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Delaware Reexamines its Merger Laws: New Protection for Minority Shareholders?

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The inquiry into how and when a parent corporation\(^1\) can legitimately eliminate a minority interest has gained increased significance in light of the recent popularity of “going private” transactions.\(^2\) The Supreme Court of Delaware reached this question in Singer v. Magnavox Co.,\(^3\) which had been decided below in the court of chancery on a motion to dismiss for failure to state a claim upon which relief can be granted. The Supreme Court of Delaware held that, despite technical compliance with the state’s statutory merger provisions, a long form cash-out merger\(^4\) is improper if its

\(^1\) A parent corporation is one which owns all of the stock of another corporation or owns enough to control it. Control has been defined as the power to cause the corporation to do as one wishes. See Kaplan v. Centex Corp., 284 A.2d 119, 123 (Del. Ch. 1971). Majority stock ownership normally carries with it such control. However, stock ownership alone, at least when it amounts to less than a majority, is not sufficient proof of control or domination. See id. Often, control of the corporation is concentrated in a group of insiders. An insider is a person who has special access to information about the corporation as a result of his financial interest in the corporation or his role in the management of the corporation.

\(^2\) “Going private” is a relatively recent phenomenon. During the inflated market conditions of the late 1960’s, many companies “went public” by offering equity participation to the public. This provided needed capital and an opportunity to benefit financially from a sale of a part of their interest in the business while still retaining a substantial or majority interest. When the market declined, these same insiders who took the company public desired to return the company to private status by reacquiring the public shares at now deflated prices. As a result, the insiders directed the reacquisition and became the surviving shareholders in a once again privately held enterprise. This type of transaction has prompted much commentary. See, e.g., Borden, Going Private—Old Tort, New Tort or No Tort?, 49 N.Y.U.L. Rev. 987 (1974); Greene, Corporate Freeze-out Mergers: A Proposed Analysis, 28 Stan. L. Rev. 487 (1976); Note, The Developing Law of Corporate Freeze-outs and Going Private, 7 Loy. Chi. L.J. 431 (1976); Note, Going Private, 94 Yale L.J. 903 (1975); Phalon, Personal Investing, Inside the Insider Buyout Boom, N.Y. Times, Sept. 24, 1977, at 28, col. 1.

\(^3\) 380 A.2d 969 (Del. 1977). The Singer decision also involved a question of first impression concerning Delaware securities law. Construing the Delaware Securities Act, Del. Code tit. 6, §§ 7301-7328 (1974 & Cum. Supp. 1977), as a blue sky law, the court held that a Delaware corporation is not bound by the Act simply because it is incorporated in Delaware. “[W]e do not read the Act as an attempt to introduce Delaware commercial law into the internal affairs of corporations merely because they are chartered here.” Id. at 981.

\(^4\) A long form merger must be approved by a requisite percentage of the out-
sole purpose is to freeze out a minority interest. Further, even if a legitimate purpose is found, the merger is still subject to judicial scrutiny to consider its "entire fairness" to minority stockholders. In reaching its decision, the court relied on an amalgam of principles of fiduciary responsibility, fairness, and the concept of a valid business purpose.

At a time when the number of unchallenged going private transactions was steadily increasing, this decision represents an extremely prominority position from an unexpected proponent of minority rights. Delaware is regarded as a corporate home, and the decisions of its courts have long set the mode for the development of corporate laws in other jurisdictions. Since Singer marks a changing attitude towards corporate management and raises serious doubts about future corporate flexibility, this note will discuss its precedential value for the viability of going private transactions as a mode of future corporate combination.


5. A freezeout has been defined as follows:
In its broadest sense, it might be taken to describe any action by those in control of the corporation which results in the termination of a stockholder's interest in the enterprise . . . . The term has come to imply a purpose to force a liquidation or sale of the stockholder's shares, not incident to some other wholesome business goal.


7. New York had already recognized the merits of allowing a parent to bring a subsidiary that is partially held by the public within the parental fold. See Tanzer Economic Assocs., Inc. v. Universal Food Specialties, Inc., 87 Misc. 2d 167, 383 N.Y.S.2d 472 (Sup. Ct. 1976). See also Singer v. Magnavox C. 367 A.2d 1349 (Del. Ch. 1976), aff'd in part, rev'd in part, 380 A.2d 969 (Del. 1977). Though there is no accurate count of the number of companies that have gone private since the early 1970's when stock prices began to decline, "[o]ne securities lawyer who has done a thorough study of the subject . . . estimates that at least 'several hundred' have done a buyout and thinks that many more are likely to follow suit." Phalon, supra note 2, at 28, col. 1. Some states, however, did disapprove of or question the propriety of these transactions. See Albright v. Bergendahl, 391 F. Supp. 754 (D. Utah 1974); Jutkowitz v. Bourns, No. CA 000268 (Cal. Super. Ct. Nov. 19, 1975); Berkowitz v. Power/Mate Corp., 135 N.J. Super. 35, 342 A.2d 566 (1975).
RIGHTS OF MINORITY SHAREHOLDERS

FREEZEOUT: A MEANS TO AN END

Going private describes only the incidental result in some cases of much broader categories of transactions, all calculated to eliminate a minority interest while the majority retains the assets and goodwill of the enterprise. One type of going private transaction involves a controlling shareholder, itself not an operating parent, desiring to eliminate a minority interest: This is often referred to as the true going private transaction.\(^3\) Another variation of going private occurs when a publicly held corporation acquires control of a second corporation. To complete the takeover, the acquiring corporation eliminates the participation of those holding the remaining outstanding shares in the acquired corporation.\(^4\) Similarly, when a publicly held corporation brings a long held public subsidiary within the parental fold and in the process eliminates the minority interest in the subsidiary, a going private transaction has been accomplished.\(^5\) Another variation occurs when a nonpublic parent

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\(^3\) In this form of corporate combination, the controlling shareholder of corporation A places his shares of A into a newly formed private corporation. This second corporation, B, is a shell corporation since its sole purpose is to assist in the merger of A and B. Since the controlling shareholder, X, owns all of the outstanding shares of B and a controlling interest of A, approval of the merger by the requisite majority is usually a foregone conclusion. When A and B are merged, the plan of merger provides that the remaining shareholders of A will receive cash in exchange for their shares. Upon completion of the merger, the controlling shareholder owns all of the stock in the new merged corporation, thus attaining the private status he sought. X now continues to operate the very same business with no change other than the elimination of the minority public interest. See, e.g., Jutkowitz v. Bourns, No. CA 000,268 (Cal. Super. Ct. Nov. 19, 1975). This same technique is employed in closely held corporations to eliminate a dissident minority. See Bryan v. Brock & Blevins, Co., 490 F.2d 563 (5th Cir. 1974).

\(^4\) This is the typical two-step acquisition merger, of which Singer is an example. In this transaction, publicly held buyer corporation D, directly or indirectly through a subsidiary, tenders for the stock of corporation E. Depending upon the success of the tender offer, the acquiring corporation, D, then effects a merger using either the long or short form merger provisions of the particular state. D, therefore, succeeds in eliminating the minority interest of E, the acquired corporation. This obviates the problem of a dissident minority hostile to the new management of the now merged DE. See Schulwolf v. Cerro Corp., 86 Misc. 2d 292, 380 N.Y.S.2d 957 (Sup. Ct. 1976).

\(^5\) Here, the parent is the controlling shareholder in the subsidiary and an operating parent. Since the parent and subsidiary are often in the same business, there are problems of allocating common management and duplicative professional and other costs, and questions of who will receive a corporate opportunity and even advantages received by one entity at the expense of the other. Merging the two entities obviates these conflicts. When such a merger is effected and the minority is paid cash for its holdings, minority members often claim to be squeezed out. See Green v. Santa Fe Indus., Inc., 533 F.2d 1283 (2d Cir. 1976), rev'd, 430 U.S. 462 (1977); Borden, supra note 2, at 1018-19.
corporation freezes out the minority in a subsidiary. In each case, the minority shareholders could claim that the majority is freezing them out by forcing them to relinquish their equity position.

There are a variety of techniques to accomplish a freezeout. Mergers, pursuant to long form and short form provisions of applicable state law, cash tender offers or exchange offers, reverse stock splits, and sale of assets followed by dissolution of

11. When a nonpublic parent corporation effects a takeout of the minority in a publicly held subsidiary, the remaining entity will be a private corporation. Unlike the case of a publicly held parent corporation, which can offer the minority an equity position in the merged corporation, the nonpublic parent can offer only cash to accomplish the takeout. See Borden, supra note 2, at 1019.

12. Use of the merger technique most often requires the existence of a second corporation which either preexists or is a shell created solely for the merger. The controlling shareholders of the first corporation, X, place their shares of X in a second corporation, Y. A merger of X and Y is then effected, with X's minority receiving cash or debt securities as consideration. Since minority shareholders have no opportunity to become equity participants in the surviving corporation, this method of merger differs from the conventional merger. In the latter, two or more operating businesses combine and the stockholders of each corporation become equity owners of the surviving corporation. For example, in the merger of X and Y, the holders of X and the holders of Y will receive an equity position in the surviving XY. See Securities Act Release No. 5884, [1977-1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 81,366, at 88,737 n.9 (Nov. 17, 1977). Long form merger statutes typically require the approval of the holders of a specified percentage of the outstanding shares of each corporation involved. However, proponents may already control the requisite percentage, thereby assuring approval of the merger. In Delaware, for example, the statute requires that only a majority approve the transaction. DEL. CODE tit. 8, § 251 (1974 & Cum. Supp. 1977).

13. Short form merger statutes are in effect in 38 states. The salient feature of these statutes is that a holder of a large percentage of the outstanding shares may cause the merger without the approval of the remaining shareholders. The required percentages are fixed by statute and vary from state to state: in one state, 99% is required; in nine states, 95% is necessary; in 27 of the 38 states, including Delaware, 90% is required; and in one state, the vote of 80% of the shareholders can effectuate merger without the approval of the remaining shareholders. See Green v. Santa Fe Indus., Inc., 533 F.2d 1283, 1299 n.1 (2d Cir. 1976) (Moore, J., dissenting), rev'd, 430 U.S. 462 (1977).

14. A tender offer is a device by which one can gain control by offering cash or debt securities as consideration to existing shareholders for their shares of a corporation. While the decision to tender appears voluntary, there are pressures to accept the offer in a going private transaction. If most shareholders accept the terms and tender their shares, the nontendering holder may be faced with illiquidity. Moreover, if the issuer becomes available for deregulation under the securities laws, the nontenderer also loses the benefits and protections provided by the securities laws. A tender offer does not require shareholder approval, but rather is dependent for its success on the participation of the individual shareholder. See Note, Going Private, supra note 2, at 910.

