187. *Id.*, slip op. at 9-10.

188. *Id.*, slip op. at 11.

valuation alone, it should have been afforded greater weight in the court's analysis.

The court's decision to enjoin the proposed merger as unfair was heavily influenced by the fact that Contran had designed the merger of Valhi into its subsidiary, VIS, to circumvent the eighty percent vote requirement of the otherwise applicable anti-takeover provision. "Contran has undertaken to manipulate corporate machinery to accomplish an inequitable result, namely the unilateral elimination of . . . minority stockholders in exchange for cash by a vote of less than 80% of such corporation's voting stock."[189] This conclusion, however, ignores the fact that anti-takeover provisions are not enacted to protect minority shareholders but rather to protect incumbent management from the possibility that the acquiring corporation might no longer desire their services.[190] Moreover, the prospect of unemployment for the incumbent management was extremely high here since prior to Contran's acquiring control of Valhi at least an eleven million dollar loss was attributable to mismanagement.[191] Thus, the future effect of the court's holding will be to grant extraordinary protection to the inefficient management of target corporations and to deter the socially desirable acquisition of "sick" corporations by economically sound corporations.

As *Tanzer* and *Young* illustrate, the extent of the *Singer* holding is unclear. Although the court in *Singer* pointedly limited its holding to cases involving an exchange of cash for stock, whether the court also limited its holding to long-form mergers is questionable. The uncertainty in this regard is created by the court's treatment of *Stauffer v. Standard Brands, Inc.*[192] There the Delaware Supreme Court had held that appraisal was the exclusive remedy for the eliminated minority shareholders of a short-form merger utilizing a straight stock for cash conversion.[193] By refusing to read *Stauffer* as endorsing "a merger accomplished solely to freeze-out the minority without a valid business purpose,"[194] the *Singer* court cast doubt upon the use of the valuation

189. *Id.*, slip op. at 13.

190. *See generally* E. KINTNER, PRIMER ON THE LAW OF MERGERS 90-93 (1973).

191. No. 5430, slip op. at 5.

192. 178 A.2d 311 (Del. Ch.), *aff'd*, 187 A.2d 78 (Del. 1962).

193. 187 A.2d at 80.

194. 380 A.2d at 979. The court's reading of *Stauffer* was clearly erroneous. *See* note 158 *supra* and accompanying text. Additionally, the holding in *Stauffer* was firmly based on the valuation approach. Observing that Delaware's short-form merger statute was modeled after New York's short-form merger statute, the *Stauffer* court cited a New York case:

> 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 an

approach in short-form mergers as well. In *Kemp v. Angel*,[195] a Delaware Chancery Court recently extended the *Singer* rationale to short-form mergers. In *Kemp*, fraud was alleged in the acquisition of the ninety percent stock interest necessary to effectuate the short-form merger. It should be noted that technically *Kemp* was not incompatible with *Stauffer* since the *Stauffer* holding was specifically directed to situations *not* involving fraud.[196] However, a subsequent case, *Najjar v. Roland International Corporation*[197] held that the *Singer* rationale was applicable to short-form mergers even though no allegation of fraud was contained in the complaint. The *Najjar* court concluded that

> when a complaint attacking a merger "alleges" that its sole purpose is to eliminate minority interests, such a complaint is now virtually immune from a motion to dismiss for failure to state a cause of action, especially when the basis for such a motion would be, as here, that the plaintiff is only complaining about the amount paid for the minority shares.[198]

The importance of the *Najjar* holding, however, is uncertain. In response to *Singer* and the possibility that its holding would be extended to short-form mergers, the General Corporation Law Committee has recently proposed amendments to the General Corporation Law.[199] The proposed amendment to section 253 would codify the *Stauffer* holding that made appraisal the exclusive remedy for displaced minority shareholders in short-form mergers. Should the legislation be adopted, the *Najjar* holding would be stripped of its momentary significance.

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appraisal . . . . He has no right to stay in the picture, to go along into the merger, or to share in its future benefits.

178 A.2d at 315 (quoting Beloff v. Consolidated Edison Co., 300 N.Y. 11, 87 N.E.2d 561 (1949)).

195. SEC. REG. & L. REP. (BNA) No. 434, at A-12 (Jan. 4, 1978).

196. 178 A.2d at 314.

