

A Step Forward: Exclusivity of the Statutory Appraisal Remedy for Minority Shareholders Dissenting from Going-Private Merger Transactions

I. INTRODUCTION

There are times when the owners and directors of a public corporation grow weary of the requirements and trappings associated with being a public corporation. Often this weariness results in a move to take the corporation private by purchasing all the outstanding stock. The procedure for going private involves an exchange of cash for all shares held by the minority shareholders.¹ Forced to sell, these minority shareholders are often dissatisfied with the price they receive for their shares. Generally, there are two courses dissatisfied shareholders may follow in seeking relief: a common law suit for breach of fiduciary duty and the statutory appraisal remedy. This is no longer the case in Ohio, however, as a shareholder who is dissatisfied with the price paid per share in a going-private merger is limited to the appraisal remedy.

The minority shareholder is limited to the statutory appraisal remedy by operation of the holding in *Stepak v. Schey*.² The Ohio Supreme Court has eliminated the common law cause of action for breach of fiduciary duty when the minority shareholder's complaint is centered on the price paid per share in the going-private transaction, regardless of attendant claims that seem to support a claim for breach of fiduciary duty.³ The holding of *Stepak* endorses the notion that appraisal is the exclusive remedy for disagreements between the corporation and the minority shareholder over price.

This Note will explore the exclusivity of the appraisal remedy in the going-private merger transaction by examining the relationship between the statutory appraisal remedy and the common law cause of action for breach of fiduciary duty. Section II will outline the procedures and requirements of the appraisal

¹ "Going private" transaction is defined in Section II of this Note. See *infra* note 5 and accompanying text. Cash out, freeze out, take out, force out, and squeeze out are alternative terms for the same going-private transaction. In the interest of simplicity, going-private transaction will be the term used in this Note; however, some quoted material may use one or more of the alternate terms.

² 553 N.E.2d 1072 (Ohio 1990).

³ "Provable injury under whatever theory asserted is compensable so long as it does not seek to overturn or modify the fair cash value determined." *Stepak*, 51 Ohio St. 3d at 10, 553 N.E.2d at 1074 (citation omitted). This quotation may be interpreted as foreclosing any remedy other than appraisal when the focus of the dissatisfied shareholder's complaint is on the price paid per share.

remedy, the elements of a sound claim for breach of fiduciary duty, and the Ohio Supreme Court's clarification of the nature and interaction of the two remedies. Sections III and IV will outline a hypothetical going-private transaction, analyze the impact, and assess the implications of the exclusivity of the appraisal remedy.

By establishing unequivocally the exclusivity of the appraisal remedy, the Ohio Supreme Court has eliminated much of the confusion concerning the available remedies that has traditionally surrounded disagreements between corporations and shareholders over price paid per share in merger transactions. While the methodology to be employed in the appraisal proceeding may require further refinement and additional sophistication as appraisal becomes an all encompassing remedy,⁴ the underlying recognition of appraisal as exclusive is recognition of the need for consistency, efficiency, and responsiveness in the resolution of disagreements over price in merger transactions.

II. THE GOING-PRIVATE TRANSACTION

A. Definition

The application of the statutory appraisal remedy to a going-private transaction will provide a framework within which to examine the reach and exclusivity of the appraisal remedy. The first step in understanding the exclusivity of the appraisal remedy is understanding the going-private transaction.

A "true" going private transaction . . . is one by which an individual or a group of individuals controlling a public corporation undertake a corporate transaction in order to acquire, either immediately or on a deferred basis, the entire equity interest in the corporation. . . . In a typical going private transaction, the founder of a company that had previously gone public elects to reverse his steps and restore the corporation to the status of sole ownership.⁵

The going-private transaction is initiated by the controlling shareholder or shareholders. Typically, the controlling majority will own a sizable block of shares and will be able to insure approval of the proposed merger transaction by virtue of their percentage ownership. If the majority controls eighty-five percent of the outstanding shares and votes all eighty-five percent in favor of

⁴ The appraisal proceeding may need to be expanded in scope in order to include all factors that go into valuation. This expansion will necessarily include an evaluation of future trends and growth potential rather than solely an analysis of past performance.

⁵ Glenn C. Campbell, *Weinberger v. UOP, Inc.: Delaware Reevaluates State-Law Limitations on Take Out Mergers*, 62 N.C.L. REV. 812, 815 (1984) (quoting A. Borden, *Going Private* § 1.02 at 1-3 (1982)).

the proposed merger, the merger will be approved. Upon approval of the merger transaction, and setting aside for the moment the question of remedies, the minority shareholders will be bound by the vote and will be forced to exchange their shares in the corporation for cash. More often than not, the amount of cash that the minority shareholders receive for their shares is calculated by the controlling shareholders.