15. If the controlling interest is held in large blocks, the corporation issues one full share of stock for a number in excess of that held in the largest block. This
the corporation\textsuperscript{16} are among the more common techniques employed. These techniques typically fall into two basic categories: one-step acquisitions of publicly held shares usually accomplished through a simple merger; and two-step acquisitions which generally involve a tender offer followed by one of several "mop up" devices.\textsuperscript{17}

The two-step acquisition requires a mop up device because tender offers are rarely entirely successful. A management intent on gaining entire control can effect a reverse stock split,\textsuperscript{18} one of the mop up devices. This results in all shareholders receiving fractional shares. Since most states have laws which permit a corporation to unilaterally buy out fractional shares,\textsuperscript{19} the reverse stock split can be an effective means of removing a minority interest.

A second mop up technique following a relatively successful tender, and one of the most often used, is the merger. If, following the tender, a substantial minority remains in the acquired corporation, the acquiring corporation may employ the long form merger provisions. However, if the insiders control almost all of the outstanding stock as a result of the tender, they can take advantage of short form merger statutes in effect in most states.\textsuperscript{20}

Use of these various means of removing minority stockholders from equity participation has been referred to pejoratively as freezeouts\textsuperscript{21} or squeezeouts.\textsuperscript{22} However, at least one commentator,

\begin{itemize}
  \item leaves the minority with fractional shares which the corporation can repurchase. For example, if the controlling interest is held in large blocks of 500, the corporation offers one new share for 500 outstanding shares. The terms of the split are devised to assure that the smaller securities holders will receive only fractional shares. The small shareholder must then sell his fractional shares to the corporation or "round up" by purchasing enough fractional shares to receive a whole share. Since rounding up usually involves a substantial investment, the controlling shareholder achieves complete control of a now private entity. \textit{See} Securities Act Release No. 5567, [1974-1975 Transfer Binder] FED. SEC. L. REP. (CCH) \$ 80,104, at 85,090-91 (Feb. 6, 1975); Address by A.A. Sommer, Jr., Law Advisory Council Lecture, Notre Dame Law School (1974) reprinted in [1974-1975 Transfer Binder] FED. SEC. L. REP. (CCH) \$ 80,010.
  \item In this type of takeout, the assets of the first corporation, A, are sold to a new corporation, B, created and owned by the controlling shareholders of A. Once B is in control of the assets of A, A is liquidated. The controlling shareholders now operate essentially the same enterprise without interference from the minority shareholders. \textit{See} Borden, supra note 2, at 997-99.
  \item \textit{See} note 15 supra and accompanying text.
  \item \textit{See}, \textit{e.g.}, DEL. CODE tit. 8, \S 155 (1974).
  \item \textit{See} note 13 supra and accompanying text.
  \item \textit{See} Vorenberg, supra note 5, at 1192.
  \item \textit{See} Borden, supra note 2, at 988.
\end{itemize}
recognizing the merits of various forms of going private, refers to them as takeouts, a more neutral denomination.\textsuperscript{23}

The takeout which has spawned the most commentary is the true going private transaction.\textsuperscript{24} Many corporations involved in this type of transaction first went public in the bull market era of the late 1960's. Taking advantage of an inflated market, these corporations eagerly sought public participation. When market conditions subsequently became depressed, these same corporations capitalized on the decrease in stock prices and repurchased all of their outstanding publicly held stock. This provided a means of buying their way back into private status by buying up corporate assets more valuable than the price reflected, at very modest expense. Though this form of transaction is often singled out as the most odious,\textsuperscript{25} it shares a common bond with other forms of takeouts: Once the transaction is effected, the majority retains control and the minority shareholders face illiquidity of their stock and a majority who can dictate the terms of the takeout.\textsuperscript{26}

Former Securities and Exchange Commissioner Sommer awakened public interest in these transactions when it became evident that some corporations and persons were taking undue advantage of the economic climate created in the early 1970's.\textsuperscript{27}

\textsuperscript{23} Id. at 989.
\textsuperscript{24} See note 8 supra and accompanying text.
\textsuperscript{25} Admittedly there seems something fundamentally inequitable about such a stark progression of events and perhaps a use of the . . . statutes should not be permitted which would allow those with controlling interests who originally sought public participation to later kick out public investors for the sole reason that they have outlived their utility to those in control and are made easy pickings by existing market conditions.


\textsuperscript{26} However one looks at it, "going private" is most often a no-win situation for public stockholders. For the buy-out price is almost always a small fraction of what the investor paid for the stock. The price, moreover, is determined by a consultant hired by the buyers. The investors have the choice of taking what is offered or holding a stock that is no longer readily marketable.

Hershman, Going Private—Or How to Squeeze Investors, DUN'S REV., January 1975, at 37. As former Securities and Exchange Commissioner Sommer noted: "If [the investor] chooses to stay aboard he may find the liquidity of his investment—the ability to sell readily at a price reasonably proximate to the last sale—reduced, perhaps completely destroyed." Address of A.A. Sommer, Jr., supra note 15. Commissioner Sommer went on to describe the conditions during a takeout: "Faced with the prospect of a force-out merger, or a market reduced to glacial activity and the liquidity of the Mojave Desert, . . . how real is the choice of the shareholder . . . ?" Id. at 84,696.

\textsuperscript{27} Address of A.A. Sommer, Jr., supra note 15.
The coercive efforts of the majority and the inherent conflict of interest caused other critics to call for an end to the "rape of the minority." Courts, responding to increasing abuse, tried to expand the remedies available to aggrieved shareholders. Indeed, the Securities and Exchange Commission, spurred not only by potential harm to the investor, but by the possible adverse effect on confidence in the marketplace, has proposed strict new rules governing all forms of takeouts.

Delaware, a leading corporate home, has now taken significant steps to protect minority rights by placing restrictions on future corporate combinations. Whether Delaware will pursue this course

29. As one commentator acknowledged: "I cannot imagine that the continued flourishing of schemes through which small shareholders are squeezed out against their will, or given an alternative between surrendering their ownership and engaging in prolonged and expensive litigation, does anything to promote confidence in the markets." Address of A.A. Sommer, Jr., supra note 15, at 84,699.
30. The Securities and Exchange Commission has recently proposed two new rules and accompanying schedules which would regulate going private transactions: proposed rule 13e-3 and proposed rule 13e-4. See Securities Act Release No. 5884, 1977-1978 Transfer Binder Fed. Sec. L. Rep. (CCH) ¶ 81,366 (Nov. 17, 1977). Proposed rule 13e-3 will provide definitions, specific disclosure and dissemination requirements, and antifraud provisions for most going private transactions. Id. at 88,735. The definition of going private will extend to the identity of the person who proposed the transaction, the type of transaction, and the likelihood of the transaction producing certain specified results, such as delisting from a national exchange. Id at 88,744. The antifraud provisions will make going private unlawful unless the transactions are fair and not fraudulent or manipulative. Id. at 88,747. The use of the fairness standard extends the reach of the new rule beyond the purview of existing rule 10b-5 in affording relief to minority shareholders. The SEC has indicated that the fairness of the transaction will, of course, depend on the facts and circumstances of each case.

Since it was thought that these going private rules alone would not adequately cover all corporate transmutations, proposed rule 13e-4 was suggested. This rule will "provide substantive regulation and disclosure requirements with respect to tender and exchange offers by certain issuers for their own securities." Id. at 88,735. See also Metz, Marketplace, Proposed Rules on Going-Private Moves, N.Y. Times, Jan. 26, 1978, at D-2. In light of the Supreme Court's recent decision in Santa Fe Indus., Inc. v. Green, 430 U.S. 462 (1977), these proposals have already become the center of controversy. At a recent convention, Professor Alan R. Bromberg commented that the Supreme Court in Santa Fe refused to establish a federal fiduciary doctrine and override state regulation of corporations, yet the SEC's proposed rules require compliance with federal law notwithstanding compliance with the applicable state law. See [1978] 437 SEC. REG. & L. REP (BNA) A-28 to A-29. The proposed SEC regulations represent a major expansion of federal regulation into areas of state law, while the Supreme Court in Santa Fe sought to limit such federal interference. Professor Bromberg, who predicted that these rules will certainly be challenged, further stated that as long as the Supreme Court holds that going private is not a federal matter, states will differ in their treatment of such transactions. Id.
and provide even greater protection for the victimized minority is unclear. Certainly, pursuit of such a course would detract from Delaware’s attractiveness as a corporate home, a position it can be expected to protect. With its favorable treatment of corporate management so firmly entrenched, Delaware may soon retreat from its position in Singer.

BACKGROUND

The Facts in Singer

In the complex area of stock mergers, the facts of Singer are not uncommon. North American Phillips Corp. (North American), a Delaware corporation, sought control of the Magnavox Company, also a Delaware corporation. The takeover was accomplished by a two-step acquisition. North American organized North American Development Corp. (Development) as a wholly owned subsidiary for the sole purpose of effecting a tender offer for Magnavox stock. The initial consideration proffered by Development was $8.00 per share. Development fully disclosed North American’s intentions and advised Magnavox of the possibility of a merger or other means to acquire the remaining shares. The Magnavox directors decided to oppose the offer and so advised their stockholders. Negotiations between the Magnavox directors and the directors of North American and Development followed. As a result of these negotiations, Development raised the consideration to $9.00 per share. Pursuant to this settlement, and at the insistence of the managements of North American and Development, employment contracts were entered into with sixteen officers of Magnavox. Thereafter, Magnavox’s compromised management withdrew its

31. See note 12 supra and accompanying text.
33. The book value of the Magnavox shares was $11.00. See Opening Brief for Appellants at 6, Singer v. Magnavox Co., 380 A.2d 969 (Del. 1977).
34. The Magnavox directors expressed disbelief at the inadequacy of the original price offered, since it was $3.00 below book value and was arrived at unilaterally without the benefit of negotiation. However, the directors’ motivation in opposing the tender offer may be more readily attributable to their loss of job security caused by a successful tender. See id.
35. Singer v. Magnavox Co., 380 A.2d 969, 971 (Del. 1977). Once their jobs were secure, the directors decided to withdraw their opposition to the offer. A recent New York decision, commenting on the facts of Singer, noted that the directors of Magnavox “‘sold-out’ the minority in the tender offer battle while taking great care to protect their own positions.” Bosee v. Babcock Int’l Inc., No. 17370/77, slip op. at 9 (N.Y. Sup. Ct. Feb. 17, 1978).
opposition to the tender offer, and Development succeeded in acquiring 84.1% of Magnavox's outstanding common stock. With Development's control firmly entrenched, the two managements set out to acquire the entire equity interest. For this purpose, Development created T.M.C. Development Corp. (T.M.C.), a wholly owned subsidiary, for the sole purpose of merging with and into Magnavox.\(^3\) The success of the merger was a certainty since the number of shares owned by Development exceeded the required statutory majority vote.\(^3\)

The minority shareholders of Magnavox brought a class action suit to nullify the merger on the theory that a merger effected without a valid business purpose is fraudulent.\(^3\) The court of chancery found the merger authorized by statute and in full compliance with the procedural requirements of Delaware law, and dismissed the suit.\(^3\) The Supreme Court of Delaware reversed the decision below,\(^4\) finding that compliance with legal requirements does not insulate a merger from judicial review.\(^4\) The court held that a merger effected under the long form merger provisions of the Delaware Code\(^4\) for the sole purpose of freezing out a minority inter-

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36. The mechanics of the merger were as follows: Development, the controlling shareholder of Magnavox, transferred its Magnavox shares to T.M.C., a wholly owned subsidiary. The intent was to merge the public corporation, Magnavox, with the private subsidiary, T.M.C. Under Delaware law, such a merger requires only majority approval; with Development owning more than 84% of the outstanding shares, the merger was a certainty. The minority shareholders were paid cash in exchange for their shares, and the resulting merged corporation had no public ownership. After the merger was effected, Magnavox was the surviving corporation, wholly owned by Development which in turn was wholly owned by North American.