197. No. 5491 (Del. Ch. May 8, 1978).

198. *Id.*, slip op. at 11.

199. The General Corporation Law Committee, Proposed Amendments to the General Corporation Law 5, 11-12, 15-16 (1978). It should be noted that at present the proposed amendments do not affect the *Singer* holding as to long-form mergers.

The General Corporation Law Committee has also suggested amendments to the appraisal statute. Significantly, the proposed amendment would eliminate the requirement that the determination of the fair value of the dissenter's stock be exclusive of any increase in value attributable to the proposed merger. The theory behind compensating the minority shareholders on the basis of majority shareholders' gain appears to be predicated on the notion that the minority shareholders would have participated in this gain had they not been excluded from the on-going enterprise. Such logic is, of course, fallacious since any gain to the majority from the going-private transaction would not have occurred without the minority shareholders being eliminated from the enterprise. If the minority shareholders had remained in the corporation the value of their stock would not have changed because the corporation would have remained public. Determining the value of the minority shareholders' stock on the basis of the majority's gain, therefore, does not accurately reflect the actual injury the minority shareholder has suffered. *Id.*

Finally, the coercive effect of these decisions should be noted. Under *Singer*, plaintiffs acquire a powerful instrument of persuasion—the threat of litigation.[200] No matter how weak the plaintiff's case, it is frequently less expensive for the majority to meet the plaintiff's demands than it is to litigate the issue.[201] Thus, the court's contention that the decision did not resurrect minority veto power seems unrealistic.[202]

IV. PROPOSAL

A. *Generally*

The extra-valuation protections adopted in *Singer* are ill-founded. As will be demonstrated, extra-valuation protections represent an emotional response to an economic problem and are based on misconceptions concerning the investor's interest within the corporation. Since these protections can be maintained only at the expense of corporate flexibility and shareholder democracy tenets, they should be abandoned. The remedy for the displaced public shareholder should be limited to fair valuation, which affords the shareholder the necessary protection of his investment with the minimal impairment of corporate flexibility.

The essential issue in going-private transactions is the nature of the shareholder's interest in the corporation. The notion that a shareholder may be forcibly ejected from a corporation without his individual consent is offensive to a society that values self-determination.[203] Indeed, the most pointed criticism of going-private transactions centers on the majority's unilateral action which terminates the minority's interest in the corporation.[204]

Similarly, the proposed solutions focus on correcting the involuntariness of the shareholders' elimination. Thus, the majority's unilateral action in *Singer* is tempered by imposing the burden of proving the fairness of the transaction upon the interested majority. *Singer* also remedies the apparent flaw in corporate democracy which allows the

200. Vorenberg, *supra* note 135, at 1215 (referring to *Sterling*).

201. *See* note 45 *supra*.

202. 380 A.2d at 978. "And from the majority's point of view, the removal of the minority's veto of basic transactions will lose much of its significance if, in order to consummate a transaction which gives rise to appraisal, the majority must sustain an unrealistically rigorous burden of showing the fairness of the transaction." Vorenberg, *supra* note 135, at 1205.

203. It is the lack of volition on the part of the minority which is advanced as a primary justification for restrictions on going-private transactions. *See Going Private, supra* note 52, at 923.

204. "Going private will raise significant issues under corporate common law to the extent that insiders can use corporate mechanisms unilaterally to slice the corporate pie into portions which satisfy their appetite alone." *Id.* at 913-14. *See also* Vorenberg, *supra* note 135, at 1202.

minority's continued participation in the corporation to be predicated solely upon the percentage of outstanding stock owned by the insiders and subject exclusively to their whims. Hence, the majority shareholders retain their right to vote, but the power of that vote is dependent upon their ability to prove the fairness of and demonstrate a valid business purpose for the transaction. Conversely, the minority shareholders are given a contingent right of continued participation within the enterprise, since if the merger is unfair or does not have a valid business purpose minority shareholders may seek to enjoin or void the majority-approved merger.

Thus, the majority shareholders, once the predetermined victors in the intra-corporate struggle, are now given a judicial handicap. With the bargaining power of the minority enhanced, the ensuing struggle becomes more sporting,[205] and unfortunately, more expensive. Undoubtedly, the legal reasoning which produces such a result is emotionally appealing.[206] At issue, however, is whether it is also logically sound.

