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SHAREHOLDERS’ RIGHTS IN SHORT-FORM MERGERS: THE NEW DELAWARE FORMULA

I. INTRODUCTION

The short-form merger is a statutory procedure by which a parent corporation can merge with its ninety percent-owned subsidiary through a simple board resolution. Since neither

1. The Model Business Corporation Act is a comprehensive analysis of the business corporation acts of all the states, the District of Columbia and Puerto Rico. Following is the Model Business Corporation Act proposal for the short-form merger statute:

MERGER OF SUBSIDIARY CORPORATION

Any corporation owning at least ninety per cent of the outstanding shares of each class of another corporation may merge such other corporation into itself without approval by a vote of the shareholders of either corporation. Its board of directors shall, by resolution, approve a plan of merger setting forth:

(A) The name of the subsidiary corporation and the name of the corporation owning at least ninety per cent of its shares, which is hereinafter designated as the surviving corporation.

(B) The manner and basis of converting the shares of the subsidiary corporation into shares, obligations or other securities of the surviving corporation or of any other corporation or, in whole or part, into cash or other property.

A copy of such plan of merger shall be mailed to each shareholder of record of the subsidiary corporation.

Articles of merger shall be executed in duplicate by the surviving corporation by its president or a vice president and by its secretary or an assistant secretary, and verified by one of its officers signing such articles, and shall set forth:

(a) The plan of merger;

(b) The number of outstanding shares of each class of the subsidiary corporation and the number of such shares of each class owned by the surviving corporation; and

(c) The date of the mailing to shareholders of the subsidiary corporation of a copy of the plan of merger.

On and after the thirtieth day after the mailing of a copy of the plan of merger to shareholders of the subsidiary corporation or upon the waiver thereof by the holders of all outstanding shares duplicate originals of the articles of merger shall be delivered to the Secretary of State. If the Secretary of State finds that such articles conform to law, he shall, when all fees and franchise taxes have been paid as in this Act prescribed:

(1) Endorse on each of such duplicate originals the word “Filed,” and the month, day and year of the filing thereof,

(2) File one of such duplicate originals in his office, and

(3) Issue a certificate of merger to which he shall affix the other duplicate original.

The certificate of merger, together with the duplicate original of the articles of merger affixed thereto by the Secretary of State, shall be returned to the surviving corporation or its representative.

shareholder meetings nor shareholder votes are required for authorization of the merger, the short-form procedure clearly saves both time and money for the corporations involved. But, what happens to the leftover ten percent of the subsidiary's shareholders? Most state statutes simply provide for the ten percent minority to be paid off in cash, securities, or other consideration after a short-form merger. But, what if the minority does not want to be paid off? What if the minority wants continued participation in the merged enterprise?

While on its face the short-form merger statute appears simple and economical, some corporate insiders have abused the statute in recent years by using it for the sole purpose of eliminating the minority interest by exchanging their interest for cash. As a result, if the statutory requirements have been met, the minority shareholders have had no voice in the merger and no remedy against their own elimination.

In response to such abuses, the Delaware Supreme Court has recently revived traditional equity concepts and applied them to the area of mergers. The court has focused on the fiduciary duty the majority shareholders owe the minority shareholders and in so doing has developed a workable and appropriate solution. The Delaware approach involves a two-step court inquiry: (1) an inquiry into the business purpose of the merger; and (2) an inquiry into the "entire fairness" of the merger transaction. Using this approach, courts can make the analysis on a case-by-case basis and protect the rights of the minority while at the same time consider the best interests of the corporation.

New York and Delaware pioneered the law of short-form mergers. These legislative enactments have undergone a series of changes and refinements since the genesis of the short-form merger concept, and court decisions in these two states have paralleled the statutes' evolution. A review of the law as it evolved sheds great light on the area by revealing what initially moved legislatures to enact the statute, how the original purpose became distorted, how abuses developed and how

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2. See id. at (B).
3. See text accompanying notes 44-83 infra.
4. See text accompanying notes 89-120 infra.
5. See text accompanying notes 110-17 infra.
courts today are seeking to protect minorities from these abuses.

II. GENERAL BACKGROUND

At common law, a sale or other disposition of all corporate assets required the unanimous approval of the shareholders. However, an exception to the unanimity rule developed which allowed a majority of shareholders to authorize major transactions when the enterprise was experiencing financial difficulties, and when the transaction was calculated to meet the crisis.

As corporations grew in economic power and political influence, they demanded of the law more flexibility than the unanimity rule could provide. Stubborn minorities could no longer be permitted to frustrate major transactions until financial difficulties permitted the majority to act. In response to this problem, every state legislature eventually enacted statutes to permit the majority (usually a two-thirds majority) of each class of shareholders to authorize major transactions involving corporate assets, including consolidations and mergers.


The unanimity rule arose from the common law view that the relationship between the shareholders and the corporation was contractual. Since a major transaction involving corporate assets would affect the contract and property rights of every shareholder (including even the smallest minority) the rule held that only a unanimous vote could protect the rights of all. Kean v. Johnson, 9 N.J. Eq. 401 (1853). See generally Kremer v. Public Drug Co., 41 S.D. 365, 170 N.W. 571 (1919); Gibson, How Fixed are Class Shareholder Rights?, 23 L. & CONTEMP. PROB. 283 (1958).

7. "Neither the directors nor a majority of the stockholders have power to sell all the corporate property as against the dissent of a single stockholder, unless the corporation is in a failing condition." 3 COOK ON CORPORATIONS § 670 (7th Ed. 1913). See also Geddes v. Anaconda Copper Mining Co., 254 U.S. 590 (1921); Treadwell v. Salisbury Mfg. Co., 73 Mass. (7 Gray) 393 (1856).


Many states have reduced the requirement still further to a simple majority of the vote. For a comparison of state statutes regarding shareholder approval, see 2 MODEL
A merger occurs when one or more corporations are absorbed into another already-existing corporation (the "surviving" corporation) which retains its name and corporate identity along with the added capital, franchise, and powers of the former constituent corporation (the "acquired" corporation). When legislatures enacted statutes allowing mergers to be authorized by majority vote, they were forced to provide some remedy for dissenting minority shareholders. The remedy took the form of "appraisal" provisions which were incorporated into the merger statutes. Today's appraisal statutes provide dissenting shareholders with the right to sell their shares back to the corporation (the "surviving" corporation) in return for a cash sum equal to the "fair market value" of the shares. If an agreement cannot be reached on the value of the shares, the appraisal statutes provide that a petition be filed after which the courts will make the determination of value.

There are numerous disadvantages to the appraisal remedy. First of all, the appraisal remedy can only pretend to protect the value of the investment, not its form. In many cases, establishing the fair market value of stock is time-consuming and expensive. Furthermore, the statutes themselves raise the possibility of litigation when the parties cannot

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11. The Fifth Amendment of the United States Constitution protects the individual against the deprivation of property without due process of law. Majority rule of the corporate form would give the majority the right to alter or dispose of a dissenting shareholder's property without his consent. It was clear that mergers affected "the very essence of the stockholder's investment," but commercial pressures necessitated majority rule. E. Kintner, Primer on the Law of Mergers 29 (1973).