39. Id. at 1362.


41. Id. at 980. The Supreme Court expressed this proposition in an early case dealing with fiduciary principles: “[A controlling shareholder] cannot use his power for his personal advantage and to the detriment of the stockholders . . . no matter how absolute in terms that power may be and no matter how meticulous he is to satisfy technical requirements.” Pepper v. Litton, 308 U.S. 295, 311 (1939). The court in Singer relied on Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437 (Del. 1971), where the court noted that “inequitable action does not become permissible simply because it is legally possible.” Id. at 439. See Petty v. Penntech Papers, Inc., 347 A.2d 140, 143 (Del. Ch. 1975) (“[T]he fact that charter or bylaw provisions may technically permit the action contemplated does not automatically insulate directors against scrutiny of purpose.”). See also Condec Corp. v. Lunkenheimer Co., 43 Del. Ch. 353, 230 A.2d 769 (1967); Bennett v. Breuil Petroleum Corp., 99 A.2d 236 (Del. Ch. 1953).

42. Section 251 of the Delaware Code provides in pertinent part:
est is a violation of fiduciary principles governing the relationship between controlling and minority shareholders.\textsuperscript{43}

**Potential Federal Regulation**

The Delaware statutes governing mergers were recently the subject of judicial review in \textit{Green v. Santa Fe Industries, Inc.},\textsuperscript{44} decided prior to the \textit{Singer} decision. Prior to \textit{Green}, an aggrieved shareholder who believed a merger was improper could rely on principles of fiduciary obligations and pursue a state remedy.\textsuperscript{45} However, fiduciary duty lacks a clear statutory basis; this uncertainty regarding evolving state law standards impelled plaintiffs to seek relief under federal securities law.\textsuperscript{46} When \textit{Green} reached the

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(a) Any 2 or more corporations existing under the laws of this State may merge into a single corporation, which may be any 1 of the constituent corporations or may consolidate into a new corporation formed by the consolidation, pursuant to an agreement of merger or consolidation, as the case may be, complying and approved in accordance with this section.

(b) The board of directors of each corporation which desires to merge or consolidate shall adopt a resolution approving an agreement of merger or consolidation. The agreement shall state: . . . (4) the manner of converting the shares of each of the constituent corporations into shares or other securities of the corporation surviving or resulting from the merger or consolidation and, if any shares of any of the constituent corporations are not to be converted solely into shares or other securities of the surviving or resulting corporation, the \textit{cash, property, rights or securities} of any other corporation which the holders of such shares are to receive in exchange for, or upon conversion of such shares and the surrender of the certificates evidencing them, which cash, property, rights or securities of any other corporation may be in addition to or in lieu of shares or other securities of the surviving or resulting corporation. . . .

(c) The agreement required by subsection (b) of this section shall be submitted to the stockholders of each constituent corporation at an annual or special meeting for the purpose of acting on the agreement. Due notice of the time, place and purpose of the meeting shall be mailed to each holder of stock, whether voting or nonvoting, of the corporation at his address as it appears on the records of the corporation, at least 20 days prior to the date of the meeting. At the meeting, the agreement shall be considered and a vote taken for its adoption or rejection. If a majority of the outstanding stock of the corporation entitled to vote thereon shall be voted for the adoption of the agreement, that fact shall be certified on the agreement by the secretary or assistant secretary of the corporation.

\textsuperscript{43} Singer v. Magnavox Co., 380 A.2d 969, 980 (Del. 1977).
\textsuperscript{44} 430 U.S. 462 (1977), rev'g 533 F.2d 1283 (2d Cir. 1976).
Second Circuit, the court held that the majority breached its fiduciary obligation by effecting a merger absent a justifiable business purpose.\(^4\) Those who have long inveighed against the permissive, management-oriented standards accepted by the states welcomed this decision.\(^4\) Yet while the decision appeared to be a major victory for proponents of minority rights, it was not long-lived. The Supreme Court reversed the Second Circuit's decision,\(^4\) holding that federal law was the wrong remedy for prob-

\(^{47}\) Green v. Santa Fe Indus., Inc., 533 F.2d 1283, 1291 (2d Cir. 1976), rev'd, 430 U.S. 462 (1977). In Green plaintiff sought to enjoin a merger between a parent corporation and its subsidiary by invoking rule 10b-5, 17 C.F.R. § 240.10b-5 (1977), the antifraud provision of federal securities law. The merger was to be effected pursuant to the short form merger provisions of Delaware law, the salient feature of which is that a majority of 90% of the shareholders can eliminate the 10% minority without any vote of the shareholders. The plaintiffs alleged that the merger was fraudulent, since the insiders attempted to acquire complete control at a grossly undervalued price. Rule 10b-5 makes it unlawful "[t]o engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person in connection with the purchase or sale of any security." \(\text{Id.}\) Finding that the rule is to be broadly construed, the court in Green stated:

When controlling shareholders of a publicly held corporation use corporate funds to force extinction of the minority shareholders' interest for the sole purpose of feeding the pocketbooks of the controlling shareholders, such conduct goes beyond mere negligent mismanagement and is properly cognizable as "an act, practice, or course of business which operates or would operate as a fraud."


lems of internal mismanagement.\textsuperscript{50} Perhaps the Court was concerned that procedural attractions alone would induce plaintiffs to pursue federal rather than state relief; or, the Court might have been influenced by a recognition that state law contains adequate but under-utilized legal principles to deal with such problems. Nevertheless, the Court declined the role of "lord high adjudicator"\textsuperscript{51} on the question of the propriety of takeouts and placed the responsibility on the states: "Corporations are creatures of state law, and investors commit their funds to corporate directors on the understanding that, except where federal law\textit{expressly} requires certain responsibilities of directors with respect to stockholders, state law will govern the internal affairs of the corporation."\textsuperscript{52}

Possibly this call upon the states to aggressively provide adequate protection for victimized minorities motivated the court in \textit{Singer} to depart from the longstanding permissive attitude towards takeouts.

**THE BUSINESS PURPOSE TEST**

The defendants in \textit{Singer} effected a merger pursuant to section 251, the long form merger provision, which expressly provides that "[a]ny 2 or more corporations existing under the laws of this State may merge into a single corporation."\textsuperscript{53} The statute also details the appropriate procedure and the consideration shareholders may receive in exchange for their stock.\textsuperscript{54} However, the statute is silent as to any requirement of a business purpose to justify the merger. It seemed that the legislature had balanced the rights of the major-

\textsuperscript{50} Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 478 (1977). In narrowly interpreting rule 10b-5 to preclude challenging a merger's fairness as long as management made full disclosure, the Supreme Court removed "'a major stumbling block to going private.'" Phalon, \textit{supra} note 2, at 28, col. 2 (quoting Arthur Rosenbloom, senior vice president of Standard Research Consultants).


\textsuperscript{52} Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 479 (1977) (quoting Cort v. Ash, 422 U.S. 66, 84 (1975)) (emphasis in original).


\textsuperscript{54} \textit{Id. Before 1967, Delaware required that shares of each constituent corporation in the merger be convertible only into securities of the surviving corporation. Cash was only permitted to be used for fractional shares. \textit{Del. Code tit.} 8, § 251 (1953). However, in 1967, the statute was amended to permit cash to be issued for shares of the merged corporation. An Act to Amend Chapter 1 of Title 8 of the Delaware Code, Entitled "General Corporation Law of the State of Delaware," \textit{56 Del. Laws} 151 (to be codified at \textit{Del. Code tit.} 8, § 251(b)(4) (Supp. 1977)).
ity and the minority. Judge Moore endorsed this position in his dissent to the Second Circuit opinion in Green, noting:

Delaware law does not require that the merger be pursuant to any corporate purpose more limited than the general corporate purposes contained in the corporate charter, which set the boundaries beyond which the corporation will be said to act ultra vires. The short form merger statute is not a procedure designed to effect certain business outcomes; it is the articulation of certain substantive rights.

The court of chancery's decision in Singer accords with this view of the merger statute. Relying on prior cases and on longstanding legislative approval and encouragement of mergers, the court stated that "as a general principle Delaware courts will not inquire into the reasons motivating a merger or the business justification for it as a part of determining its validity." In short, the court seemed to acknowledge that the statute means what it says. Noting this discussion by the lower court, the Supreme Court of Delaware

55. By enacting merger statutes, the legislature expressly recognized that once the percentage of minority shareholders becomes sufficiently small, the majority should be permitted to eliminate them, subject always to the minority's right to receive fair value in an appraisal. E. FOLK, THE DELAWARE GENERAL CORPORATION LAW § 251 (1972).

56. Green v. Santa Fe Indus., Inc., 533 F.2d 1283, 1304 (2d Cir. 1976) (Moore, J., dissenting) (emphasis in original), rev'd, 430 U.S. 462 (1977). In reversing, the Supreme Court noted that since Delaware does not require a business purpose to justify a merger, interpreting rule 10b-5 to require one would impose a stricter fiduciary standard than that required by the state. Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 479 (1977).

57. See Singer v. Magnavox Co., 367 A.2d 1349, 1355 (Del. Ch. 1976), aff'd in part, rev'd in part, 380 A.2d 969 (Del. 1977). In Federal United Corp. v. Havender, 24 Del. Ch. 318, 11 A.2d 331 (1940), the Supreme Court of Delaware noted that mergers are encouraged to the extent that they conserve and promote corporate interests. Id. at 334, 11 A.2d at 338. In MacCrone v. American Capital Corp., 51 F. Supp. 462 (D. Del. 1943), the court held that reasons for a merger are not matters for judicial determination since the merger "is an act of independent legal significance." Id. at 469 (footnote omitted). In Bruce v. E. L. Bruce Co., 40 Del. Ch. 80, 174 A.2d 29 (1961), the court stated that "it is the policy of the courts of Delaware to permit contracting corporations to take advantage of statutory devices for corporate consolidation ... ." Id. at 82, 174 A.2d at 30. See also Bastian v. Bourns Inc., 256 A.2d 680, 684 (Del. Ch. 1969), aff'd, 278 A.2d 467 (Del. 1970), where the court commented that the 1967 revisions of the merger statutes reflect continuing legislative approval of mergers and avoidance of their disruption by protesting shareholders.


in Singer began its discussion by focusing on the merits of importing a business purpose requirement into the merger provisions as a limitation on the majority's power to compel a merger.