Protection of minority shareholders has become an increasingly popular theme in corporate law generally and particularly in the going-private area. The validity of such safeguards, however, is dependent upon the extent to which they prevent an actual injury or the invasion of certain rights. In addition, these safeguards should accurately reflect the nature of the minority's interest within the corporation.

Ultimately, minority shareholder protection which extends beyond the fair value of the investor's shares assumes that the minority's interest within the corporation is not exclusively economic. Neither courts nor commentators, however, have identified the nature of the shareholder's non-economic interest. A careful review of commentaries and cases reveals that they also do not address the specific injury which the business purpose test prevents. A breach of fiduciary duty which produces no injury surely is not actionable.[207] Furthermore, the implication that the shareholder's elimination itself is the injury merely begs the

205. As Professor Vorenberg observes: "To the extent that an injunction against the proposed action is an effective third choice available to the dissenter, his bargaining position may be significantly strengthened and the freedom of action of those in control of the corporation correspondingly inhibited." Vorenberg, *supra* note 135, at 1191.

206. The emotional flavor such protections have developed is well illustrated by Applestein v. United Board & Carton Corp., 60 N.J. Super. 333, 352-53, 159 A.2d 146, 157, *aff'd*, 33 N.J. 72, 161 A.2d 474 (1960): "The majority, no matter however overwhelming it may turn out to be, may not trample upon the property and appraisal rights of the minority shareholders . . ., no matter how few they may be in number."

207. The Restatement of Torts makes a distinction between "harm" and "injury". RESTATEMENT (SECOND) OF TORTS § 7 (1965). Although a detriment is involved in a harm, it is not necessarily involved in an injury. *Id.*, Comment d. An injury, it is noted, may be an invasion of a legally protected interest. For example, trespass upon land is an injury which

question. Aside from investment valuation, the issue critically posed is whether the shareholder's elimination *is* an injury.

Indeed, the nature of the minority's injury becomes apparent only through the circuitous approach of examining the remedy. The effect of the business purpose test is to give the shareholder a conditional right of continued participation and thus indicates that the minority's injury is the invasion of this conditional right.[208] It is, of course, important to note that the provision of such a right is the effect of any remedy in going-private transactions which allows the minority to prevent its elimination from the enterprise.

B. Continued Right of Participation

If the shareholder does have a right of continued participation within the corporation, the right clearly is not pervasive.[209] There is, of course, no guarantee that the corporation will continue to exist in any form and the possibility of its dissolution is merely one of the risks inherent in investment.[210] Similarly, in the case of major corporate changes, there is no assurance that the corporation will continue to exist in its initial form. The investor may thus find that the corporation in which he initially invested is for all practical purposes not the one in which he is presently a shareholder.[211] Arguably, if the corporation continues to exist in some

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frequently occurs without a harm. *Id.*, Comment a. For purposes of this article when "injury" is referred to in the text, a harm will be assumed.

In going-private transactions, it would appear that an injury is necessary in order to justify the imposition of a remedy. The property interest a shareholder has in the corporation is at best an intangible interest with none of the static physical qualities of land. Indeed, Professor Bayless Manning describes the shareholder's claim as evolving from "'ownership' to the status of a fungible dollar claim." Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L.J. 223, 230 (1962). Moreover, he reasons: "This approach represents a relatively refined state of judicial development, for it means that the modern court will not today enjoin the transaction without a substantive showing of severe economic injury to the plaintiff—an inquiry that a nineteenth century court would not have found necessary." *Id.* at 246 n.38.

208. At one extreme, the theory has been advanced that a shareholder has the *right* to retain his interest in the corporation. Relying on the premise that the shareholder, as the owner of a unit of interest in the corporation, possesses a property right, it is argued that he should not be deprived of his ownership unless there are clear and imperative reasons for such an occurrence in terms of the needs of the corporation. Comment, *Corporate Freeze-Outs Effected by Merger: The Search for a Rule*, 37 U. PITT. L. REV. 115, 117 (1975).

209. Borden states that an outside shareholder's "right" to continued participation has been "so diluted by the variety of permissible permutations in corporate equities that the contemporary shareholder probably does not even imagine that such a vested right exists." Borden, *supra* note 21, at 1017.