In sum, having determined, for whatever reason, that the presence of minority shareholders is undesirable, the controlling shareholders set the price for the minority shares and force the minority shareholders to sell their shares to the corporation for cash. Given this scenario, some minority shareholders may be dissatisfied with the price set by the controlling shareholder. These dissatisfied minority shareholders may challenge the exchange price and may seek a judicial determination of a "fair" price through appraisal.

B. Remedies Available to Dissatisfied Minority Shareholders

1. Statutory Remedy: Appraisal

The procedure that a dissatisfied minority shareholder must follow in order to take advantage of the statutory appraisal remedy in Ohio is involved and confusing.⁶ To benefit from the relief provided by statute, the dissatisfied minority shareholder must comply strictly with the procedures outlined in the statute.⁷

The first of the many procedural requirements within the appraisal statute is tied to the shareholders' meeting called to determine the merger issue. Assuming a going-private transaction, the controlling shareholders will hold a shareholders meeting to gain official approval of the transaction. The calling of a shareholders meeting requires that notice be sent to the record holders of shares in the corporation.⁸ Record holders are determined by reference to ownership of shares on a specific date determined by the corporation.⁹ The appraisal statute requires that a dissenting shareholder be a record holder as determined for the purpose of notice of the shareholders' meeting.¹⁰

In addition to the record holder requirement, the dissenting shareholder cannot vote any shares in favor of the transaction.¹¹ Note that the Ohio appraisal procedure requires only that the dissenting shareholder not vote *in*

⁶ See OHIO REV. CODE ANN. § 1701.85 (Baldwin 1990).

⁷ OHIO REV. CODE ANN. § 1701.85(A)(1) (Baldwin 1990).

⁸ OHIO REV. CODE ANN. § 1701.41 (Baldwin 1990).

⁹ OHIO REV. CODE ANN. § 1701.45 (Baldwin 1990).

¹⁰ OHIO REV. CODE ANN. § 1701.85 (Baldwin 1990) (Comm. Comment 1955). Ohio uses the record holder limitation as a means of curtailing the speculative use of appraisal that may arise after the purchase of unvoted shares subsequent to the shareholders' meeting.

¹¹ OHIO REV. CODE ANN. § 1701.85(A)(2) (Baldwin 1990).

favor of the proposed transaction.¹² Thus, the Ohio statute opens the door for nonvoting shares to exercise appraisal rights.¹³

Having complied with the requirements at the shareholders' meeting, the dissenting minority shareholder faces a series of deadlines. Within ten days of the meeting, the dissenting minority shareholder must give the corporation notice of her dissent from the transaction.¹⁴ The notice shall be in the form of a written demand for payment of the fair cash value of the shares.¹⁵ This written demand shall include the shareholder's address, a description of the holdings including the number of shares and the class of shares, and the demand shall also include "the amount claimed by [the shareholder] as the fair cash value of the shares."¹⁶ No doubt the shareholder's claimed fair value will serve as a starting point for negotiations between the controlling majority and the dissatisfied minority shareholder. The service of written demand on the corporation is only the preliminary step in the appraisal procedure.¹⁷

Once the corporation has received the written demand for fair cash value from a dissenting shareholder, the corporation may require the dissenting shareholder to deliver the shares in question to the corporation.¹⁸ The

¹² OHIO REV. CODE ANN. § 1701.85 (Baldwin 1990) (Comm. Comment 1955) (Several states require, and many Ohio lawyers have suggested, that in order to become entitled to receive the appraised value of shares, the holder thereof must vote in opposition to the proposal.)

The requirement that shareholders vote against the proposed transaction in order to preserve their right to dissent is the exception rather than the rule. The majority of states require—as in Ohio—only that the shareholder not vote in favor of the proposed transaction. See DEL. CODE ANN. tit. 8, § 262(a) (1990); REVISED MODEL BUSINESS CORP. ACT § 13.21(a)(2) (1984); 15 PA. CONS. STAT. ANN. § 1574 (Purdon 1991). But see CAL. CORP. CODE § 1300(b)(2)(ii) (West 1990) (shares not listed on any national securities exchange nor on the over-the-counter margin stock list approved by the Board of Governors of the Federal Reserve must be voted against reorganization).

¹³ OHIO REV. CODE ANN. § 1701.85 (Baldwin 1990) (Comm. Comment 1955) (right to seek appraisal is not limited to holders of voting shares).

¹⁴ OHIO REV. CODE ANN. § 1701.85(A)(2) (Baldwin 1990).