12. For a comparison and listing of statutes providing for the rights of dissenting shareholders, see 2 Model Bus. Corp. Act Ann. 2d § 81 ¶ 3 & 6 (1971).


agree. A particularly difficult problem with appraisals arises in the case of closely-held corporations which lack both a ready market and set standards for fixing the value of the shares in dispute.

A significant body of decisional law exists regarding the fiduciary duties owed within the corporate form, particularly as developed by the courts of equity. The duties are owed by management (directors and officers) and by controlling shareholders to the corporation and to the minority shareholders. However, since procedures such as mergers are authorized by statute, redress for oppressed minorities has too often been allowed only in transactions in which fraud or blatant overreaching could be proven. Thus, statutory compliance by the majority or corporate management has served to frustrate minority redress in equity.

III. THE DEVELOPMENT OF THE SHORT-FORM MERGER

A. New York Origins

1. Statutory Development

Commercial demands for still more management flexibility gave rise to a procedure for corporate mergers called the short-form merger. Short-form merger statutes generally require the board of directors to vote on a plan containing, inter alia, the terms of the merger in detail and the manner of share conversion. If such a plan is approved by board resolution, notice is sent to the shareholders, the plan is executed, filed with the secretary of state of the corporation's domicile, and the merger is complete. Shareholder votes and meetings, which are required in the traditional or "long-form" statutory merger, are deemed unnecessary because the short-form

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18. Id. at § 231 at 450.
19. Id. at § 240 at 475.
22. For the model short-form merger statute after which many state statutes are patterned, see 2 Model Bus. Corp. Act Ann. 2d § 75 ¶ 1 (1971).
merger is considered the practical equivalent of a liquidation of the subsidiary into the parent. 23

The short-form merger apparently had its origin in New York in 1924 when the legislature adopted a provision which would allow a simple board resolution to authorize a merger between a parent and its wholly-owned subsidiary. 24 The procedure was indeed comparable to a liquidation of the subsidiary. This "short" form of merger avoided the time and expense of shareholder meetings and votes on a corporate action which would not materially affect the individual shareholder's interests. Obviously, when the subsidiary was wholly-owned, there existed no dissenting minority of the subsidiary whose rights and holdings would be jeopardized by the merger. This first short-form merger law was thus a desirable statutory shortcut which brought a certain economy to the merger procedure and had no adverse effects.

A drastic change in the concept of the short-form merger developed during the depression when "overleveraged" utility empires found themselves on the verge of collapse. 25 These utilities, greatly in need of some method to simplify their holding and operating company relationships, lobbied for a provision which would allow a short-form merger even if the subsidiary were less than "wholly-owned." 26 Subsequently, in 1936, the Joint Legislative Committee to Investigate Public Utilities recommended to the New York Senate and Assembly that the "wholly-owned" provision be changed to a 95% provision which would apply only to utilities. 27

The committee reported that "the consolidation of operating companies will tend to effectuate greater economies, more efficient management and rate reductions." 28 Furthermore, the report showed evidence that "simplification of holding and operating company relationships in the public utilities field had been made difficult by the blocking tactics of small

23. For a comparison of short-form merger statutes, appraisal rights, and cash-for-shares provisions, see 2 Model Bus. Corp. Act Ann. 2d § 75 ¶¶ 3-6.
24. 1924 N.Y. Laws ch. 441.
26. Id.
28. Id.
minority interests."\textsuperscript{29} The committee report added, however, a requirement that every such contemplated merger between utilities receive prior approval by the Public Service Commission of New York.\textsuperscript{30} The conclusion drawn from the committee report was that "in 1935, and for years thereafter, there was a nationwide demand for such simplification of the complex intercorporate structures of public utilities, and it [was] apparent that the 1936 and 1937 amendments [allowing a merger with a 95\%-owned subsidiary] were part of an effort to meet that demand."\textsuperscript{31}

In 1936, the New York statute was thus amended, eliminating the requirement that the subsidiary be wholly-owned and authorizing a merger between a parent utility and its subsidiary in which the parent owned a 95\% or more interest.\textsuperscript{32} This 95\% provision of the statute changed the character of the short-form merger in a very significant way. For the first time there existed a five percent minority of subsidiary shareholders whose status and rights remained in question: How was the 5\% interest to be treated? Since the subsidiary's minority had no opportunity to vote on the merger, what was to happen to their interest?

The 1936 New York Statutes provided for the five percent minority interest in the following way:

[I]n case the possessor corporation shall not own all the outstanding stock of the other corporation to be merged, the resolution of the board of directors of the possessor corporation shall state the terms and conditions of the merger, including the securities, cash or other consideration to be issued, paid or delivered by the possessor corporation upon surrender of each share of the merged corporation not owned by the possessor corporation.\textsuperscript{33}

The statutory language is clear: the minority interest in the subsidiary could be eliminated by a board resolution and a payout in "securities, cash or other consideration." The mi-

\textsuperscript{29} Id.
\textsuperscript{30} Id.
\textsuperscript{31} Id.
\textsuperscript{32} 1936 N.Y. LAWS CH. 778. In 1937 "domestic district steam corporations" were added to the utilities allowed to use the short-form merger statute. 1937 N.Y. LAWS CH. 815.
\textsuperscript{33} N.Y. STOCK CORP. LAW CH. 60 § 85(1) (Consol.) (1936 Supp.).
nority need not be given an opportunity to participate in the continuing enterprise. Thus, while the form of the minority's investment goes unprotected, the legislature apparently concluded that the value of the investment was sufficiently protected by the appraisal remedy.  

However, the operation of the 95% provision still contained important restrictions. The statute still applied only to mergers of utilities and those mergers had to be authorized by the Public Service Commission of New York. The statutes directed the PSC "to make such investigations and/or hold such public hearings as [were] in its opinion necessary or desirable to enable it to determine if such approval should be granted." Thus, even though the minority of the subsidiary could not vote on the merger, they could make an appeal to the PSC to deny authorization of the merger. A further restriction on the operation of the 95% provision was the requirement that the subsidiary corporation be "engaged in business similar to or incidental to the business which the possessor corporation is authorized to engage in . . . ." These restrictions stood as checks upon the parent corporation's use of the short-form merger. As these statutes indicate, at that time, it was necessary for the parent to show some purpose for the merger sufficient to gain the approval of the PSC.