Vested Shareholder's Rights

Imposition of such a limitation is not novel. This circumscription reflects the now dated concept of vested shareholder's rights, which recognized the shareholder's continuing property interest in the corporation.\(^6^0\) The once prevailing doctrine required that affixing the label “vested right” to a shareholder’s equity position barred any majority action which might injure that interest.\(^6^1\) However, a recent commentary has recognized this concept as a “hopeless anachronism”\(^6^2\) in today’s corporate society, in which tax laws, corporate laws, and securities laws perpetuate a variety of corporate permutations. The demise of this relic was noted in Grimes v. Donaldson, Lufkin and Jenrette, Inc.:\(^6^3\) “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.”\(^6^4\) As long as the shareholder is compensated for what he is asked to relinquish, “he has no constitutionally protected right to continue as a stockholder.”\(^6^5\) Yet the term freezeout, connoting wrongful exclusion, persisted in courts’ discussions of minority interests. Still concerned about the dilution of basic shareholder rights in the name of cor-

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\(^{60}\) See Vorenberg, supra note 5. See also Bove v. Community Hotel Corp., 105 R.I. 36, 44 & n.4, 249 A.2d 89, 94 & n.4 (1968).

\(^{61}\) See Outwater v. Public Service Corp., 103 N.J. Eq. 461, 143 A. 729 (1928), aff’d, 104 N.J. Eq. 490, 146 A. 916 (1929): “Continued membership, until dissolution, is an inherent property right in corporate existence.” id. at 466, 143 A. at 731.

\(^{62}\) Borden, supra note 2, at 1016. Professor Manning has suggested that discussion of vested shareholders rights is little more than “platonic muck.” Manning, The Shareholder’s Appraisal Remedy: An Essay for Frank Coker, 72 YALE L.J. 223, 245 (1962). This opinion has also been expressed by the New York courts: “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 appraisal . . . .” Beloff v. Consolidated Edison Co., 300 N.Y. 11, 19, 87 N.E.2d 561, 564 (1949) (citation omitted). See also Willcox v. Stern, 18 N.Y.2d 195, 202, 219 N.E.2d 401, 404, 273 N.Y.S.2d 38, 43 (1966). Another representative comment is that “changes have occurred in class shareholder rights, and the old words of ‘vested rights’ now seem equally out of fashion. Such rights are now ‘fixed’ only in the sense that they continue until changed by the vote of a specified majority.” Gibson, How Fixed are Class Shareholder Rights?, 23 LAW & CONTEMP. PROB. 283, 283 (1958).

\(^{63}\) 392 F. Supp. 1393 (N.D. Fla. 1974) (citations omitted), aff’d, 521 F.2d 812 (5th Cir. 1975).

\(^{64}\) Id. at 1403.

porate flexibility, various courts posited another limitation to support their disapproval of displacing the minority: the business purpose test.

The threshold policy determination in considering the viability of any corporate combination is whether the majority should ever be permitted to force the minority to take cash for their interest while the majority retains control of the assets of the enterprise. This question must be answered affirmatively; state legislatures have steadily adjusted corporate statutes to respond to the requirements of business and commercial growth, thereby facilitating mergers. Indeed, Delaware has exemplified legislative deference to corporate need. However, once it was determined that the need for corporate flexibility had overshadowed the importance of protecting minority shareholder interests, at least some states questioned this deference. The notion emerged that some limits must remain on the majority's power, because even meticulous compliance with statutory procedure could still be a device for unfair dealing. Professor Vorenberg gave currency to the business purpose test by suggesting that assertion of a plausible business objective, before forcing the minority shareholders to surrender their interest, appeared to make the transaction less repugnant. This view has been advocated by the academic community and followed and articulated in decisions of the Delaware courts and of other state and federal courts.

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66. See generally, Greene, supra note 2.
67. As one commentator has noted:

Corporations like the Delaware law for a number of reasons. It is called a model of clarity and so thorough that a question rarely arises that cannot be resolved in advance. Thus a corporate manager can make decisions with an eye on the Delaware statute and be fairly sure that he will avoid challenge.

\[\text{\ldots As one student of the state's corporate law put it: "They have always spotted new problems and have revised the law to meet them."}\]


70. Vorenberg, supra note 5, at 1204.

71. Id. Compare Borden, supra note 2, at 996, 1037-38 with Vorenberg, supra note 5, at 1204. See also Albright v. Bergendahl, 391 F. Supp. 754 (D. Utah 1974).
The Test Without a Definable Standard

One of the most cited cases for the proposition that the majority's power to effect a merger must be qualified by requiring a valid business purpose is Bryan v. Brock & Blevins Co. Distinguishable from Singer, Bryan involved the controlling shareholders of a private corporation, who, after several attempts to buy out a minority shareholder, transferred their shares to a shell corporation organized solely to effect a merger and thereby remove the dissident minority. The majority merged the existing corporation with the privately owned shell corporation and cashed out the minority interest. The court held that absent a valid business purpose, the transaction was a sham used "to circumvent the rule of law that prohibits a majority . . . [from forcing] the minority interests to surrender their stock holdings." Though Bryan involved a true going private transaction, the court made no effort to limit its holding to such transactions and did not elucidate which reasons a corporation might advance as justifiable corporate purposes.

Similarly, in Jutkowitz v. Bourns, a California court, obvi-

**Footnotes:**
74. Id. at 570. In Berkowitz v. Power/Mate Corp., 135 N.J. Super. 36, 342 A.2d 556 (1975), a New Jersey court faced with facts similar to those in Bryan did not unequivocally adopt the business purpose test: "While the Bryan approach is tempting to follow, it is unnecessary at this time to rule that the lack of a valid business purpose is sufficient to prevent a merger which otherwise complies with our Business Corporation Act." Id. at 48, 342 A.2d at 573. However, Bryan was distinguished in Grimes v. Donaldson, Luften & Jenrette, Inc., 392 F. Supp. 1393 (N.D. Fla. 1974), aff'd, 521 F.2d 812 (5th Cir. 1975). In Grimes the court acknowledged that Bryan was simply a paper transaction. Id. at 1402. Since the shell corporation had no corporate existence prior to its formation for the purpose of the merger, the merger could have no effect on the business of the corporation. Unlike Bryan, Grimes involved the combination of two businesses in which the elimination of potential conflicts of interest and the realization of future savings upon the merger of two similar businesses was found to justify the merger. Id. Notwithstanding the freezeout of the minority, these justifications were recognized as valid business purposes: "While plaintiff may not care to see this happen, since there is no evidence of fraud or over-reaching he is not entitled to enjoin the merger." Id. at 1404 (citations omitted).
75. No. CA 000268 (Cal. Super. Ct. Nov. 19, 1975). In Jutkowitz, plaintiff brought a class action on behalf of all minority shareholders seeking to prevent the merger of Bourns, Inc., into Bourns Newco. Id., slip op. at 1. The Bourns family, owners of 90% of Bourns, Inc., caused the creation of Newco, a shell corporation, to which they transferred their Bourns, Inc., shares. Newco was then to be merged into Bourns, Inc., with the minority holders of Bourns, Inc., to be cashed out at $10.00 per share. Id., slip op. at 2. The defendants, the Bourns family, explicitly stated that their sole purpose in going private was to eliminate the minority. Id. They contended that
ously incensed at what it considered a plan of merger akin to "private condemnation," held that a business purpose is required and that elimination of the minority in and of itself is clearly not a proper purpose. In condemning the use of takeouts, such courts appear to have reacted emotionally, with a predisposition to decide in favor of a perceived injured minority. As one court noted:

The claim of "freeze-out" by a predatory majority using their power as insiders to mulct corporate funds . . . and to unjustly enrich themselves tends to lead a sympathetic court to look indulgently upon extra-statutory remedies.

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.

Viewing going private transactions with disfavor, these courts have made little effort to analyze the competing interests involved, the values to be protected, or the feasibility of requiring a business purpose in various transmutations of the true going private transaction. Requiring a business purpose, they have refused to uphold business procedures which have long received legislative sanction.

New York Speaks out on Going Private

Delaware has long shared with New York the status of leading corporate home. Indeed, some of Delaware's statutes are modeled
after those of New York. An examination of how New York has balanced corporate flexibility with protection of the minority is useful in predicting Delaware's approach towards going private.

New York's Business Corporation Law expressly authorizes two domestic corporations to merge upon the approval of two-thirds of the shareholders of each constituent corporation. As protection for the minority against unfair merger terms, the legislature has also provided a means for the minority to challenge the consideration offered them in the merger. A dissatisfied shareholder may commence an appraisal proceeding to have the court determine the fair value of his shares. Until recently, it appeared to be well-settled that, given compliance with statutory requirements, appraisal was the exclusive remedy for a minority shareholder, even if there were a freezeout.

The exclusivity of the appraisal remedy was reaffirmed in Willcox v. Stern. In Willcox the court noted: "So long as the value of petitioner's interest is compensable, he has no constitutionally protected right to continue as a stockholder." Yet the court added a caveat that, where there is fraud or illegality, equity will intervene despite the existence of an appraisal remedy. Presumably, the caveat was only a "warning footnote to curb predatory appetites," since public policy would permit corporate takeovers by an entity overwhelmingly in control regardless of minority claims of "squeeze out," "freeze out" or "push out."

The early 1970's brought depressed market conditions and an economic climate conducive to control groups buying up publicly held shares. Going private transactions increased and minority shareholders were squeezed out of their equity positions. Going

79. See E. Folk, supra note 55, at 351.
81. Id. §§ 623, 910.
82. In Beloff v. Consolidated Edison Co., 300 N.Y. 11, 87 N.E.2d 561 (1949), the court commented that "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 appraisal." Id. at 19, 87 N.E.2d at 564 (citation omitted). See also Vine v. Beneficial Fin. Co., 374 F.2d 627 (2d Cir. 1967); Endicott Johnson Corp. v. Bade, 37 N.Y.2d 585, 590, 338 N.E.2d 614, 617, 376 N.Y.S.2d 103, 108 (1975); Anderson v. International Minerals & Chem. Corp., 295 N.Y. 343, 67 N.E.2d 573 (1946).
84. Id. at 202, 219 N.E.2d at 404, 273 N.Y.S.2d at 43.
85. Id. at 205, 219 N.E.2d at 405, 273 N.Y.S.2d at 45.
87. Id.
private mergers were completely in accord with statutory requirements: There was no illegality to justify judicial interference.88 The courts responded by expanding the remedies available to the aggrieved shareholder. Indeed, a new rule appeared to be emerging in New York: Absent a clear showing of a proper business purpose, judicial intervention in a merger is justified, despite the existence of an appraisal remedy.