210. Manning, *supra* note 129, at 250-51; Vorenburg, *supra* note 135, at 1203.

211. Although the New York Court of Appeals was dealing with the duties of a trustee, its observations concerning corporate changes are relevant here:

form, the determination of whether the shareholder remains within the corporation should be one of personal choice.[212] Generally, the shareholder confronted with a corporate change can either accept the investment risks reflecting that alteration or exercise the dissatisfied shareholder's option of selling his stock. Moreover, in a merger transaction, appraisal statutes typically insure the investor's right to opt out.[213] In going-private transactions, however, allowing the continued participation of the investor in the corporation to be one of personal choice necessarily conflicts with the notion that the individual may not prevent fundamental corporate changes. It is important to note that this conflict is irreconcilable since the investor's decision to remain in the corporation would effectively thwart the corporation's plan to go private.

C. *Vested Rights Theory*

Although the right of continued participation is not generally recognized in corporate law, it is by no means an entirely new concept.[214] Its forerunner, the vested rights theory, gave the individual shareholder the right to veto any major corporate change[215] and haunted polemicists until it was finally abandoned by the courts.[216] The vested rights doctrine did not retire gracefully; "[w]henever the court was of the opinion that certain rights of stockholders could not be interfered with, they characterized those rights as 'vested'."[217] Thus, the doctrine's resurrection in the going-private area is accompanied by a natural reluctance by the courts to recognize its presence.[218]

> We think the identity of the Shuttleworth shares was ended by the merger . . . . Here the investment is radically different. The change of identity has relation not to form only, but to substance. The tale is only partly told when we say that the consolidated corporation is a new juristic person. It is that, but it is something more. The shares have been issued in new proportions and classified in new ways . . . . The old investment has been subordinated to alien priorities. The ancient venture has exposed itself to strange and unexpected hazards.

Mertz v. Guaranty Trust Co., 247 N.Y. 137, 141-42, 159 N.E. 888, 889 (1928).

212. *See Going Private, supra* note 52, at 923 (involuntariness of elimination warrants imposing restrictions on going-private transactions).

213. Manning, *supra* note 129, at 226.

214. Brudney, *A Note on "Going Private"*, 61 VA. L. REV. 1019, 1022 n.12. Brudney explains: "The common law concept that an equity interest could not be terminated by dissolution or structurally altered without unanimous consent underlies . . . the notion that equity owners cannot be 'forced' out of their enterprise." *Id.*

215. Gibson, *How Fixed Are Class Shareholder Rights?*, 23 L. & CONTEMP. PROB. 283, 285 (1958) [hereinafter cited as Gibson].

216. The doctrine was not formally rejected, but rather fell into a state of disuse when transactions previously barred as an invasion of vested rights were allowed under merger statutes. *Compare* Keller v. Wilson & Co., 190 A. 115 (Del. 1936) *with* Federal United Corp. v. Havender, 11 A.2d 331 (Del. 1940).

217. McNulty v. W. & J. Sloane, 184 Misc. 835, 841, 54 N.Y.S.2d 253, 259-60 (Sup. Ct. 1945).

218. None of the Delaware opinions, for instance, mention the historical basis of the

It is important to note, however, that there are significant distinctions between the vested rights theory and the continued participation right doctrine. Under the vested rights theory, the individual shareholder had the power to veto any major corporate change. As the rate of technological growth accelerated, the individual's veto power severely inhibited the corporation's ability to adapt.[219] Eventually, this veto power was replaced by majoritarian decision making.[220]

In contrast, the minority's power to override a transaction approved by the majority is substantially restricted under the doctrine of continued participation. The minority's veto power arises only if the transaction will result in his elimination from an on-going enterprise and was approved by the majority without a valid business purpose. Thus the validity of the right of continued participation is not necessarily precluded by the judicial rejection of the vested rights thory, and the factors that initially justified the vested rights doctrine are equally applicable to the continued participation doctrine.