2. Early Court Treatment in New York

The 95% statute was challenged in the courts and upheld in Alpren v. Consolidated Edison Co. of New York. There,

34. The appraisal statute at that time was contained in N.Y. Stock Corp. Law ch. 60 § 21 (Consol.) (1936 Supp.).
35. N.Y. Stock Corp. Law ch. 60 § 85(5) (Consol.) (1936 Supp.).
36. Id.
37. The 1936 New York Statutes provided that notice of a proposed merger be mailed to each stockholder of the subsidiary corporation before the merger was filed with the Secretary of State. N.Y. Stock Corp. Law ch. 60 § 85(1) (Consol.) (1936 Supp.). The statute also provided that the Public Service Commission's authorization be obtained before filing with the Secretary of State. Id. at § 85(5). When read together, the apparent legislative intent of those two sections was to give notice to shareholders so that their dissent could be registered at the Commission's hearings, before the merger was approved and before it was finalized with the Secretary of State.
38. N.Y. Stock Corp. Law ch. 60 § 85(1) (Consol.) (1936 Supp.).
the plaintiff challenged the constitutionality of the 95% provision, alleging that the statute interfered with her vested rights as the owner of stock in the merged corporation. The court denied the plaintiff's action, however, and applied a judicial "hands-off" policy by holding that the short-form merger was "primarily a matter of public policy within the province of the legislature to control." Unfortunately, this summary dismissal of the plaintiff's claims became the typical judicial treatment on the theory that the legislature had not shown any intent to give greater protection to the minorities. For instance, in a subsequent challenge to the constitutionality of the New York statute in Beloff v. Consolidated Edison Co. of New York, the court was more explicit in its rejection of the plaintiff's claim and in its characterization of the plaintiff minority shareholder's rights:

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, see Voeller v. Neilston Warehouse Co., 311 U.S. 531, 535, 61 S. Ct. 376, 85 L.Ed. 322. He has no right to stay in the picture, to go alone into the merger, or to share in its future benefits. He has no constitutional right to deliberate, consult or vote on the merger, to have prior notice thereof or prior opportunity to object thereto. His disabilities in those respects are the result of his status as a member of the minority, and any cure therefor is to be prescribed by the Legislature, if it sees fit. In none of this do we see any deprivation of due process, or of contract rights.

The court in Beloff returned to the legislative committee reports to attempt to discern the legislative intent in enacting the 95% provision. The court made reference to the legislature's concern that "blocking tactics of small minority interests" were hindering major corporate transactions. In making this reference, the court endorsed the theory that minorities must not be allowed to unfairly cripple majority decision-

40. Id. at 383, 5 N.Y.S.2d at 256. The Alpren case is often cited as an endorsement of the judicial "hands-off" policy and judicial deference to legislative authority in this area of the law.
41. 300 N.Y. 11, 87 N.E.2d 561 (1949).
42. Id. at 19, 87 N.E.2d 564-65.
43. See text accompanying notes 27-31 supra.
making. But, it is clear from the court's decision and the authority cited, that the elimination of the minority, while undesirable, was meant by the legislature to be merely incidental to a necessary corporate action, an incidental cost which was incurred so that the entire enterprise could continue to function. In no way did the court view the legislature's intent as condoning the use of the short-form merger procedure for the purpose of eliminating the minority. But again, at the time the Beloff case arose, the legislature had placed strict limitations on the application of the short-form merger (it applied only to utilities), and had required the utilities to obtain Public Service Commission authorization.

In 1949, the New York legislature removed two restrictions on the short-form merger, thereby making the procedure available to all stock corporations and removing the requirement that the merger receive prior agency approval. The statute still required, however, that the subsidiary be "authorized to engage in business similar to or incidental to the business which the possessor corporation is authorized to engage in." Eventually, this requirement was also eliminated when the New York statutes were revised to follow the Model Business Corporation Act of 1960.

As these checks on the operation of the statute were removed, the short-form merger became a tool which management could more freely wield to whatever end they desired. The initial impetus and rationale for the short-form merger (the simplification of corporate restructuring in the desperate utility empires) became buried in the history of the statute. The short-form merger as a management tool remained, applying to corporations generally in many states by 1960.

44. The Beloff opinion at 87 N.E.2d 565 cites In re Timmis, 200 N.Y. 177, 181, 93 N.E. 522, 523 (1910) for the proposition that the minority must yield to the wishes of the majority in order for the corporate form to function.

45. See text accompanying notes 35-38 supra.

46. 1949 N.Y. LAWS CH. 762.

47. Id.

48. N.Y. BUS. CORP. LAw § 905 (McKinney) (Legislative Studies and Reports) at 55.

B. Delaware and Beyond

Delaware modeled its short-form merger statute after that of New York.50 As originally enacted in 1937, Delaware required the subsidiary to be wholly-owned.51 But in 1957, Delaware went beyond even the New York statute and allowed a short-form merger where the parent owned a 90% interest in the subsidiary.52

The first test of the Delaware 90% short-form merger statute came in Coyne v. Park & Tilford Distillers Corp.53 In Coyne, the plaintiffs, four percent minority shareholders in the subsidiary, questioned the parent’s right to pay off the minority of the subsidiary in cash and thus eliminate without choice the minority’s property interest in the corporation. The plaintiffs argued that the short-form merger statute was only a procedural statute and that the substantive power for the statute was conferred by the general merger statute, which did not allow the payment of cash for stock surrendered in a merger.54 The court held that the statute conferred both procedural and substantive powers, allowing the parent to pay off the minority of the subsidiary in “securities, cash, or other consideration . . . .”55 In denying the plaintiff’s claim, the Coyne court cited Beloff as authority.56

With an arsenal of case law to back up the constitutionality of the statute, the short-form merger grew in popularity. The 1960 Model Business Corporation Act offered the short-
form merger as an optional section but endorsed the 95% provision. However, when the Model Act was revised in 1971, the drafters followed Delaware’s lead and adopted the 90% provision. None of the statutes made any restrictions as to the purpose of a proposed merger. The courts took their cue from the legislative silence and made no inquiry into the purposes of mergers under the statute.

The 1962 decision of the Supreme Court of Delaware in *Stauffer v. Standard Brands, Inc.* is a landmark in the history of the short-form merger. Without basing its conclusion on either legislative history or legislative intent, the court boldly stated that “the very purpose of the short-form merger statute is to provide the parent corporation with a means of eliminating the minority shareholder’s interest in the enterprise.” Thus, according to *Stauffer*, the elimination of the minority was the purpose of a short-form merger, not merely incidental to such a merger effected for another purpose. *Stauffer’s* interpretation, however, flies in the face of the statute’s history, distorting the original legislative intent and setting the stage for the abuses which developed.

As construed by the *Stauffer* decision, the short-form merger had become a “cash-out” procedure rather than a merger statute. The statutes, so construed, clearly leaned in favor of the parent corporation, conferring the power to choose arbitrarily to eliminate the minority’s property interest in the enterprise by paying cash for the minority shares. The

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subsidiary's minority was left with no recourse in asserting their property rights, and only an unpredictable appraisal remedy to "assure" a "fair" cash-out price. A further disadvantage and long-ignored effect of the cash-out process was the tax consequences which such a remedy had upon the eliminated minority after the merger was completed.\textsuperscript{62} The potentially adverse tax consequences might be used as a threat to coerce the minority shareholder into accepting securities worth less than the fair value of his interest so that the tax could be avoided.\textsuperscript{63}

American economic history played an important role in the sudden popularity of the merger device among corporate management groups. The bull market of the late 1960's encouraged many privately-held corporations to go public.\textsuperscript{64} But, the recession of the 1970's caused the value of the publicly-held stock to plummet.\textsuperscript{65} In an effort to capitalize on the collapse in the value of the stock\textsuperscript{66} and at the same time rid themselves of the headaches of public ownership,\textsuperscript{67} corporate

\textsuperscript{62} When the minority interests are paid off in cash, securities or other property, the individual minority shareholders will have to recognize gain on the transaction, for tax purposes, to the extent that the fair market value of the cash, securities or other property exceeds the shareholder's basis in the property. I.R.C. § 1001(a) & (c), TREAS. REG. § 1.1001-1(a).