In People v. Concord Fabrics, Inc.,89 the court enjoined a merger which had no palpable corporate purpose. Until 1968, Concord Fabrics, Inc. (Concord) had been a private family-controlled company. However, determined to capitalize on inflated market conditions, the controlling family decided to take the company public by selling 32% of its interest in the corporation to the public at $15 and $20 per share.90 The insiders retained 68% of the stock. As market conditions eroded, defendants began tendering for the publicly held shares at prices far below the original price at which the public had been lured into the company. When the tender route became impractical, the insiders attempted a merger. By 1974, the stock of Concord had fallen to $1.00 per share. In what was becoming a typical scenario, the insiders then placed their 68% stock ownership into a private corporation created solely to effect a merger with Concord and cash out the minority shareholders. The insiders therefore, attempted to acquire 100% control for $1,500,000 after having exploited the public for approximately $8,500,000.91 The merger was enjoined, and the court, outraged by these events, noted: “Adding to the odium of the scheme is that [sic] fact that no real corporate purpose has been demonstrated . . . .”92 After Concord it appeared that the expressly sanctioned power to merge was to be qualified by the requirement of a valid business

90. When the company first went public, it sold 500,000 shares. The insiders were able to obtain needed capital while still retaining a controlling interest in the company. Id. at 121, 371 N.Y.S.2d at 551.
91. The insiders offered the minority $3.00 per share based on an appraisal the independent basis of which was questioned. Id.
92. Id. at 125, 371 N.Y.S.2d at 554. The proxy statement stated that the purpose of the merger was to return control of the corporation to the family so they could determine all corporate policies “without public scrutiny and solely with regard to their own interests.” Id. at 122, 371 N.Y.S.2d at 551.
Echoes of minority rule were returning to corporation law, and corporate flexibility seemed in jeopardy.

Subsequent decisions, however, limited Concord and recognized distinctions between the various kinds of going private transactions. Tanzer Economic Associates, Inc. v. Universal Food Specialties, Inc.94 involved the merger of two substantial corporations which effectively eliminated the public holdings in the acquired corporation and vested complete control in the acquiring corporation. Recognizing the express legislative sanction of mergers, the court refused to upset such procedures based on emotional claims of "freeze-out" or "squeeze-out."95 Whether to impose an additional requirement on the merger process "must be decided on the facts of each case and not on the ready application of labels."96 By distinguishing Concord as involving manipulation by an inside group "which sold the stock high in 'going public' and repurchased it low to its [own] benefit,"97 the court apparently limited Concord to such facts. The court in Tanzer recognized other business purposes inherent in the combination of two operating businesses.98 This broad spectrum of justifiable corporate purposes would seem to permit most combinations while outlawing only those which are manifestly naked grabs for power and egregiously unfair to the minority.

96. Id., 383 N.Y.S.2d at 479.
97. Id. at 177, 383 N.Y.S.2d at 480.
98. Id. at 182, 383 N.Y.S.2d at 483. Some of these business purposes recognized by the court were:

1. improved management and corporate planning . . . ; (2) existing management experience . . . will be mutually available; (3) savings will result from economies in centralized procurement of raw materials; (4) there will be marketing economy in joint distribution, warehousing and advertising; (5) duplication of departments and personnel can be avoided; (6) a greater diversity of products would result in the evening out of cyclical demand; (7) both companies will be in a stronger financial position . . . ; (8) . . . there will be no concern about possible conflicts of interest . . . ; and (9) without public shareholders the company would not be subject to charges of over-reaching or unfairness to the minority, and would eliminate all the time, expense and energy incurred in connection with . . . dividends, proxy notices, annual reports, SEC compliance and the attendant legal problems.

Id.
This reliberalization of New York law governing corporate combinations was affirmed recently in *Bosee v. Babcock International, Inc.* 99 On a motion to dismiss for failure to state a cause of action, the court held that in a merger situation, absent a clear showing of "extraordinary circumstances," appraisal is the exclusive remedy for a dissenting shareholder. 100 The plaintiff in *Bosee* was a minority shareholder in American Chain & Cable Co. (ACCO), a New York corporation. Babcock International, Inc. (BII), a Delaware corporation, wanted to acquire complete control of ACCO. Through a successful tender offer, BII acquired almost 97% of ACCO's outstanding shares. Thereafter, BII created Newco Industries Corp. in New York, as a wholly owned subsidiary of BII, to merge with and into ACCO pursuant to the New York merger provisions. The merger plan provided that upon approval of the merger each share of ACCO held by shareholders other than BII would be canceled with the shareholders receiving cash in exchange for their shares. 101 As a result, plaintiffs' equity position in ACCO was cashed out. Plaintiffs, relying mainly on *Concord* and the newly decided *Singer* decision, challenged the merger alleging that it served no business purpose.

Rejecting plaintiff's assertion that the emerging law in New York required a valid business purpose, the court held that both *Singer* and *Concord* involved exceptional circumstances not present in *Bosee*. 102 The Court in *Bosee* noted that in *Singer* there was clear evidence that the directors and officers were selling out the minority in the tender offer battle "while taking great care to protect their own positions." 103 The court held that, absent a showing of extraordinary circumstances, judicial intervention is not warranted in a merger situation.

Application of a standard which permits a court to determine a merger's validity on a case-by-case basis indicates New York's retreat from the prominority position in *Concord*. New York appears

101. *Id.* at 4.
102. *Id.* at 9.
103. *Id.*
to have tipped the balance in favor of corporate management. One can fairly assume that the business purpose test will be resurrected in New York only to outlaw blatant grabs for power in which judicial intervention is necessary to prevent the "rape" of the minority. Having thus preserved its status as a corporate home, New York has come full circle from its decision in Willcox: The minority is again relegated to seeking an appraisal, unless it can establish a fraudulent transaction or extraordinary circumstances, both of which are difficult to prove.

**Delaware and the Business Purpose Test:**

*A Departure from Precedent*

Though the requirement of a business purpose was a question of first impression in Singer, two unreported decisions of the court of chancery had addressed the issue. Until recently, it was well-accepted in Delaware, as in New York, that where all statutory requirements were met, appraisal was the exclusive remedy available to a dissenting shareholder.\(^{104}\) Yet in *Pennsylvania Mutual Fund, Inc. v. Todhunter International, Inc.*,\(^{105}\) plaintiffs sought a temporary restraining order against effectuation of a merger on the theory that the only purpose was an unlawful freezeout.\(^{106}\) The court granted the order, noting:

> This is probably or possibly not a case in which a dissenting stockholder is merely entitled to an appraisal because of his unwillingness to continue in a changed business. Here there is to be no change in the business but merely an elimination of unwanted minority stockholders.

> I feel therefore, that there is some possibility on further argument... of a showing of illegality... by reason of it being a possible manipulation of corporate control for private purposes with no proper business purpose in mind.\(^{107}\)

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104. Stauffer v. Standard Brands, Inc., 41 Del. Ch. 7, 187 A.2d 78 (1962) (appraisal is exclusive remedy in absence of showing of fraud); David J. Greene & Co. v. Schenley Indus., Inc., 281 A.2d 30 (Del. Ch. 1971) (if no fraud or blatant overreaching is demonstrated, plaintiffs' only recourse is to appraisal proceeding); Cole v. National Cash Credit Ass'n, 18 Del. Ch. 47, 156 A. 183 (1931) (discussing rights of creditors to enjoin merger, court stated that exercise of statutory right to merge is subject to nullification only for fraud).


107. *Id.* at 975 n.5.
In *Tanzer v. International General Industries, Inc.*,\(^{108}\) the court also alluded to a requirement of a business purpose: "It should be noted . . . that IGI [the acquiring corporation] had a legitimate and present and compelling business reason . . . . IGI is not freezing out the minority just for the purpose of freezing out the minority."\(^{109}\) The lower court in *Singer* acknowledged this precedent but noted that if it is the true going private transaction that is to be outlawed, and if such an exception to the merger statute is to be made, the facts of *Singer* do not present such an opportunity.\(^{110}\)

The Supreme Court of Delaware's concern in *Singer* with the business purpose test seems to raise more questions than it answers. The court grappled with the two unanswered questions raised by such a test: whose purpose and whose business? The first enigma is that if it is the business purpose of the subsidiary that is to be advanced by the merger, the result may be viewed as academic, since its shareholders have been cashed out. Analysis along these lines would justify the merger, and since such reasoning would be useless in protecting minority rights, the court in *Singer* did not fully consider it. On the other hand, the court posited that if one looks to the parent's business purpose as justification for the merger, the minority shareholders of the subsidiary "may have undue difficulty in raising and maintaining the issue."\(^{111}\) If the court's analysis had proceeded along these lines, it would be little consolation for shareholders of the subsidiary that their elimination has benefited the combined corporation out of which they were forced. Finding itself enmeshed in a seemingly irresolvable dilemma, the court left these questions unanswered.

Though the court professed the inutility of the business purpose test for determining if the merger is valid, its holding rests on a finding of such a purpose. Yet, other than a facile assertion that such a requirement is a prerequisite to a valid merger, the court does not indicate what constitutes a valid business purpose. Indeed, the same court, in a case decided less than one month after *Singer*, acknowledged the inadequacies of the term "business purpose" and suggested that such a test is ambiguous, at best, and, at


worst, "states a result and not a right or duty." Importation of such a requirement into Delaware corporate law departed from precedent, and the court's decision, so lacking in definition of what constitutes business purpose, was inadequate.

Freezeouts: The Competing Interests

The court has correctly focused the threshold determination. We must question whose purpose or business the merger is to advance. Though at common law a merger could not be effected without unanimous approval of the shareholders, the legislatures soon recognized the need to eliminate this power of absolute veto. Once we recognize this need for corporate flexibility, the questions should answer themselves.

By permitting various corporate permutations, the needs of the corporation or controlling interest are protected. It is, therefore, the minority interests which require protection, since it is the minority which is being "victimized." The minority's interest or business purpose is not difficult to ascertain. Few shareholders would disagree with the notion that their investment motives are assured liquidity of their stock and appreciation of their investment. Stated bluntly, their interest is monetary. Therefore, if

113. See, e.g., Voeller v. Neilston Warehouse Co., 311 U.S. 531, 535 n.6 (1941); Francis I. duPont & Co. v. Universal City Studios, Inc., 343 A.2d 629, 634 (Del. Ch. 1975). The statutory right of appraisal is given to the shareholder as compensation for the abrogation of the common law rule that a single shareholder could veto a merger.
115. Whether the shareholder's interest is in the "value" of his stock as opposed to the "form" of his investment has long been a subject of controversy. See Vorenberg, supra note 5, at 1203-04. Though the modern view appears to recognize the value over the form, some courts persist in relying on older notions of vested shareholder's rights: "Money now may well satisfy some or most minority stockholders, but others have differing investment goals . . . or even a sentimental attachment to the stock which leads them to have a different judgment as to the desirability of selling out." Jutkowitz v. Bourns, Inc., CA No. 000268, slip op. at 4 (Cal. Super. Ct. Nov. 19, 1975). However, former SEC Commissioner Sommer noted that, when a company goes public, [It] acquires a new "family" consisting of people who, overwhelmingly, have no ties with the corporation other than their shareholdings, which they acquire with the hope that they will be a means of profit: appreciation, dividends, a combination.