D. Viability of a Property-Oriented Approach to Shareholder's Rights

The vested rights doctrine arose at a time when corporations were small and their shareholders were few.[221] Typically, the shareholder's investment included a substantial expenditure of time and energy to ensure the corporation's success. In a very real sense, the shareholder's involvement with the corporation and his fellow shareholders was of a personal nature.[222]

In this context, the requirement of unanimous consent for major corporate changes accurately reflected the shareholder's interest within the corporation.[223] The veto power was necessary to protect the shareholder's reasonable expectation that his ownership and employment within the corporation would not be altered without his consent. Additionally, the veto power prevented a tangible injury since the market value of the corporation's stock was not representative of the shareholder's personal investment in the corporation. Finally, the need for corporate flexibility was not considerable.

Today, however, the public shareholder's investment is primarily

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shareholder's right to prevent his elimination from the enterprise. *See, e.g.*, Singer v. Magnavox, 380 A.2d 969 (Del. 1977); Tanzer v. International Gen. Indus., Inc., 379 A.2d 1121 (Del. 1977); Young v. Valhi, Inc., No. 5430 (Del. Ch. Feb. 22, 1978).

219. Gibson, *supra* note 215, at 284.

220. *Id.* at 291.

221. *Id.* at 283.

222. *Id.*; *see* Lattin, *The Minority Stockholder and Intra-Corporate Conflict*, 17 IOWA L. REV. 313, 319 (1932).

223. Gibson, *supra* note 215, at 283.

speculative in nature.[224] Generally he is neither employed by the corporation nor does he meaningfully participate in its growth.[225] The investor's reasonable expectations are focused on the corporation's ability to achieve a profitable return on his investment.[226] Thus, the right of continued participation reflects neither the investor's interest within the corporation nor his reasonable expectations concerning his investment.[227]

Moreover, the monetary nature of the public shareholder's investment negates the possibility of a non-economic injury. Certainly the cost of reinvesting in another corporation is not a serious disadvantage.[228] The cash-out price is generally substantially higher than the market value of the investor's stock[229] and actually enables the investor to increase the size of his holdings in another corporation.[230]

Furthermore, the suggestion advanced in *Singer* that the public shareholder might have an emotional attachment to his investment is not convincing.[231] Even assuming arguendo that a public shareholder might actually have such an emotional interest in a company, given the rarity of its occurrence, that interest should not be one that society considers reasonable and worthy of protection. Indeed, the concept of a sentimental investment completely ignores the return-on-investment orientation of the stock market.[232] As one commentator has suggested, "[p]erhaps it is not unreasonable to assume that if the parties proceed on the basis of a [non-economic] link between stockholding and some other connection, it should be protected by a contract or charter provision."[233] Clearly, the

224. *Id.* at 287; *see* Eisenberg, *The Legal Roles of Shareholders and Management in Modern Corporate Decisionmaking*, 57 CALIF. L. REV. 1, 45 (1969).

225. *See* Borden, *supra* note 21, at 1015.

226. Eisenberg, *The Legal Roles of Shareholders and Management in Modern Corporate Decisionmaking*, 57 CALIF. L. REV. 1, 82 (1969).

227. Eisenberg reasons that "[i]n the absence of any hard data concerning the expectations of shareholders in publicly held corporations, the following assumption . . . will be made: The extent to which a shareholder in such a corporation expects and wants to participate in structural decisions is intimately related to the size of his holdings." *Id.* at 33.

228. *Contra*, Brudney, *A Note on "Going Private"*, 61 VA. L. REV. 1019, 1023 (1975).

229. *Id.* at 1019.

230. Borden, *supra* note 21, at 1015.

231. 380 A.2d at 977 n.7.

232. *See* Dodd, *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145, 1161 (1932).

233. Vorenberg, *supra* note 135, at 1203. Some critics contend that it is the use of shareholder equity to finance the going-private transaction which injures the public shareholders; making the majority's gain to be "at the expense of the minority." *Second Circuit, supra* note 13, at 1210. Still, it is clear that the minority cannot participate in a gain which accrues only as the result of their elimination. Furthermore, insofar as the criticism is directed to the fact that the public shareholder contributed more to the equity of the corporation than he is now being offered, it would seem that a decline in stock market prices is a risk inherent in investment.

right of continued participation cannot be justified on the basis that it prevents an injury not reflected in share valuation.[234] Recognition of the economic nature of the public shareholder's interest within the corporation, however, does not negate the increased possibility of abuse present in going-private transactions.