Although the minority shareholder's conversion of his stock into cash, securities or property is, in fact, involuntary, it does not fall within any of the Internal Revenue Code's non-recognition provisions which postpone recognition of gain. See I.R.C. § 1031(a) ("not including . . . stock") and I.R.C. § 1033 ("property destroyed in whole or in part by theft, seizure, requisition or condemnation").

Fortunately, the minority shareholder will be entitled to treat these gains as long-term capital gains if they qualify under I.R.C. §§ 1221-1223. This entitles a taxpayer to a deduction for 60% of the net capital gain recognized on an item. I.R.C. § 1202(a). This will, to some extent, mitigate the adverse tax consequences to minority shareholders who have been forced out in a short-form merger.


\textsuperscript{64} Note, Going Private, 84 YALE L.J. 903, 903 n.3 (1975). This article states that between 1967 and 1972, some 3000 corporations filed registration statements with the SEC for the first time (citing Sommer, "Going Private": A Lesson in Corporate Responsibility, BNA SEC. REG. & L. REP. No. 278 at D-1 (Nov. 20, 1974)).

\textsuperscript{65} Note, Going Private, 84 YALE L.J. 903 (1975).

\textsuperscript{66} Id.

insiders\textsuperscript{68} looked for ways to reacquire all of their publicly-held common stock and to return their enterprise to their own private hands. Such a program aimed at share reacquisition is known as “going-private.”\textsuperscript{69} When the minority shareholders are given cash or debt securities for their equity interests instead of continued participation in the enterprise, this type of “going-private” transaction is referred to as a “take-out,” or pejoratively termed a “freeze-out” or “squeeze-out.”\textsuperscript{70}

The merger thus became a key management tool in enabling a corporation to “go private.” A classic going-private freeze-out merger is accomplished when the majority stockholders of one corporation form a second corporation, over which the majority has 100\% ownership, then merge the original corporation with the second corporation and pay off the minority shareholders in cash. The minority shareholders are thus removed from the surviving corporation.\textsuperscript{71} A contrived and manipulable freeze-out procedure such as this was not contemplated (nor would it have been condoned) by the New York legislature which enacted the first short-form merger statute.\textsuperscript{72} Indeed, freeze-outs go far beyond the legislative intent\textsuperscript{73} and thus represent an abuse of the statute. A plan which charters a new corporation solely so that it may merge with the existing corporation and eliminate the minority, perverts the original intent of the statute, yet remains within the boundaries of the corporation laws.

But, is such minority elimination unfair? The going-private mergers which only became frequent practice in the 1970’s\textsuperscript{74} too often were grossly unfair.\textsuperscript{75} When the corporations

\textsuperscript{68} By the term “insiders” it is meant the core group which directs the operation of the corporation. Even when the corporations went public, the “insiders” retained sufficient interest to maintain this “majority” status. For a discussion of insiders’ motives and techniques in “going private,” see Note, Going Private, 84 Yale L.J. 903, 905-11 (1975).

\textsuperscript{69} Note, Going Private, 84 Yale L.J. 903 (1975).


\textsuperscript{71} 46 Geo. Wash. L. Rev. 877, 879 n.29 (1978). This is precisely the procedure utilized by the defendant in Singer v. Magnavox Co., 380 A.2d 969, 971 (Del. 1977) discussed infra.

\textsuperscript{72} See text accompanying notes 24-38 supra.

\textsuperscript{73} Id.

\textsuperscript{74} Note, Going Private, 84 Yale L.J. 903, 903-04, n.5 (1975).

\textsuperscript{75} Id. at 905. In a 1974 address, a commissioner of the SEC referred to going-
went public in the 1960’s, the public, in many cases, purchased shares at very high prices.\textsuperscript{76} When the public was “cashed out” in the 1970’s, however, they received only a fraction of the earlier price.\textsuperscript{77} The insiders determined the terms offered to the public shareholders and thus enriched themselves at the direct expense of the investing public.\textsuperscript{78} In cases in which the cash out price was higher than that which they originally paid, the “cashed out” shareholders not only lost their property rights, but incurred a capital gains tax as well.\textsuperscript{79}

The use of the merger device in both its long\textsuperscript{80} and short forms for going-private freeze-outs became increasingly widespread,\textsuperscript{81} but state laws and courts continuously failed to check the abuse.\textsuperscript{82} Frustrated minorities finally sought refuge in the federal courts under the authority of Securities and Exchange Rule 10b-5\textsuperscript{83} which outlaws fraud and deceit in connection with the purchase or sale of securities.

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private transactions as “serious, unfair, and sometimes disgraceful, a perversion of the whole process of public financing, and a course that inevitably is going to make the individual shareholder even more hostile to American corporate mores and the securities markets than he already is . . . .” Address by Commissioner A. Sommer, Jr., Law Advisory Council Lecture, Notre Dame Law School, (Nov. 1974), \textit{reprinted in} 278 Sec. Reg. & L. Rep. (BNA), D-1, D-2 (1974), \textit{quoted in} Note, 64 Va. L. Rev. 1101, 1112.

\textsuperscript{76} Note, \textit{Going Private}, 84 Yale L.J. 903, 905-06 (1975).
\textsuperscript{77} Id. at 905.
\textsuperscript{78} Id. at 906.
\textsuperscript{79} See notes 62 & 63 \textit{supra} and accompanying text.
\textsuperscript{80} Inherent in the long-form merger is the right of all shareholders (of both merging corporations) to meet and vote on such a major measure. \textit{See} 2 \textit{Model Bus. Corp. Act Ann.} 2d § 73 ¶ 1 (1971). However, many states now require only a simple majority for authorization of the merger plan, including its conversion provisions. \textit{Id.} For a listing of state statutes regarding approval of shareholders, \textit{see} \textit{Id.} at ¶ 6.

Thus, a 51% majority could effect a freeze-out of a 49% minority even under a long-form merger. The problems peculiar to the long-form merger are outside of the scope of this article except as they relate to the problems of the short-form merger.

\textsuperscript{81} Note, \textit{Going Private}, 84 Yale L.J. 903, 903-04, n.5 (1975).
\textsuperscript{82} The few reported cases in this area predominantly arose from appraisal disputes. It would be impossible to determine how many complaints filed to attack a short-form merger have been dismissed for failure to state a cause of action. Statutory compliance by the parent, coupled with judicial approval of parental power would indeed seem to leave minorities with no cause of action and no willing ear. In most cases, the defendant parent corporation moves to dismiss for failure to state a cause of action. \textit{See}, \textit{e.g.}, Singer v. Magnavox Co., 380 A.2d 969 (Del. 1977); Roland Int'l Corp. v. Najjar, 407 A.2d 1032 (Del. 1979).