... One of the things a stock purchaser in a corporations [sic] wants is liquidity—that is, the assurance that when he wants to sell there will be a reasonable market for the stock.
the merger advances the monetary interests of minority shareholders, it should be permitted without the need for a showing of further justification. Recognition of a monetary interest would permit the court to remedy the problem on a practical level and would obviate the necessity for ad hoc determinations of business purpose and the resultant uncertainty in future corporate combinations.

For the corporation seeking to go private, there is a wide spectrum of benefits:

Freedom from worry about the impact of corporate decisions on stock prices; ability to take greater business risks than those sanctioned by federal securities agencies; a switch to more conservative accounting, resulting in lower taxes; [and] the savings which result from no longer having to prepare, print and issue the myriad of documents required under federal and state disclosure laws . . . ."116

When a public parent eliminates a minority interest in a publicly held subsidiary, there are also economies of operation and more efficient allocation of management and professional and other costs and expenses.

The judicial response to these benefits inuring to the corporation has not been favorable. Especially in the true going private transaction, the courts refuse to recognize savings of costs resulting from compliance with securities regulations as a justifiable business purpose.117 Nor will the courts recognize that some corporations are not suited for public life.118 As one executive has noted, being

Address of A.A. Sommer, Jr., supra note 15, at 84,695. Professor Alan Bromberg, at a recent meeting of lawyers to discuss the issue of going private, commented that the "critical aspect" of a going private transaction is the fairness of the price paid to the minority shareholders. See [1978] 437 SEC. REG. & L. REP. (BNA) A-28.


117. See Jutkowitz v. Bourns, CA No. 000268, slip op. at 6 (Cal. Super. Ct. Nov. 19, 1975). It is generally agreed that one of the broad objectives of going private is to avoid the expense and bother of compliance with the myriad disclosure and dissemination requirements imposed by the Securities Exchange Act of 1934, see 15 U.S.C. §§ 78m(a), 78o(d) (1970). If a corporation is able to reduce sufficiently the number of its shareholders, it can remove its shares from registration with the SEC. For a publicly held corporation, such a reduction is to less than 300 shareholders. Id. § 78(g)(4). Former SEC Commissioner Sommer noted that though he could foresee business considerations which would justify reducing liquidity or even forcing a shareholder to relinquish his equity position, he "would not include among these avoiding the cost and bother of SEC compliance and shareholder servicing." Address of A.A. Sommer, Jr., supra note 15, at 84,699. See also Note, Going Private, supra note 2, at 904.

118. See Borden, supra note 2, at 1007.
The public makes life difficult. The majority holdings in a corporation usually represent a long term investment; conversely, the minority's interest is characteristically short term. These two seemingly inconsistent interests impinge on the same investment, creating conflict. There is a "fundamental incompatibility . . . between prudent management and the constraints imposed by public ownership." Avoiding these conflicts certainly appears to constitute a valid business purpose. Courts, however, seem offended by what they perceive to be purely selfish motives. But as one commentator notes:

The selfish motivation is often adverted to in connection with going private, but one wonders why that should be. Are only those corporate transactions to be favored which are not motivated by greed? Must we seek to do public good in order to avoid regulatory sanctions? The questions answer themselves. To observe that greed is a compelling motivation is merely to observe that we live in a free-enterprise society.

In sum, though the investment interests of the controlling group seem different from those of the minority, both groups are selfishly concerned with protecting the value of their investments; neither group should be impeded because it is motivated by greed. Once we accept the interest of the shareholder as primarily monetary, it is difficult to understand what protection the business purpose test affords. The court must therefore concentrate on shaping another type of protection for the minority.

Defendant in Singer contended that if a shareholder's interest is exclusively in the value of his investment, that right is protected by the appraisal statute. In theory, the availability of appraisal

119. "For many small companies, and some not so small, public ownership is one of the bummers of business life today." Roscow, Hard Times for OTC Stocks, FINANCIAL WORLD, June 12, 1974, at 30.
120. Borden, supra note 2, at 1006-07.
121. Id. at 1013 (emphasis added) (footnote omitted).
guarantees that the minority's economic interest is protected, thereby permitting the majority to consummate corporate changes without objection. However, even if it can be called a remedy, appraisal is totally unresponsive to the minority's needs. As long

A.2d 216 (Del. 1975). Though the costs of the appraisal and the appraiser's fee can be taxed to the parties as the court deems equitable, attorney's fees and expert's fees must be borne by the individual shareholder, DEL. CODE tit. 8, § 262(h) (Cum. Supp. 1977), resulting in, perhaps, a costly proceeding. See Brudney, A Note on "Going Private," 61 VA. L. REV. 1019 (1975). Though corporate statutes are designed to prevent undue obstruction of business decisions, the appraisal statute was designed to protect minority shareholders from arbitrary action by compensating them for their shares. The Delaware statute has, therefore, recently been amended to deal with some of the inequities suffered by the minority. The most relevant section of the amended statute attempts to alleviate some of the financial burden of the appraisal remedy by spreading the costs of the proceeding. The statute provides:

[T]he Court may order all or a portion of the expenses incurred by any stockholder in connection with the appraisal proceeding, including, without limitation, reasonable attorney's fees and the fees and expenses of experts, to be charged pro rata against the value of all the shares entitled to an appraisal.

DEL. CODE tit. 8, § 262(h) (Cum. Supp. 1977). Although this amendment was an attempt to make appraisal a more viable remedy, the legislature has retained, in the amended statute, the notion that the dissenter is entitled to the "fair value exclusive of any element of value arising from the accomplishment or expectation of the merger." Id. § 262(f) (emphasis added). The new statute, therefore, affords little additional protection for the minority.

A2. When corporations merge, the shareholder can acquiesce to merger or seek an appraisal of his shares. In this respect, appraisal is a focal point in the relationship between the corporation and the stockholder. Appraisal has been called "the quid pro quo for statutes giving the majority the right to override the veto" which a single shareholder previously had over corporate combinations. Vorenberg, supra note 5, at 1194 (footnote omitted). However, the process invariably "involves delay and uncertainty, with expenses which may cut into [the minority shareholder's] recovery." Id. at 1201. Professor Vorenberg has also pointed out the difficulties of valuation inherent in the appraisal statutes as well as the difficulties of the procedural requirements which may frustrate a dissenter's use of the remedy. Id. Finally, appraisal statutes expressly deny the dissenter any share of the opportunity or increased value the corporation acquires by reason of the merger. Another commentator has noted that the expense and complexity involved in an action by the minority shareholders makes it "impossible for the majority stockholders not to be tempted to undercompensate those they displace, and improbable that they will not yield to the temptation." Brudney, supra note 122, at 1025. See also Eisenberg, The Legal Rules of Shareholders and Management in Modern Corporate Decisionmaking, 57 CALIF. L. REV. 1, 85 (1969). Appraisal has been characterized as a "remedy of desperation," "expensive," and "uncertain in result." Brudney & Chirelstein, supra note 17, at 306-07. See also Comment, Protection of Minority Shareholders from Freeze-outs Through Merger, 22 WAYNE L. REV. 1421 (1976). Former SEC Commissioner Sommer, speaking of appraisals, noted that "they take forever, and during that time typically the dissatisfied shareholder is locked-in with an asset he can't sell and he receives no dividends. Furthermore, these actions do not take that form most dreaded by management, the class action . . . ." Address of A.A. Sommer, Jr., supra note 15, at 84,696.
as appraisal statutes operate to keep the prospective gain in the hands of the majority, they will not protect the minority. The task of distributing postmerger gain is legislative, not judicial. If appraisal statutes could be modified to distribute insider profits among the minority, as well as the majority, the deterrent effect would be twofold.

First, if those who exercise control for their own benefit pay an appropriate proportion of the gain to the minority as a premium for this privilege, the minority is assured that their interest in the corporation will not be contravened. Underlying the concern with going private transactions is the recognition that inherent in any concentration of authority or power is the potential for abuse through self-dealing. Although Delaware courts have consistently claimed that they do not permit mergers which benefit one class to the exclusion and detriment of another,\textsuperscript{124} they have not strictly adhered to this notion. The Supreme Court of Delaware has recently commented that "[s]elf dealing occurs when the parent, by virtue of its domination of the subsidiary, causes the subsidiary to act in such a way that the parent receives something from the subsidiary to the exclusion of and detriment to, the minority stockholders of the subsidiary."\textsuperscript{125} The judicial objective has been to curb the predatory appetite of the majority. However, employing the business purpose test may prove inappropriate, since it may operate to nullify an otherwise legitimate merger. If the insiders contemplating taking a corporation private were compelled to share the profits that would accrue from such a transaction with the eliminated minority, this might prove adequate motivation to raise the initial offer to the minority to avoid litigation by dissatisfied minority interests. Thus, corporations could be assured the flexibility they desire, but the minority would also be assured meaningful compensation for loss of their equity participation through the payment of a premium.

Second, such a modified appraisal statute may also operate not only to curtail insider self-dealing, but to provide indirectly a valid business purpose before the corporation goes private. Much of the

\textsuperscript{125} Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971). In determining the legitimacy of the parent corporation's actions, the application of this standard has been referred to as the "advantage-disadvantage" test. Note, \textit{The Fiduciary Duty of Parent to Subsidiary Corporation}, 57 Va. L. Rev. 1223, 1237 (1971).
objection to going private transactions centers on economic gain by insiders at the expense of the minority.\textsuperscript{126} However, a revised appraisal statute would not permit the insiders to divide the corporate assets so as to give themselves disproportionate benefits. If the insiders knew that going private would force them to share their profits by paying a premium to the minority shareholders, they might be less willing to go private unless there is a good business reason for doing so. Without sacrificing either corporate flexibility or minority protection, the competing interests raised by such transactions could be satisfied.

Finally, there is some fear that if controlling interests can compel the surrender of minority equity interests at will, the small investor will lose faith in the marketplace, and the economy will suffer.\textsuperscript{127} However, if the insiders compensate the economic interests of the minority, adequate compensation would provide the investor with funds to reinvest in an equally depressed market. This compensation also protects the minority shareholder's interest in minimizing his market losses.

Unfortunately, such a remedy was unavailable to the court in Singer. The business purpose test alone, however, does not impose any substantial check on the conduct of the majority in its dealings with the minority. Recognizing the limitations of such a test, the court noted that "as a threshold consideration . . . [the business purpose test] is not helpful in sorting out rights of the parties."\textsuperscript{128} The court determined that the standards governing the relationship between majority and minority shareholders is the important issue.