Minority shareholders may sincerely question the fairness of going-private terms which are unilaterally set by the majority.[235] Still, it is important to note that the unilateralnessof the majority's action is attributable primarily to the doctrine of shareholder democracy.[236] It is elementary that shareholder democracy is not based on a "one-man-one-vote principle, but on the proprietary principle of one-share-one-vote."[237] Thus, those with the largest financial stake in the corporation are given the greatest amount of control in determining general corporate policy.

Consequently, any action by the minority which may enjoin or void a merger authorized by statute[238] and approved by a majority should be

234. This viewpoint has been well described: "The rationale for this position has been that minority shareholders who receive fair compensation cannot complain that the action has worked to their detriment, and if they suffered no detriment, special advantage to controlling shareholders is inconsequential." *Establishing Federal Standards, supra* note 37, at 656 (footnote omitted) (referring to Grimes v. Donaldson, Lufkin & Jenrette, Inc., 392 F. Supp. 1393 (N.D. Fla. 1974)).

235. *See* note 204 *supra*. Borden dismisses the notion that the unilateralness of the majority's action in fixing the stock price makes the going-private transaction inherently unfair: "The unfairness, however, does not lie in the postulate that the price is necessarily unfair because fixed by the insiders, an expression of the villain theory of corporate life which we must dismiss as not justified by experience." Borden, *supra* note 21, at 1017.

236. Solomon explains the issue: "In response to the growing magnitude of corporations . . . and the possible nuisance value created by a recalcitrant minority, most state legislatures empowered a majority of two-thirds of each class of shareholders to approve a merger. This, in turn, opened the possibility for the victimization of the minority shareholders." Solomon, *supra* note 47, at 156-57.

Although the majority shareholders appear to have the most powerful position in the struggle, Borden notes that "it may be questioned how much of an advantage exists when almost every going-private transaction to date has been met by a suit brought by a self-appointed champion of the minority public shareholders." Borden, *supra* note 21, at 1017.

237. Eisenberg, *The Legal Roles of Shareholders and Management in Modern Corporate Decisionmaking*, 57 CALIF. L. REV. 1, 44 (1969). Although hypothetically this means that the majority may be only one shareholder, so might the minority. And, if judicial policy must favor one above the other, the most logical choice is the majority shareholder since he has invested a greater sum of money into the enterprise and thus should have a greater voice in controlling its direction. Indeed, this is the reason that share democracy rather than shareholder democracy was adopted. One commentator contends that "[w]hile extending extraordinary protection to minority shareholders, [the Court's adoption of the business purpose test] ignores the existence of the majority's interest in the corporation and overlooks the fact that one of the risks assumed by every purchaser of a corporation's stock is that his investment may be extinquished through events beyond his control." Note, *Second Circuit Note, 1975 Term*, 51 ST. JOHN'S L. REV. 417, 426 (1977) (footnotes omitted) (referring to Green v. Santa Fe Indus., Inc., 533 F.2d 1283 (2d Cir. 1976), *rev'd*, 430 U.S. 462 (1977)).

238. Legislative intent concerning going-private transactions will, of course, vary from

viewed with caution and handled with judicial restraint.[239] If it seems inequitable that those who remain within the corporation are given the power to exclude the minority, it seems equally inequitable to allow a minority of shareholders to determine whether the corporation may go private.[240] Such a remedy merely replaces the self-serving will of the majority with the similarly self-serving will of the minority.[241]

It should also be noted that while the majority shareholders must have a valid business purpose to consummate the transaction, the minority need not have a comparable purpose for seeking to void the merger. And, the notion that greed is not attributable solely to the majority shareholders was apparent to at least one court:

> The obverse of the minority claim, however, may well be that an obdurate and obstructionist minority is engaged in a "hold-up" of legitimate majority desires, motivated solely by greed for the top dollar obtainable. The crime of "self-interest" is always attributable to the other side. How the court reacts emotionally to a linguistic barrage or to a sympathetic factual presentation should not be the determinant.[242]

Additionally, an element of unilateralness is unavoidable in going-private transactions, since a corporation cannot attempt to go private

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state to state. For a discussion of the legislative intent of the merger statutes in Delaware, see notes 158-66 *supra* and accompanying text. A discussion of the legislative intent in California is contained in notes 80 & 154 *supra*. Still, as Borden concludes: "Viewed broadly, the social policy reflected in these statutes is a preference for corporate flexibility and corporate democracy over notions of vested shareholder rights." Borden, *supra* note 21, at 1026.