\textsuperscript{83} 17 C.F.R. § 240.10b-5 (1977). The section is entitled “Employment of Manipulative and Deceptive Devices” and makes it:
However, in 1977, the United States Supreme Court in *Santa Fe Industries, Inc. v. Green*\(^4\) narrowly construed Rule 10b-5 in a case involving a short-form merger, and found no "deceptive" or "manipulative" conduct as required by the Rule. The frustrated minorities were thus denied the refuge they sought. The *Santa Fe* case sent back to the states these corporate issues which had historically involved state regulation,\(^5\) and left it up to the states to fashion an appropriate remedy for the minority in freeze-out situations.\(^6\)

**IV. The New Delaware Formula**

**A. Singer and Tanzer: Long-Form Mergers**

Shortly after *Santa Fe Industries v. Green*,\(^87\) the Delaware Supreme Court handed down the leading case of *Singer v. Magnavox Co.*\(^88\) Although *Singer* involved a long-form merger, it followed the federal precedent set by *Santa Fe*. The Delaware court saw the *Santa Fe* ruling as "a current confirmation by the Supreme Court of the responsibility of a State to govern the internal affairs of corporate life."\(^380\) A.2d at 976 n.6.


85. The Court expressed the fear that such "extension of the federal securities law would overlap and quite possibly interfere with state corporation law" in a wide variety of corporate areas. 430 U.S. at 479.

86. The *Singer* court saw the *Santa Fe* ruling as "a current confirmation by the Supreme Court of the responsibility of a State to govern the internal affairs of corporate life." 380 A.2d at 976 n.6.

The Court in *Santa Fe* had concluded that "'it is entirely appropriate in this instance to relegate respondent and others in his situation to whatever remedy is created by state law.'" 430 U.S. at 478 (quoting *Cort v. Ash*, 422 U.S. 66, 84 (1975)). The Court stated further: "There may well be a need for uniform federal fiduciary standards to govern mergers . . . But those standards should not be supplied by judicial extension of § 10(b) and Rule 10b-5 to 'cover the corporate universe.'" 430 U.S. 479-80 (quoting Cary, *Federalism and Corporate Law: Reflection Upon Delaware*, 83 YALE L.J. 663, 700 (1974) (footnote omitted)).


88. 380 A.2d 969 (Del. 1977).
merger, it nevertheless set the groundwork for later decisions on the short-form merger statutes.

_Singer v. Magnavox Co._ involved a going-private freeze-out merger which was utilized in the latter stages of a take-over by a previously unrelated giant corporation. North American Philips Corporation,⁹⁹ (North American) sought to acquire⁹⁰ Magnavox Company.⁹¹ As part of their plan, North American incorporated a “shell” corporation, North American Development Corporation (Development), in order to make a tender offer for the Magnavox common shares.⁹² Through the tender offer, Development acquired 84.1% of Magnavox’s outstanding stock.⁹³ But, in order to eliminate the remaining 15.9% of public shareholders’ interest and thus to acquire 100% of Magnavox’s equity interest, North American had to use a merger procedure.⁹⁴ To that end, another “shell” (T.M.C. Corporation) was created, a wholly-owned subsidiary of Development, for the purpose of merging with Magnavox.⁹⁵ Using the long-form merger procedure, shareholder meetings and votes were held.⁹⁶ Of course, Development’s 84.1% holding alone was enough to approve the merger.⁹⁷ The action was thus accomplished and the publicly-held stock was eliminated in exchange for cash.⁹⁸

The plaintiffs⁹⁹ brought an action seeking an order nullifying the merger as well as compensatory damages.¹⁰⁰ The allegations were: (1) that the merger was fraudulent because it served no business purpose other than the elimination of the

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⁹⁹. North American, a Delaware corporation, was the American subsidiary of Philips, the Dutch electronics giant. 66 CAL. L. REV. 118, 125.
⁹¹. Magnavox, a Delaware corporation, was engaged in the manufacture and sale of consumer, defense and industrial products in the electronics field. Singer v. Magnavox Co., 367 A.2d 1349, 1351 (Del. Ch. 1976).
⁹². Id. at 1351-52.
⁹³. 380 A.2d at 971.
⁹⁴. Id.
⁹⁵. Id.
⁹⁶. Id. at 972.
⁹⁷. Id.
⁹⁸. Id.
⁹⁹. The plaintiffs, Louis and Mollie Singer, were common stockholders of Magnavox at the time of the merger. 367 A.2d at 1351. The Singers brought the action on their own behalf and as a class action on behalf of all persons other than the defendants who owned common stock on the day before the merger. Id.
¹⁰⁰. 380 A.2d at 972.
public minority;\(^{(101)}\) (2) that in approving the merger at a cash price per share which they knew to be grossly inadequate, defendants\(^{(102)}\) breached their fiduciary duties to the minority shareholders;\(^{(103)}\) and (3) that the merger violated the antifraud provisions of the Delaware Securities Law.\(^{(104)}\)

In a thorough and carefully written decision, the Delaware Supreme Court in \textit{Singer} overturned most of the lower court's decision\(^{(105)}\) and focused on the "obligation owed by majority shareholders in control of the corporate process to minority shareholders, in the context of a merger . . . ."\(^{(106)}\) The defendants claimed that since they had fully complied with the statutory procedures, the merger was unassailable.\(^{(107)}\) The court drew from Delaware case law\(^{(108)}\) the proposition that "inequitable action does not become permissible simply because it is legally possible."\(^{(109)}\) The court's analysis was thus based on an application of the law governing corporate fiduciaries.

\(^{(101)}\) \textit{Id.}

\(^{(102)}\) The defendants were Magnavox, North American Philips Corporation, North American Philips Development Corporation and individual members of Magnavox management. \textit{Id.} at 971.

\(^{(103)}\) \textit{Id.} at 972.

\(^{(104)}\) \textit{Id.} The alleged violations were (1) the issuance, through proxy documents, of false and misleading statements of material facts relating to the merger and (2) the failure to disclose other material facts pertinent thereto. \textit{Id.} at 980-81. The Chancery Court concluded that this claim must fail because the proxy materials did not have a significant enough impact upon the consummation of the merger. The Delaware Supreme Court upheld the dismissal on the above grounds and on the grounds that the plaintiffs, Pennsylvania residents, did not have the proper standing to be covered by the Delaware Securities Act. \textit{Id.} at 981.

\(^{(105)}\) The Court of Chancery decision was reversed in part and affirmed in part. 380 A.2d at 970. The Court of Chancery had granted the motion to dismiss the entire complaint, finding that (1) the merger was not fraudulent merely because it was accomplished without any business purpose other than to eliminate the Magnavox minority shareholders; (2) dissatisfied shareholders, like the plaintiffs, have their remedy in an appraisal; and (3) plaintiffs were not entitled to relief under the Delaware Securities Act because the proxy materials did not have a significant impact on the accomplishment of the merger. The issue of standing was not reached. \textit{Id.} at 972.

\(^{(106)}\) \textit{Id.} at 972.

\(^{(107)}\) \textit{Id.} at 975.


Drawing again from case law, the court held that "corporate officers and directors, and controlling shareholders owe their corporation and its minority shareholders a fiduciary obligation of honesty, loyalty, good faith and fairness," since the minority's property interests are under their control. The opinion rested on essentially two principles of law:

First, it is within the responsibility of an equity court to scrutinize a corporate act when it is alleged that its purpose violates the fiduciary duty owed to minority stockholders; and second, those who control the corporate machinery owe a fiduciary duty to the minority in exercise thereof over corporate powers and property, and the use of such power to perpetuate control is a violation of that duty.