¹⁵ *Id.* While the statute indicates that the dissenting shareholder must make a "written demand for payment of the fair cash value of the shares as to which he seeks relief," the dissenting shareholder may not accept the terms of the proposed transaction for a portion of her shares and also seek appraisal for the remainder. This would allow the shareholder to have her cake and eat it too, or, in the very least, it would allow the shareholder to engage in speculation similar to the type precluded by the record holder requirement discussed *supra* note 10. Therefore, the shareholder must seek appraisal for all or none of her shares, and she should consider her options and plan her strategy accordingly.

¹⁶ *Id.*

¹⁷ The Ohio Revised Code allows service on the constituent corporation as service on the surviving corporation in the case of merger or consolidation. OHIO REV. CODE ANN. § 1701.85(A)(4) (Baldwin 1990).

¹⁸ OHIO REV. CODE ANN. § 1701.85(A)(5) (Baldwin 1990).

dissenting shareholder must comply with such a request and must deliver the shares to the corporation within fifteen days after the date the corporation sent the request.¹⁹ The purpose of the request from the corporation and the subsequent delivery by the dissenting shareholder is to allow the corporation to affix to the share certificates a legend indicating that the shares are subject to an appraisal proceeding.²⁰ Once the legend has been stamped on the share certificates, the corporation must promptly return the certificates to the shareholder.²¹ This legend serves to restrict the transferability and marketability of the shares. A shareholder contemplating dissent and appraisal will want to consider this restriction because the shareholder's money will be "frozen" throughout the appraisal procedure. Conceivably the appraisal procedure, from start to finish, could continue for more than four months. Depending on the individual shareholder's situation, this reduced liquidity may be a factor in deciding whether to pursue appraisal.

Should the shareholder fail to deliver the certificates within the allotted fifteen days, the corporation may send written notice to the shareholder terminating the shareholder's right to dissent.²² The corporation must send the notice of termination within twenty days of the expiration of the fifteen day delivery period.²³

In addition to the time limits detailed in the statute, there are other time limits relative to the negotiation of fair value. The corporation will receive written notices of demand for fair value beginning twenty days before the shareholders' meeting convened to consider and vote on the proposed transaction and ending ten days after the same meeting.²⁴ The corporation must agree to pay the fair value demanded by the shareholder or must make a counteroffer within ten days after the close of the period in which dissenting shareholders may make written demand (or, stated simply, twenty days from the date of the meeting).²⁵ Thus, the corporation and the shareholder must keep track of two timelines operating at the same time, one for delivery and restriction of the certificates and another for negotiation.

¹⁹ *Id.*

²⁰ *Id.*

²¹ *Id.*

²² *Id.*

²³ *Id.*

²⁴ OHIO REV. CODE ANN. § 1701.85(A) (Baldwin 1990) (Comm. Comment 1955).

²⁵ *Id.* The corporation must answer the individual demands for payment within ten days of receipt. Interpretation of the statute allows the corporation to consider all of the individual demands for payment as being received on the tenth day after the meeting "thus obviating the useless task of keeping track of the hour when each demand was received and also permitting the corporation to have the full period within which to establish an amount [that] it considers to be the fair cash value of the shares." *Id.*

The timeline for negotiation does not necessarily end with the corporation's counteroffer. Though the appraisal statute does not provide any guidelines for negotiation, surely the corporation and the dissenting shareholder may continue their negotiations for as long as negotiations are viable. If no price is agreed upon during the course of negotiations between the corporation and the dissenting minority shareholder, however, either party may initiate proceedings in the court of common pleas within ninety days after the date of the initial service of the dissenting shareholder's written demand on the corporation.²⁶ The proceedings are initiated by a complaint filed "in the court of common pleas in the county in which the principal office of the corporation that issued such shares is located. . . ."²⁷

While the various timelines and deadlines may be confusing, the requirements for the complaint and the attendant procedures are straightforward. "The petition shall contain a brief statement of the facts, including the vote and the facts entitling the dissenting shareholder to the relief demanded. No answer to such petition is required."²⁸ The wording of the statute relative to the requirements of the complaint—"facts entitling the dissenting shareholder to relief demanded"—implies that the dissenting shareholder frequently is the party to file the claim, despite earlier language indicating that either party may file.²⁹ This stands to reason since failure by the dissenting shareholder to file a complaint within the ninety days required by statute would terminate the shareholder's right to relief under the appraisal statute.³⁰ The corporation is unlikely to revive the shareholder's right to appraisal by filing a complaint when the shareholder has failed to do so. If negotiations are at an impasse, however, the corporation may seek an early end to the dispute. For example, the corporation may preempt the shareholder's filing of a complaint by first filing a complaint. In such a situation it is conceivable that the complaint would contain a statement of the facts indicating that the price per share offered by the corporation to the minority shareholders was the fair cash value.