239. In passing upon whether these additional requirements [of a valid business purpose] are to be imported into the proceedings, the court at the outset must be wary of acting precipitiously to upset [an appraisal] . . . procedure which has been given express legislative sanction because of an emotional reaction or instinctive predisposition to sympathetic presentation. Skill in choosing appropriate semantic labels may foreshadow the outcome. The claim of "freeze-out" by a predatory majority using their power as insiders to mulct corporate funds and to overreach in order to unjustly enrich themselves tends to lead a sympathetic court to look indulgently upon extra-statutory remedies.

Tanzer Economic Assoc. v. Universal Food Specialties, Inc., 87 Misc. 2d 167, 175, 383 N.Y.S.2d 472, 479 (Sup. Ct. 1976) (footnote omitted).

240. *See* Borden, *supra* note 21, at 1016. This is particularly true when a majority of the minority approve the transaction since protection of the minority is not a convincing rationale where the majority of the protected class approve the transaction. While requiring approval by a majority of the minority might appear to be an attractive solution to this judicial balancing of equities, the judicial imposition of such a voting requirement would nevertheless appear to be an unacceptable usurpation of express legislative commands.

241. *See* Green v. Santa Fe Indus., Inc., 533 F.2d 1283, 1308 (2d Cir. 1976) (dissenting opinion), *rev'd*, 430 U.S. 462 (1977). Manning concludes that "[t]his concern for the minority has a familiar and congenial ring to the American mind. It sounds of Madison's warning that tyranny by the majority is more to be apprehended than tyranny by the few." Manning, *supra* note 129, at 226.

242. Tanzer Economic Assoc. v. Universal Food Specialties, Inc., 87 Misc. 2d 167, 175, 383 N.Y.S.2d 472, 479 (Sup. Ct. 1976).

without affecting the market liquidity of the issuer's stock.[243] As shares are either repurchased by the corporation or tendered to the acquiring company, the volume of shares available for public trading is reduced and the marketability of such shares is correspondingly diminished.[244]

Although methods of going private have been characterized as either voluntary or involuntary,[245] the distinction seems insubstantial. On the one hand, tender offers are regarded as a voluntary method of going private since the elimination of the public shareholders depends upon the individual's election to terminate his participation in the enterprise.[246] In contrast, the elimination of public shareholders through a merger is regarded as an involuntary method of going private since the individual's continued existence within the corporation is determined by a vote of the statutorily mandated percentage of outstanding shares.[247]

Under either method, however, the element of coercion necessarily exists.[248] The shareholder contemplating tendering his shares is certainly influenced, and possibly compelled, by the prospect of deregistration and/or delisting with a stock exchange which may render his securities unmarketable.[249] And, full disclosure of the company's future plans, including the possibility of a freeze-out merger if the tender offer is not completely successful, may only serve to increase the pressure on the public shareholders to accept the tender offer.[250]

It is not surprising that this element of coercion, induced by the prospect of a loss of market liquidity, has prompted some of the most extreme criticisms of going-private transactions.[251] One commentator suggests that the acquiring company should be required to insure a market for the untendered shares.[252] Although such a safeguard would undoubtedly alleviate the amount of coercion present in tender offers, some coercion, engendered by the loss of publicly available information on the company,[253] will nevertheless remain.

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243. Greene, *supra* note 73, at 515-16; Solomon, *supra* note 47, at 171.

244. Brudney, *A Note on "Going Private"*, 61 VA. L. REV. 1019, 1020 (1975).

245. *Establishing Federal Standards, supra* note 37, at 649-50.

246. *Id.* at 649.

247. *Id.* at 650.

248. *Id.* at 649.

249. *Id.*

250. *Id.* at 649-50.

251. *See* Greene, *supra* note 73, at 516; *Going Private, supra* note 52, at 917-18.