By analogy, if not *a fortiori*, use of corporate power solely to eliminate the minority is a violation of that duty. From these two fundamental principles, the court held that the defendants had violated the fiduciary duties owed the minority and thus that the plaintiff minority's complaint did state a cause of action for violation of fiduciary duty upon which relief could be granted in equity.

The *Singer* court held that the elimination of the minority was an improper purpose for a merger and was a violation of the majority's fiduciary duty. However, the court left to another day the question of what actually constitutes a proper business purpose in the merger area. The court did hold that courts were "duty bound" to closely examine any allegations that the purpose for the merger was improper even if all of the statutory requirements are met. The rule placed the

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110. 380 A.2d at 977. See also Allied Chemical and Dye Corp. v. Steel and Tube Co. of America, 120 A. 486 (Del. Ch. 1923).
111. 380 A.2d at 979-80.
112. *Id.* at 980. On April 3, 1981, the Delaware Supreme Court in *Lynch* v. *Vickers* Energy Corp., 429 A.2d 497 (Del. 1981), held that rescission is the proper remedy for a case involving a tender offer in which material facts had not been disclosed to the minority shareholders. In *Lynch*, the court held that the appraisal method is improper when determining damages in a fiduciary duty case, and rescission should be used in order that the plaintiff stockholders be adequately compensated. While *Lynch* did not involve a short-form merger, it did emphasize the law of fiduciaries in the corporate form and thus may have an impact on the remedies available in short-form merger cases.
113. *Id.* at 980 n.11.
114. *Id.* at 979.
115. *Id.*
burden of proving a proper business purpose on the defendant, once the plaintiff has claimed that the purpose violates a fiduciary duty.\textsuperscript{116}

Furthermore, the court stated that even if a purpose other than a freeze-out is found, "[T]he dominant corporation, as a majority stockholder standing on both sides of a merger transaction, has 'the burden of establishing its entire fairness' to the minority stockholders, sufficiently to 'pass the test of careful scrutiny by the courts.'"\textsuperscript{117} This statement is highly significant as it places another burden of proof on the defendant: proof of the transaction's "entire fairness."

Thus, the two prongs of the Singer test are: (1) inquiry into purpose, to determine whether the sole purpose was to "freeze out" a minority, or whether there was a business purpose, and, if there was not, then (2) scrutiny for "entire fairness." The decision makes clear that the test must be met even if the merger is in statutory compliance, and thus stands as judicial recognition of the inadequacy of the appraisal remedy.\textsuperscript{118} The entire decision bears a striking contrast to the treatment given minorities in such early cases as Beloff\textsuperscript{119} which had held that the minority's only redress was provided by statute in the form of an appraisal.\textsuperscript{120}

Singer was followed only one month later by Tanzer v. International General Industries, Inc.\textsuperscript{121} which probed the "business purpose" rule of Singer in a proceeding brought to enjoin a long-form merger.\textsuperscript{122} The Tanzer court recognized the ambiguity of the Singer "business purpose" test by noting that there are a number of competing parties and at least two corporate bodies involved in a merger. Thus, the difficulty lies in establishing just whose business and whose purpose should

\begin{footnotesize}
116. Id. at 975.
117. Id. at 976.
118. Id. at 977.
119. See text accompanying notes 41-45 supra.
120. See text accompanying note 42 supra.
121. 379 A.2d 1121 (Del. 1977).
122. Id. at 1123. In Tanzer, the parent corporation, International General Industries, Inc., (IGI), owned 81% of Kliklok Corporation. As part of the plan to eliminate the 19% minority of Kliklok, IGI formed KLK Corporation (the "shell" corporation). The appropriate statutory procedure was followed and KLK Corporation merged with Kliklok, in a cash freeze-out of the 19% minority of Kliklok. The plaintiffs were minority stockholders and the defendants were IGI and its directors. Id. at 1122.
\end{footnotesize}
be probed under the first prong of Singer's test.

The lower court in Tanzer had found that "the principal reason for the merger, and evidently the only reason for the merger, [was] to facilitate long term debt financing by [the parent corporation]." The plaintiffs conceded that there was support for this finding in the record, but grounded their claim on the premise that a freeze-out merger designed solely for the benefit of the parent was a violation of the fiduciary duty so recently affirmed in Singer. The Delaware Supreme Court relied heavily on the lower court's conclusion that the parent corporation had a "legitimate and present and compelling business reason" to be the sole owner of the subsidiary, and that the parent was "not freezing out the minority just for the purpose of freezing out the minority."

On the basis of the facts, the court allowed the merger and held that while the business purpose must be "bona fide," the parent "need not sacrifice its own interest in dealing with a subsidiary." But, the court cautioned against a "subterfuge"—the real purpose of which is to freeze out the minority. Furthermore, the case was remanded so that the parent could show it had met the second test of Singer: the "entire fairness" to the minority. Thus, even after the court has found that a "bona fide" purpose for a merger exists, the minority of the subsidiary are still entitled to a judicial review of the "entire fairness" of the transaction.

B. Kemp and Roland: Short-Form Mergers

The Singer and Tanzer rulings, which finally provided redress for minority shareholders in long-form merger freeze-outs, were first applied to short-form mergers by the Delaware Court of Chancery in Kemp v. Angel, but were not given

123. Id. at 1124, (quoting the Chancellor's opinion).
124. Id. at 1125.
125. Id. at 1124.
126. Id.
127. Id.
128. Id.
129. Id. at 1125.
130. 381 A.2d 241 (Del. Ch. 1977). Plaintiffs in Kemp sought a preliminary injunction from the Court of Chancery preventing a short-form merger on the grounds that the proposed merger was the "last step in a premeditated course" to fraudulently eliminate the minority for grossly inadequate consideration. 381 A.2d at 241. The
full consideration by the Delaware Supreme Court until Roland International Corporation v. Najjar.131

In Roland, a 97.6% majority of the Roland Corporation caused another corporation (Landro, a “shell” corporation) to be chartered for the sole purpose of merging with Roland under Delaware’s short-form merger statute.132 Hence, the stage was set for what the court later described as a “classic ‘going private’ transaction, with the majority having complete control over the timing of the ‘squeeze play’ on the public stockholders — a timing conceivably selected to favor the majority only, based upon the status of the market and the elements of an appraisal.”133 While the clear purpose of this merger was to eliminate the minority of Roland, the defendants contended that under Stauffer a proper purpose is presumed in a short-form merger.134 The Delaware Supreme Court, specifically overruling any inconsistent statements in Stauffer, held that:

[T]he duty arises from long-standing principles of equity and is superimposed on many sections of the Corporation Law . . . . Differences between [the long-form and short-form statutes], in terminology or in procedure, do not alter the duty which exists apart from the procedures permitted by the Statutes. . . . [W]e find nothing magic about a 90% ownership of outstanding shares which would eliminate the fiduciary duty owed by the majority to the minority. . . . In fact, the need to recognize and enforce such equitable principles is probably greater when the size of the minority is smaller.135