Following the filing of the complaint, the court shall set a date for the hearing and shall order service of the complaint on the opposing party.³¹ The opposing party shall also receive notice of the filing and the hearing date.³² If the court determines that the dissenting shareholder has a valid claim for an appraisal to determine fair value of the shares, then "the court may appoint one or more persons as appraisers to receive evidence and to recommend a decision

²⁶ OHIO REV. CODE ANN. § 1701.85(B) (Baldwin 1990).

²⁷ *Id.*

²⁸ *Id.*

²⁹ See *supra* note 26 and accompanying text.

³⁰ See *infra* note 43 and accompanying text.

³¹ OHIO REV. CODE ANN. § 1701.85(B) (Baldwin 1990).

³² *Id.*

on the amount of the fair cash value. The [court-appointed] appraisers have such power and authority as is specified in the order of their appointment.”³³ In addition, this procedural subsection of the appraisal statute outlines the process for quick payment, determination of accrued interest, appeal, coordination with pending injunctions, and exchange of shares.³⁴ The ultimate resolution of the disagreement over price is surprisingly simple when compared with the deadlines, timelines, and procedures that serve as prerequisites for the actual appraisal.

The appraisal proceeding has as its only function the determination of the fair cash value of the shares held by the dissenting shareholder. In general, the corporation argues that the price offered in the transaction was fair, while the dissenting shareholder alleges that same price to be inadequate. The appraisal proceeding is used to determine the fair value when these two parties are unable to do so. The Ohio statute provides a definition for fair cash value and some guidance for appraisers:

The fair cash value of a share for the purposes of this section is the amount that a willing seller, under no compulsion to sell, would be willing to accept, and which a willing buyer, under no compulsion to purchase, would be willing to pay, but in no event shall the amount thereof exceed the amount specified in the demand of the particular shareholder.³⁵

The “willing seller-willing buyer” definition employs an upper boundary equal to the dissenting shareholder’s initial demand. Therefore, if the corporation, in the course of the original transaction, offered \$100 per share, the dissenting shareholder demanded \$125 per share, and the appraisal resulted in a value of \$135 per share, then—regardless of the higher appraisal value—the dissenting shareholder will receive a fair cash value of \$125 per share since the appraisal cannot exceed the dissenting shareholder’s initial demand.

Other limitations of note are imposed by the operation of the market for the stock. Market limitations are imposed by both the statute and judicial interpretation. The appraisal of dissenting shares will be heavily influenced by market price:

Where facts presented to the trial court evidence a reasonably suitable, active market of the particular corporate stock under consideration, and the actual market may be deemed to be sufficiently active in the trading of such stock, then the trial court should give substantial weight to such evidence. This actual

³³ *Id.*

³⁴ *Id.*

³⁵ OHIO REV. CODE ANN. § 1701.85(C) (Baldwin 1990).

market price would satisfy the willing seller-willing buyer test set forth in R.C. 1701.85, and would be the "fair cash value" of such stock.³⁶

Thus, if the corporation is actively traded and there is an active market in the stock, the starting point for an appraisal proceeding to calculate the fair cash value will be the market price of the shares. The Ohio Supreme Court, however, has cautioned that the market price in the days leading to the merger is not necessarily a completely accurate fair cash value since the premerger market price must be adjusted to reflect any market reaction to the merger proposal.³⁷

The fair cash value excludes consideration of any fluctuation in market value of the shares that is caused by the announcement of the transaction. "In computing . . . fair cash value, any appreciation or depreciation in market value resulting from the proposal submitted to the directors or to the shareholders shall be excluded."³⁸ The Supreme Court of Ohio has indicated that the fair cash value is to be determined "as of the day prior to the vote of the shareholders."³⁹ The court went on to indicate that "[t]here is no reason to consider, nor is the dissenting shareholder entitled to receive, any of the premium offered as consideration to those who in fact tendered their shares."⁴⁰ Therefore, any market reaction to the merger proposal that affects the value of the stock in the days leading to the actual vote will be disregarded in the determination of fair cash value. On remand of *Armstrong v. Marathon Oil Co.*,⁴¹ the Ohio Court of Appeals noted:

The Ohio Supreme Court in *Armstrong* and R.C. 1701.85 both provide that in establishing the fair cash value to be paid dissenters, the court must take into account the appreciation or depreciation in the market value of the stock

³⁶ *Armstrong v. Marathon Oil Co.*, 513 N.E.2d 776, 778 syllabus 2 (Ohio 1987).