252. Greene, *supra* note 73, at 516 (citing Brudney, *A Note on "Going Private"*, 61 VA. L. REV. 1019, 1043-44 (1975)). Greene also mentions the likelihood that "an investor who purchased shares in a publicly held company will not be interested in remaining as an investor in a private company in which he has no role in management." Greene, *supra* note 73, at 516.

253. Swanson, *The Elimination of Public Shareholders: Going Private*, 7 CONN. L. REV. 609, 610-11 nn.4-10, 616 & n.31 (1975).

While the possibility of abuse is created by the inherently coercive nature of going-private transactions, this possibility does not mandate the imposition of restrictions on all such transactions.[254] Public shareholders should be protected when such abuses do occur. But, again, those protections should not exceed the interest actually invaded, and thus should be limited to the issue of fair valuation for the investor's shares.

V. CONCLUSION

Competing policy considerations have been advanced in the going-private area.[255] Corporate flexibility, a factor in the rejection of the vested rights doctrine,[256] continues to play a critical role in any consideration of minority shareholder protections.[257] The possibility of shareholder litigation injects an element of uncertainty[258] and delay in business transactions which may require prompt action.[259] This is particularly true in the case of acquisition mergers. To the extent that pure going-private transactions reflect a basic change in management approach and business orientation,[260] as they usually do, or a recapitalization of the corporation[261] there is a similar need for unretarded action.

An alternative policy consideration advanced is that public shareholder protection in going-private transactions is necessary to prevent public disillusionment with the stock market.[262] Evidently, the view is that such an unsettling experience with the corporation will adversely affect other businesses attempting to obtain funds through the sale of stock to the public. The actual extent of the effect that going-private transactions have on investor confidence is unfortunately impossible to determine.

However, corporations have become increasingly independent of funds obtained from individual investors. The percentage of total dollars attributable to individual trading activity on the New York Stock Exchange has fallen by approximately fifty percent since 1961 to the current low of twenty-three percent.[263] The raising of funds through public financing has evidently become less profitable to both the individual

254. In actuality, such abuse is rare. SEC. REG. & L. REP. (BNA) No. 389, at B-4 (Feb. 9, 1977).

255. *Second Circuit, supra* note 13, at 1206.

256. *See* Chicago Corp. v. Munds, 172 A. 452, 455 (Del. 1934); Gibson, *supra* note 215, at 291.

257. *See* Gibson, *supra* note 215, at 291.

258. Vorenberg, *supra* note 135, at 1215.

259. *See* Gibson, *supra* note 215, at 295.

260. *See* notes 47-48 *supra* and accompanying text.

261. *See* notes 56-61 *supra* and accompanying text.

262. *Second Circuit, supra* note 13, at 1206; *Establishing Federal Standards, supra* note 37, at 649.

263. *See* note 51 *supra*.

investor and the corporation due to the depressed state of the public trading market.[264] Moreover, the policy of promoting investor confidence does not apply exclusively to the minority shareholders:

> It should also be noted, of course, that controlling shareholders are also shareholders, and that their continued willingness to put massive sums at risk during these turbulent times is an essential element of the capital formation process. It is of even greater importance at a time when many others are abandoning all but the most secure equity investments.[265]

Ultimately the validity of public shareholder protections which assume a right of continued participation is a policy decision determined by balancing the corporation's need for flexibility against the minority's need for protection. Insofar as the public shareholders' interests and expectations concerning the corporation are essentially monetary, and in the absence of any substantial non-economic injury, the recognition of a right of continued participation is unnecessary.

Additionally, since the protection offered to the public shareholders serves only to impair corporate flexibility, the right of continued participation implicit in the business purpose test should be abandoned. Instead, until such time as the public shareholders can demonstrate a non-economic interest (or reasonable expectation) in the corporation, the primary focus in going-private transactions should be whether the public shareholders have received fair value for their shares. Consequently, extra-valuation protections should be rejected, and the remedy for displaced minority shareholders should be limited to fair valuation.

Lorraine Beth Johnson

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264. Needham, Harper & Steers went private last July. The primary motivation for the move was the "cold shoulder the firm was receiving from investors." Shakin, *Going Private: Court Rulings Have Sharply Raised the Ante*, Barron's, Oct. 10, 1977, at 11, col. 1.

265. SEC. REG. & L. REP. (BNA) No. 389, at B-3 (Feb. 9, 1977).