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131. 407 A.2d 1032 (Del. 1979).
132. Id. at 1033.
133. Id. at 1037.
134. The Stauffer case had held that the purpose of the short-form merger was the elimination of the minority. See text accompanying notes 59-61 supra.
135. 407 A.2d at 1036. The court continued:
To state it another way, the short cut to merger afforded by § 253 [Delaware’s short-form merger statute] may not be used to short-circuit the law of fiduciary duty. [citation omitted] . . . The duty of the majority is not diluted as control is strengthened nor is the right of the minority determined by how small it is. Thus the fiduciary obligation owed in the context of a merger, be it long or short, is singular, and falls alike on those who control “at least 90% of
This rule of fiduciary duty was thus held to apply to short-form mergers just as clearly as it had applied to long-form mergers in Singer and Tanzer. The conclusion was reached despite language contained in Stauffer that the very purpose of the short-form merger statute was to eliminate the minority interest. The Roland court did much to return the short-form merger procedure to the course originally intended for it by the legislature: (1) it recognized the fiduciary duties owed to the minority regardless of size; (2) it overruled the inconsistent language in Stauffer regarding the short-form merger’s purpose; and (3) it recalled correctly that the statute’s original legislative purpose was to “simplify the steps necessary to effect a merger . . . .”\textsuperscript{138} that is, while the elimination of the minority may be incidental to such a merger, as in Singer, the majority must establish that there was a proper purpose for the transaction in the first instance. Roland expressly stated what the Singer decision had only implied by placing the burden of proving “proper purpose” and “entire fairness” on the defendants. The court thus declared that the plaintiff’s complaint did indeed state a cause of action.\textsuperscript{137}

V. THE SINGER-ROLAND TESTS INTERPRETED

A. The “Business Purpose” Test

The Singer-Roland line of cases has created the following two-prong test in cash-out merger cases: (1) the merger must be shown to have a valid business purpose (a “bona fide” purpose as Tanzer described it); and (2) the merger must survive judicial scrutiny for “entire fairness.”

The Singer Court did not invent the business purpose test, but merely applied earlier Delaware law to the merger area. Singer relied on the following quote from Bennett v. Breuil Petroleum Corporation\textsuperscript{138} in which the court had considered the purpose of the majority’s action: “As a starting point, it

\textsuperscript{136} Id.
\textsuperscript{137} Id. at 1037.
\textsuperscript{138} 34 Del. Ch. 6, 99 A.2d 236 (1953). Bennett involved a plaintiff’s attempt to have a stock issuance cancelled despite the fact that the issuance met the statutory requirements. The defendants’ motions for dismissal and summary judgment were denied.
must be conceded that action by majority stockholders having as its primary purpose the 'freezing out' of a minority interest is actionable without regard to the fairness of the price.”

The *Singer* court borrowed also from *Schnell v. Chris-Craft Industries, Inc.*[^140^] *Schnell* provided the theory that statutory compliance does not insulate a transaction from court scrutiny.[^141^] The court scrutiny in *Schnell* focused on the business purpose of the proposed action, thereby providing the precedent for the first prong of the *Singer* test. As to purpose, the *Schnell* court concluded that management, in attempting to use corporate machinery and Delaware law for the purpose of perpetuating itself in office, was abusing the corporate process.[^142^] This abuse injured rights of the minority for which *Schnell* allowed relief in equity.[^143^] Thus, the business purpose rule existed in prior Delaware case law, but it was *Singer* which first applied it to the merger area.

The business purpose rule in *Singer* emerged from principles of equity, since the merger statutes are silent as to purpose.[^144^] Based, then, in equity, the rule provides courts with a certain freedom of action which can be adapted to new circumstances. The *Singer* decision recognized the inherent flexibility of the equitable principles by applying the same approach as an earlier Delaware case: “The occasions for the determination of honesty, good faith and loyal conduct are many and varied, and no hard and fast rule can be formulated. The standard of loyalty is measured by no fixed

[^139^]: 99 A.2d at 239.
[^140^]: 285 A.2d 437 (Del. 1971).
[^141^]: Id. at 439. See text accompanying notes 108 & 109 supra.
[^142^]: Id. In *Schnell*, the managing directors were attempting to advance the date of the annual shareholders' meeting allegedly to obstruct the efforts of dissenting stockholders to undertake a proxy contest. The attempt met all of the statutory requirements but the court nevertheless reviewed the circumstances (including the business purpose for the action) and reversed the lower court's denial of a preliminary injunction.
[^143^]: Id. at 439-40.
[^144^]: See, e.g., the Model Act sections on mergers: 2 Model Bus. Corp. Act Ann. § 71 ¶ 1 (the long-form merger section) & § 75 ¶ 1 (the short-form merger section).

Indeed, the *Singer* court in applying the business purpose rule recognized the statutory silence but noted that the trend in recent unreported Delaware cases had been to require a showing of valid business purpose (citing Pennsylvania Mutual Fund, Inc. v. Todhunter International, Inc., Del. Ch. C.A. 4845 (Aug. 5, 1975), and Tanzer v. International General Industries, Inc., Del. Ch. C.A. 4945 (Dec. 23, 1975)). 390 A.2d at 975.
One month after the test was announced, in *Tanzer v. International General Industries, Inc.*, the Delaware Supreme Court itself acknowledged that the rule was "ambiguous."  

At least one commentator has criticized the *Singer* court for not distinguishing between the different types of take-out mergers in fashioning the rule. However, the so-called "ambiguity" of the business purpose rule was necessary to retain court flexibility. The broad principles underpinning the rule permit future courts to shape decisions according to all of the circumstances surrounding the challenged merger.

A survey of some of the decisions which were handed down in light of *Singer* and *Roland* provides some insight into the application of the business purpose rule. In *Kemp v. Angel*, the court looked at the corporation's history, paying special attention to the majority's past treatment of the minority. The *Kemp* facts reveal that the majority reached its superior position by making continued stock offers and purchases over the years. Finally when it reached 90.6% ownership, the majority used the short-form merger to cash-out the minority. The court apparently viewed this background as supportive of the allegation that the majority had a long-standing plan to eliminate the minority for it granted a preliminary injunction preventing the merger.

Likewise, in *Young v. Valhi, Inc.*, the court viewed the majority's three attempts to gain total control as evidence of

147. 379 A.2d at 1123.
148. See 64 Va. L. Rev. 1101, 1110 in which it is further stated: These mergers, however, serve different purposes: the merger may be intended as the second step of an outside corporation's acquisition of a target corporation; it may reflect the classic 'going private' case, ...; or it may convey the decision of a long-time public corporation to go private.
149. 381 A.2d 241 (Del. Ch. 1977). See note 130 supra.
150. Id. at 242.
151. Id. at 241.
152. Id. at 245.
153. 382 A.2d 1372 (Del. Ch. 1978). In *Young*, the majority holder of common shares of Valki, Inc. was the defendant Contrans Corporation, a holding company. The plaintiffs, minority owners of stock in Valki, prayed for an injunction against the merger between Contrans, the parent-holding company and Valki. A permanent injunction was granted by the court.
its goal to eliminate the minority in a long-form merger proposal.\(^{154}\) Interestingly, the defendants in *Young* presented evidence that the merger would serve two business purposes, namely, tax savings and the avoidance of future conflicts of interest.\(^{156}\) However, in rejecting the defendants' claims, the court stated: "[H]aving tried the case, examined the exhibits as well as the testimony of the witnesses and considered their demeanor on the stand, I am of the opinion that the basic purpose behind the merger now before the court is effectuation of a long standing decision... to eliminate the minority shares... by whatever means as might be found to be workable."\(^{158}\) *Tanzer* had warned of majorities employing a "subterfuge"\(^{157}\) to circumvent their fiduciary duty, and in *Young*, the court apparently found such a case. In fact, the court was so convinced of the impropriety of the purpose that it found it unnecessary to pass on the overall fairness of the merger,\(^{156}\) (the second prong of Singer's test) before it entered a permanent injunction.