\textsuperscript{126} Typically, attacks on mergers involve complaints of disparate treatment by the majority, especially with reference to the value exchanged at the time of the merger. In Harriman v. E.I. Du Pont de Nemours & Co., 411 F. Supp. 133 (D. Del. 1975), plaintiff argued that application of an intrinsic fairness test to mergers requires equal sharing of postmerger gain. Id. at 154. The court briefly summarized Delaware's position on such a notion: Positing the existence of a gain-sharing requirement in Delaware is difficult "since the prevailing Delaware law on fairness requires only that the consideration paid be equivalent to the premerger value of the exchanged shares and pays no attention whatsoever to any resulting post-merger gains." Id. at 154 & n.114 (emphasis added). At least one commentary has posited a postmerger gain-sharing concept in the parent-subsidiary relationship where gain-sharing provides the arms-length bargaining absent in dealings between entities so closely related. See Brudney & Chirelstein, supra note 17, at 322.


\textsuperscript{128} Singer v. Magnavox Co., 380 A.2d 969, 976 (Del. 1977).
Closely allied with the court's determination that the business purpose test is inadequate to deal with questions raised by takeouts is its reliance on another equitable limitation on the majority's power: principles of fiduciary responsibility. Citing well-known Delaware authorities, the court stated: "It is a settled rule of law in Delaware that . . . the majority stockholder . . . owe[s] to the minority stockholders . . . a fiduciary obligation in dealing with the latter's property." To the extent that takeouts enable insiders to benefit themselves at the expense of the minority, these transactions raise serious questions concerning fiduciary duty. However, merely recognizing the existence of such a duty does not describe it.

Corporate laws tend to be gracious to management: Delaware is notorious for the favorable climate its laws provide. To attract corporations and thereby raise revenue for the state, the Delaware legislature created a corporate mecca. This policy has been perpetuated by the Delaware courts; they have encouraged freedom of action on the part of a parent incorporated in the state, often with general relaxation of the fiduciary standards and requirements of fairness required by other states. Until recently, it appeared that Delaware had overcome any hostility it harbored towards takeouts and had succumbed to the corporate hegemony.

The most frequently cited authority for the proposition that a controlling shareholder occupies a position of trust is Pepper v. Lit-
ton,133 decided by the Supreme Court. This classic expression of fiduciary obligation was echoed by the Delaware courts in *Sterling v. Mayflower Hotel Corp.*134 In *Sterling* the Supreme Court of Delaware, faced with a merger situation, held that "[s]ince [insiders] stand on both sides of the transaction, they bear the burden of establishing its entire fairness, and it must pass the test of careful scrutiny by the courts."135 However, despite application of this rather strict standard in some important cases,136 there appeared to be a retrenchment from this fairness doctrine as a standard for interested merger cases.

In *Bruce v. E.L. Bruce Co.*,137 the fairness standard was substantially eroded by requiring proof of bad faith or some actionable fraud to invalidate the merger. The court noted that "absent fraud or a showing that the terms of a proposed merger are so unfair as to shock the conscience of the court it is the policy of the courts of Delaware to permit contracting corporations to take advantage of statutory devices for corporate consolidation."138 The court found appraisal the exclusive remedy for a dissenting shareholder and

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133. 308 U.S. 295 (1939). In discussing the duties of controlling shareholders, the Court commented:

Their dealings with the corporation are subjected to rigorous scrutiny and where any of their contracts . . . with the corporation [are] challenged the burden is on the director or stockholder not only to prove the good faith of the transaction but also to show its inherent fairness from the viewpoint of the corporation and those interested therein.

*Id.* at 306 (citation omitted). Courts of equity have always imposed a fiduciary duty of good faith and fair dealing on the corporation's officers and directors to shield the corporation and its stockholders from the dishonesty of those managing the corporation. When a controlling or majority shareholder is in a position to direct corporate affairs and manipulate corporate decisions, this fiduciary responsibility attaches to his actions as well. As Justice Brandeis noted: "The majority has the right to control; but when it does so, it occupies a fiduciary relation toward the minority, as much so as the corporation itself or its officers and directors." *Southern Pacific Co. v. Bogert,* 250 U.S. 483, 487-88 (1919). For a detailed discussion of the development of fiduciary duty, see Berle, *Corporate Powers as Powers in Trust,* 44 HARV. L. REV. 1049 (1931); Note, *The Fiduciary Duties of Majority Shareholders Expanded: Jones v. H.F. Ahmanson Co.***, 59 GEO. L.J. 269 (1970).


138. *Id.* at 82, 174 A.2d at 30 (citation omitted).
never discussed the fairness of the proposed merger. One year later in *Stauffer v. Standard Brands Inc.*, the court again refused to consider the substantive fairness of a merger. Confronted with a short form merger, the court held that, in light of continuing legislative approval of mergers, "the very purpose of the [merger] statute is to provide the parent corporation with a means of eliminating the minority shareholder’s interest in the enterprise." The court’s decision did not discuss fiduciary concepts.

The fairness doctrine received its most severe blow in *David J. Green & Co. v. Schenley Industries, Inc.*. That decision involved a long form merger, analogous to *Singer*, where the parent corporation, holding 84% of the subsidiary’s stock, sought to take-out the minority through a merger. The court found that the *Sterling* fairness rule was applicable, yet concluded that since the rights of minority shareholders under the long form merger provisions are no greater than those under the short form merger statute, *Stauffer* required appraisal as the exclusive remedy, absent a finding of fraud. An additional gloss on the *Sterling* doctrine was provided by the court in *Chasin v. Gluck*. There, the court determined that the intrinsic fairness rule of *Sterling* would not be triggered absent a finding of self-dealing. Having eroded the minority’s protection to a fraud standard, appraisal became the exclusive rem-

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139. 41 Del. Ch. 7, 187 A.2d 78 (1962).
140. Id. at 10-11, 187 A.2d at 80. “This power of the parent corporation to eliminate the minority is a complete answer to plaintiff’s charge of breach of trust . . . .” Id.
141. 281 A.2d 30 (Del. Ch. 1971). “While a court of equity should stand ready to prevent corporate fraud and any overreaching by fiduciaries . . . this Court should not impede the consummation of an orderly merger . . . , an efficient and fair method having been furnished which permits a judicially protected withdrawal . . . by a disgruntled stockholder.” Id. at 36 (citation omitted).
142. Id. at 35.
143. 282 A.2d 188 (Del. Ch. 1971).
144. Id. at 191-92. Professor Folk has suggested that despite the affirmation of the strict *Sterling* standard in *David J. Greene & Co. v. Dunhill Int’l, Inc.*, 249 A.2d 427 (Del. Ch. 1968), it is unclear how far the courts will go to scrutinize interested mergers, in light of subsequent cases demonstrating a preference for use of the business judgment rule in areas traditionally subject to the fairness doctrine. E. FOLK, supra note 55, at 334-35. See *Getty Oil Co. v. Skelly Oil Co.*, 267 A.2d 883 (Del. 1970); *Muschel v. Western Union Corp.*, 310 A.2d 904 (Del. Ch. 1973). Other courts have commented on the erosion of the fairness standard. See, e.g., *Collins v. SEC*, 532 F.2d 584, 597 (8th Cir.), cert. granted, 429 U.S. 815 (1976) (intrinsic fairness test requires showing of palpable overreaching and self-dealing); *Harriman v. E.I. Du Pont de Nemours & Co.*, 411 F. Supp. 133, 154 (D. Del. 1975) (in terms of result, there is no significant difference between business judgment rule and rule of intrinsic fairness).
Faced with this precedent, the court in *Singer* employed an interesting technique. The court distinguished those cases relied upon by defendants which, although factually similar to *Singer*, were not precedents for the Court's desired condemnation of the transaction in *Singer*. Yet the court relied on other cases with distinguishable facts, since the language in those cases was helpful to the court in reaching its conclusion.

The court noted that although the cases relied upon by defendants involved efforts to attack a merger, none of the decisions involved a straight cash-out. Reliance on the holdings of these cases would have justified the *Singer* merger. To eliminate any further confusion as to the status of these authorities, the court commented that any statement in these cases "which seems to be in conflict with what is said herein must be deemed overruled."

The court proceeded to rely on a series of cases, none of which involved mergers, and concluded that if use of corporate power to perpetuate control is a violation of fiduciary obligations, use of the corporate machinery to eliminate the minority must also be a violation. Consequently, all future mergers must assert a business
purpose other than the freezeout of the minority and must comply with the Sterling rule of "entire fairness" which governs the fiduciary obligation imposed on the majority in its dealings with the minority.  

Inasmuch as the minority shareholder's interest is monetary, the court could have focused the fairness inquiry on the price offered in the takeout. However, this portion of the court's decision again lacks in definition. If the permissibility of future mergers rests on a determination of their fairness, the court has provided little guidance to the businessman planning a transaction or to a lower court judging its validity. Fairness is an elusive standard subject to ad hoc determination by a court. Since such a standard is usually applied after the fact of merger, it assures only superficial objectivity, and little else. The fairness standard thrusts the court into the decisionmaking process of the corporation where, traditionally, the business judgment rule foreclosed such control. One commentator has noted that "[t]he quest for 'fairness' also leads the chancellor into new fields where he is normally not expert. It places on him the heavy burden of solving complex economic problems in order to formulate a judgment as to soundness, and hence the fairness of the proposed amendment." Whether the court will now sit as an ill-equipped member of the board of directors in determining the viability of various corporate transformations is unclear. Indeed, the majority offers no clue as to what factors should be considered in determining a transaction's entire fairness.

THE CONCURRENCE

Justice McNeilly's concurring opinion, although also a departure from precedent, attempted to establish guidelines for future

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150. It has long been accepted that absent a showing of bad faith, a court will not interfere with the discretion of directors. The acts of directors are afforded a presumption of good faith. See Warshaw v. Calhoun, 43 Del. Ch. 148, 221 A.2d 487 (1966). The Delaware Supreme Court recently commented: "A board of directors enjoys a presumption of sound business judgment, and its decisions will not be disturbed if they can be attributed to any rational business purpose. A court under such circumstances will not substitute its own notions of what is or is not sound business judgment." Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971) (emphasis added).
cases. Though he agreed that a business purpose is one factor to be considered, he added that the court should also scrutinize "economic necessity, desirability and feasibility involved, evidence of self-serving, manipulation, or overreaching, and all other relevant factors of intrinsic fairness or unfairness." Although Justice McNeilly emphasized substantive issues rather than slogans, his inquiry was still not directed at preventing specific harm to the minority. Fairness is a step in the right direction, but alone it does not afford the minority enough protection.