The pre-eminence of the "business purpose" test later came into question again: If no business purpose is found for a merger save the elimination of the minority, need the court reach the question of the "entire fairness" of the transaction? It appears from the language of *Singer, Tanzer* and *Roland* that the merger fails if no business purpose is found.\(^{159}\) In

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154. Id. at 1378. See also Terrell & Ranney-Marinelli, *What Constitutes a Valid Purpose for a Merger?*, 51 TEMP. L.Q. 852 (1978).
155. 382 A.2d at 1378.
156. Id.
157. See text accompanying notes 127 & 128 supra.
158. 382 A.2d at 1378.
159. Both *Singer* and *Roland* stated that the effectuation of a merger for the sole purpose of eliminating the minority constitutes a breach of fiduciary duty (without regard to the fairness of the price). *Singer*, 380 A.2d at 977; *Roland*, 407 A.2d at 1034-35. Indeed, the court in *Tanzer* found a "bona fide" purpose for the merger, yet remanded the case for a review of "entire fairness." 379 A.2d at 1125. See text accompanying note 129 supra.

fact, in a 1980 case, *Coleman v. Taub*, the U.S. District Court for the District of Delaware so held. Thus, the business purpose rule has emerged as the dominant element of the Singer-Roland analysis.

Other cases which have dealt with the question of a "proper purpose" have varied greatly in both factual and legal contexts. Judicial interpretations of a business purpose have been as varied as those of legal commentators, ranging from a required showing of "compelling corporate need" to a mere showing of lower operating costs. As earlier stated, the *Tanzer* court held that a merger to facilitate long-term debt financing by a majority stockholder could be regarded as a "bona fide" purpose.

Economies of production and scale, reduced operating and accounting costs, and the elimination of duplicative departments and functions may all be proper purposes for a merger, but the court will undoubtedly weigh the evidence presented in light of the surviving corporation's total financial and structural picture in a search for the true purpose. The ever-present specter of court scrutiny for the merger's true purpose should serve as a check on corporate management and protect many minority shareholders from freeze-out type abuses.

**B. The "Entire Fairness" Test**

Establishing a business purpose is the first prong of the Singer-Roland test, but as the *Tanzer* decision showed, the surviving corporation must also demonstrate the "entire fairness" of the transaction. The "entire fairness" test was borrowed from *Sterling v. Mayflower Hotel Corp.*, a 1952 case

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162. For a thorough discussion of cases involving the construction of the "business purpose" rule, both before and after *Singer* and *Tanzer*, see Terrell & Ranney-Marinelli, *What Constitutes a Valid Purpose for a Merger?*, 51 TEMP. L.Q. 852 (1978).


165. See text accompanying notes 123-26 supra.

166. 33 Del. Ch. 293, 93 A.2d 107 (Del. 1952).
in which the Delaware court, recognizing the potential for abuses in mergers between parent corporations and their dominated subsidiaries, placed the burden on the parent to establish the "entire fairness" of the transaction sufficient to "pass the test of careful scrutiny by the courts."\(^{167}\)

Although the \textit{Sterling} case involved the fairness of the price of the stocks,\(^{168}\) the \textit{Singer-Roland} cases were not so restricted. The full scope of the "fairness" inquiry remains to be developed by the courts, but there are some indications by cases which have addressed the issue. Of course, \textit{Singer} stated that "entire fairness" would be carefully scrutinized since the parent stands "on both sides of a merger transaction."\(^{169}\) But it was the concurring opinion in \textit{Singer} which gave suggestions as to the scope of the inquiry: "To determine whether the burden has been met under \textit{Sterling}, I think the Court must scrutinize the business purpose, or economic necessity, desirability and feasibility involved, evidence of self-serving, manipulation, or overreaching, and all other relevant factors of intrinsic fairness or unfairness."\(^{170}\) These suggestions are also quite broad but nevertheless do give some insight into the courts' line of inquiry.

The \textit{Tanzer} decision makes it clear that the inquiry into "entire fairness" was meant to probe more than just price fairness,\(^{171}\) and incorporates some of the suggestions of the \textit{Singer} concurring opinion. One commentator has stated that "unless courts limit the entire fairness test to price fairness, it will be too broad and uncertain."\(^{172}\) But this view would unnecessarily restrict the courts' ability to deal with the changing problems in merger situations. Again, the beauty of equitable principles lies in their flexibility in adapting to new circumstances and needs.

\begin{itemize}
\item \(^{167}\) \textit{Id.} at 298, 93 A.2d at 110.
\item \(^{168}\) \textit{Id.} at 298-311, 93 A.2d at 109-16.
\item \(^{169}\) 380 A.2d at 976.
\item \(^{170}\) 380 A.2d at 982 (McNeilly, J., concurring).
\item \(^{171}\) 379 A.2d at 1125. The Delaware Supreme Court in \textit{Tanzer} termed as "too restrictive" the chancellor's opinion which "discussed fairness only in terms of the price offered for the stock." \textit{Id.}
\item \(^{172}\) 46 \textit{Geo. Wash. L. Rev.} 877, 888 (footnote omitted).
\end{itemize}
VI. Conclusion

The Delaware cases provide a much needed formula for giving redress to oppressed minority rights by weighing all of the aspects of the merger transaction and granting relief on the basis of traditional equity concepts. The courts are the proper fora for a full consideration of testimony adduced as well as other evidence offered before reaching a determination on the fairness of the transaction. The abuses of the present corporate law regarding mergers have gone unchecked for far too long. It is time for the courts of every state in which such abuses have gone unchallenged to adopt the Delaware formula and give redress in equity for minority rights.

The role of the courts must not be to bind the hands of all corporate management, but rather to serve as a necessary check on the abuses of some. This role can be properly maintained by the use of equitable principles which can be adapted over time to the changing needs of the law, the corporation, and the public.

Catherine L. Curran

173. An alternative approach has been adopted in California to give a forum for oppressed minorities in the merger area. Under Cal. Corp. Code §§ 1101(e) and 1101.1 (West), which became effective January 1, 1978, either all of the shareholders must consent to a cash squeeze-out merger or the California Commissioner of Corporations (or one of the other named government officials) must determine that the terms and conditions of the cash squeeze-out merger are fair, just and equitable. The Commissioner will give great weight to the collective judgment of the minority. F. O'Neal, Oppression of Minority Shareholders § 5.13 (Cum. Supp. 1979) (Supplementing p. 256 n.9 of the 1975 edition).