Tanzer: A Step in Retreat

Tanzer v. International General Industries, Inc., was decided by the Supreme Court of Delaware less than one month after Singer. Returning to the question of when a parent can eliminate a minority interest in a subsidiary, the court held that a merger which primarily advances the business interests of the parent or controlling shareholder is permissible under Delaware law. In International General Industries, Inc. (IGI), a Delaware corporation, owned 81% of the outstanding common stock of Kliklok Corp. (Kliklok), also a Delaware corporation. As part of a merger plan to acquire all of Kliklok’s common stock and eliminate the minority interest, IGI created KLK, a wholly owned subsidiary. As controlling shareholder of Kliklok, IGI approved the merger of KLK and Kliklok on a cash for stock basis. Plaintiffs, minority stockholders of Kliklok, argued that since the merger advanced only the interests of the parent, IGI, the merger should be enjoined. However, in Tanzer, there was no contention that the merger benefited the subsidiary.

152. Singer v. Magnavox Co., 380 A.2d 969, 982 (Del. 1977) (McNeilly, J., concurring).
155. Id. at 1123. Discussing Singer’s holding that elimination of the minority as the sole purpose for a merger is a violation of fiduciary principles, the court noted: “In one sense, [such elimination] may be said to be what is involved in the Kliklok merger because the minority were cashed out and it is not contended . . . that Kliklok benefited from the merger.” Id. However, the court determined that the focus of its decision should not be on the minority, but rather on the right of IGI as a majority shareholder to effect a merger for its own corporate interest. Id. at 1124.
The issue posed was whether a parent or majority shareholder could effect a merger solely for its own corporate benefit or whether such action would violate a fiduciary duty. The court recognized that, rather than an analysis in terms of business purpose, an analysis, as in Singer, of the competing rights of the majority and minority is useful.

The court noted that, although Singer concentrated on the rights of the minority, majority stockholders also have rights to be protected. IGI, although holding the controlling interest in Kliklok, was also a shareholder. The distinction between a majority shareholder exercising his ownership rights as opposed to acting in his control capacity creates a dichotomy in corporate theory: Fiduciary obligations only attach to the majority shareholder’s actions when he is exercising control. The court resolved this dichotomy by focusing on IGI’s status as a stockholder of Kliklok. The court noted that “a stockholder in a Delaware corporation has a right to vote his shares in his own interest, including the expectation of personal profit, limited, of course, by any duty he owes to other stockholders.” From this premise, the court’s decision is a foregone conclusion. IGI’s action is not a per se violation as in Singer. Moreover, this same court recently held in Sinclair Oil Corp. v. Levien that self-dealing occurs when a parent manipulates a subsidiary so as to reap a benefit to the exclusion of the subsidiary. Curiously, however, the court’s decision in Tanzer lacks the heavy reliance on fiduciary principles evident in Singer, perhaps because single-minded focus on fiduciary principles or even on the advantage-disadvantage test of Sinclair Oil would nullify the merger. Although the court in Tanzer began its opinion by discarding the business purpose test, Singer is still to be reckoned with: Not only must a merger comply with “entire fair-

158. Id. at 1123.
159. Id.
161. Tanzer v. International Gen. Indus., Inc., 379 A.2d 1121, 1124 (Del. 1977). The court stated that it would be unfair to judge only IGI’s “director control of Kliklok which is a consequence of its power and not the source thereof.” Id. at 1123. Indeed, since IGI caused the merger because it voted as a stockholder, this is the status by which its interests should be measured. See id.
162. 280 A.2d 717 (Del. 1971).
163. Id. at 720.
164. See note 125 supra.
The business purpose asserted "must not be suspect as a subterfuge, the real purpose of which is to rid itself of unwanted minority shareholders in the subsidiary."165 Again, the still undefined and ostensibly discarded concept of valid business purpose recurs in the court’s holding as a measure of the validity of future mergers.

The Chancellor, in the decision below, had found that IGI’s purpose in causing the merger was to facilitate its long term debt financing.166 Accepting this as a valid business purpose, the court of chancery discussed fairness only with reference to the price offered to the minority.167 On appeal, however, the supreme court held that this was too restrictive a view of the Sterling test: “The test required by Singer, which applied the rule of Sterling, involves judicial scrutiny for ‘entire fairness’ as to all aspects of the transaction.”168 Once again, the court declined to articulate guidelines for the application of this standard as a mechanism to protect minority shareholders’ rights.

Although it is unclear how the court’s decision protects the minority, Tanzer will probably restore Delaware to good favor with corporate management. As an indication of how Delaware will deal with future corporate takeouts, the decision is somewhat clearer. In light of Tanzer, Singer appears to be no more than a warning to those enterprises contemplating takeouts that most forms of corporate takeouts will be condoned, except those so egregious as to shock the conscience of even the Delaware courts. Tanzer was a retreat from the departure from precedent established by Singer, which afforded new protection to minority shareholders. In light of Tanzer, Singer seems to have even less application to its own facts, since Singer’s only impact can be expected to be in true going private transactions. Thus, Delaware seems to be following in New York’s footsteps, returning the balance to one favoring corporate management.

**CONCLUSION**

The amorphous standard of the business purpose test as a limitation on the majority’s power to effect a merger rests on the premis-
ise that appraisal is an inadequate remedy to insure fairness in the majority's dealings with the minority. Designed to insure greater fairness to the minority, the business purpose test reflects traditional notions of the controlling shareholder's fiduciary duty to the corporation and to those acting on its behalf. By focusing on the corporation, this test does not effectively check the majority's conduct towards the minority, and therefore fails to achieve its purpose. This failure is evident in Tanzer, where the court held that if a merger advances solely the business purpose of the parent corporation, it is permissible, even if the minority shareholders of the subsidiary are squeezed out. How such a standard protects the minority remains obscure. In addition, while both Singer and Tanzer profess to discard the business purpose test, the test finds its way back into the courts' holdings; yet both holdings lack needed definition.

If Tanzer and Singer indicate Delaware's direction in dealing with mergers, most mergers will probably pass scrutiny, as long as they are not blatant grabs for power, even where the minority is cashed out. The effect is to sift out the true going private transaction where aggrandizement of the controlling shareholders' purse is the only motive. However, the minority has again been overlooked. Permitting various corporate combinations without awarding a share of the synergistic value to those cashed out in the transaction continues to sacrifice minority rights to corporate flexibility. The analysis of the business purpose test by the Delaware Supreme Court avoids the necessary confrontation with the problems inherent in protecting the minority interests: the inadequacy of the present appraisal statute and the failure to recognize the minority's interest as monetary.

The minority interests are placated by the resurrection of the fairness doctrine of Sterling. Indeed, use of an intrinsic fairness

170. Neither Tanzer nor Singer set out any guidelines for the use of the "entire fairness" standard. In Tanzer the lower court, having made the initial determination of business purpose, confined further inquiry to adequacy of the proffered consideration. Tanzer v. International Gen. Indus., Inc., 379 A.2d 1121, 1125 (Del. 1977). However, the Supreme Court of Delaware noted that entire fairness must be applied to all aspects of the transaction, of which price is only one factor. Id. Though the supreme court gave no guidance, the lower court was probably relying on the various factors set out in Sterling which appear to be directed solely at price:

[All relevant value figures of both corporations may be examined and compared in order to arrive at a decision as to the fairness of the plan. Thus, while not determinative, nevertheless, the value of each corporation for var-
test may create obstacles for many corporations. The prospect of judicial intervention may unnecessarily inhibit the flexibility and efficiency essential to corporate life. But is it the corporation's actions we wish to obstruct? If Delaware intends to reinstate minority rule in the distribution of corporate power, especially given the traditional preference for corporate management, such a decision should be predicated on a more predictable standard than "entire fairness."

If Delaware follows New York's lead, corporate management need not fear significant restraints on its flexibility in corporate affairs. Only egregious mergers will be outlawed, and these probably could have been dealt with under traditional fiduciary standards without the infusion of a business purpose test or an ad hoc fairness standard into corporate law.

On the other hand, Delaware may actively pursue the fairness standard, thereby forcing the majority to deal fairly with the minority. Though Singer specifically limited its holding to long form mergers, the court of chancery has recently extended the Sterling fairness requirement to short form mergers as well. Indeed, it can be expected that the court of chancery will be inundated with cases attempting to delineate further Delaware's attitude towards corporate combinations. For the minority, though fairness is a step in the right direction, it does not go far enough to equalize bargaining power. Moreover, the intrinsic fairness test was eroded once before

ious purposes, e.g., going concern value, book value, net asset value, market value, is pertinent to the issue presented.
Sterling v. Mayflower Hotel Corp., 33 Del. Ch. 20, 28, 89 A.2d 862, 867 (1952). This definition was incorporated into the Delaware Supreme Court's decision in Sterling. Sterling v. Mayflower Hotel Corp., 93 A.2d 107, 115 (Del. 1952).

171. Kemp v. Angel, 381 A.2d 241 (Del. Ch. 1977). The court in Kemp, referring to language in Singer, noted that there is no reason why the duty imposed on a majority stockholder in a short form merger should be subject to less scrutiny than the duty imposed in a long form merger. Despite the court's ruling in Stauffer v. Standard Brands, Inc., 41 Del. Ch. 7, 187 A.2d 78 (1962), that the very purpose of the merger statute was to enable the majority to eliminate a minority interest, short form mergers will now be subject to the "entire fairness" doctrine. See id.

172. See Young v. Valhi, Inc., 382 A.2d 1372 (Del. Ch. 1978). In Young the court found that the business purpose was contrived since the merger was an attempt to circumvent a specific charter provision. The fairness inquiry centered on the price paid to the minority shareholders. Id. at 1377-78. In another recent case, Najjar v. Roland Int'l Corp., [1978] 455 SEC. REG. & L. REP. (BNA) A-2 to A-3 (Del. Ch. May 8, 1978), the court indicated that a complaint that alleges that a merger's sole purpose is to eliminate minority interests "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 [is the] amount paid for the minority shares." Id. at A-2.
to a fraud standard and only revived to combat what the court considered a true evil: going private. Once a court confronts the merits of permitting certain combinations, the fairness test may again be eviscerated to require proof of self-dealing. Indeed, if the court’s requirement of a plausible business purpose is easily met without regard to the effect on the minority, it is likely that the fairness requirement will give rise to only a pro forma hearing to satisfy a dissident minority. If so, the minority will be in no better position than it was before Singer. To attack a merger, the minority will be forced to prove fraud, which is difficult. Application and expansion of the fairness doctrine will make Delaware a less attractive corporate home if the legitimacy of a corporation’s actions is determined on a case-by-case basis. Application of a fairness standard, an extreme example of a court exercising equitable discretion, has no place in corporate combinations so fundamental to the function of corporation life.

Whether Delaware chooses to gloss over the business purpose test and permit most corporate combinations or to expand further the fairness doctrine, the minority remains relatively unprotected. The economic interest of the minority must be recognized as the essence of the conflict produced by going private transactions before the minority will receive any substantial protection. Blinded by traditional precepts, the court in Singer was unable to recognize that corporate combinations of all kinds can and should be permitted as long as minority shareholders are compensated for what they are asked to relinquish.

Lynn F. Samuels