³⁷ *Id.* at 397 syllabus 3, 513 N.E.2d at 778 syllabus 3.

³⁸ OHIO REV. CODE ANN. § 1701.85(C) (Baldwin 1990).

³⁹ *Stepak v. Schey*, 553 N.E.2d 1072, 1075 (Ohio 1990) (citing *Armstrong v. Marathon Oil Co.*, 513 N.E.2d 776, 786 (Ohio 1987)).

⁴⁰ *Id.* Often an acquiring corporation or shareholder will pay a "premium" over market price in order to gain voting control sufficient to influence approval of the merger transaction. This premium over market price is referred to, appropriately enough, as a "control premium" and will usually be paid to shareholders with larger holdings. Proponents of the merger transaction will focus their efforts on larger shareholders since it is more efficient to deal with one or two shareholders than many smaller shareholders. Though it is unlikely that a minority shareholder in a small thinly-traded corporation will hold a percentage of shares sufficient to trigger the payment of a "control premium," it should be noted that the Ohio Supreme Court has held that "the amount tendered to obtain the controlling interest of the corporation is not properly includable in the determination [of fair cash value]." *Armstrong*, 513 N.E.2d at 790.

⁴¹ No. 35569, 1990 WL 35569 (Ohio App. March 29, 1990).

attributable to the proposed merger. The rationale underlying this principle is that, if the stock appreciates as a result of the merger, the dissenting shareholder should not be entitled to benefit from the increased value. Likewise, if the market value of the stock depreciates, the dissenting shareholders should not be penalized for the decreased value. . . . Therefore, it is apparent that the application of R.C. 1701.85 is likely to produce a fair cash value to be paid dissenting shareholders different from that received by assenting shareholders unless the fundamental corporate change is found to have had absolutely no effect on the market price of the stock, an unlikely possibility.⁴²

These limitations on the appraisal proceeding will affect the dissenting shareholder's decision to accept or reject an offer for her shares, provided there is an active market for the stock. The Ohio Supreme Court's interpretation narrows the use of the appraisal proceeding in situations involving actively traded stocks with easily determined market values to the determination of the fair cash value exclusive of any appreciation or depreciation in value attributable to the merger proposal. The intriguing questions and innovative strategies are more likely to arise in situations involving stocks without active markets. While the appraisal proceeding is the ultimate destination, there are detours that may render the proceeding unnecessary.

The fourth subsection of the Ohio appraisal statute details ways in which the appraisal process may be cut short. The most obvious way that the entire process will cease is failure by the dissenting shareholder to fully comply with the outlined procedures.⁴³ Full compliance may not be necessary if the corporation waives the dissenting shareholder's failure to comply.⁴⁴ Furthermore, the corporation may be prevented from consummating the merger by injunction, shareholder reconsideration and vote to rescind the merger, or the corporation's decision not to pursue the merger.⁴⁵ If the merger does not go through, the dissent becomes moot and the appraisal is cut off. In addition, the dissenting shareholder may withdraw her demand, and, with the consent of the corporation, the appraisal process is stopped.⁴⁶ Finally, the appraisal proceeding fails if the corporation and the dissenting shareholder fail to come to an agreement during the negotiation phase and neither of the parties file a

⁴² *Id.* at *5.

⁴³ OHIO REV. CODE ANN. § 1701.85(D)(1) (Baldwin 1990).

⁴⁴ *Id.* Neither the statute nor the case law indicates how a corporation would go about waiving the dissenting shareholder's failure to comply. In the absence of a specific procedure, it may be that the corporation need only choose not to press for termination of the shareholder's right to appraisal after the shareholder fails to follow every detail of the procedure prescribed by statute.

⁴⁵ OHIO REV. CODE ANN. § 1701.85(D)(2) (Baldwin 1990).

⁴⁶ OHIO REV. CODE ANN. § 1701.85(D)(3) (Baldwin 1990).

complaint within the ninety days prescribed by statute.⁴⁷ Thus, there are a number of escape hatches and time limitations that may prevent this process from reaching appraisal.

The final provision of the statute dictates the suspension of the dividend, voting, and distribution rights of shares subject to dissent and appraisal.⁴⁸ These rights are not totally forfeited, but are not available during the dissent and appraisal period. Should the appraisal be cut off pursuant to one of the limitations of the statute as described above, then "all the rights of the holder shall be restored and all distributions [that] . . . would have been made [but for the suspension] shall be made . . ."⁴⁹ By the same token, if appraisal results in a final determination of fair cash value, then any dividend, distribution, or interest payable during the suspension of rights "shall be paid to the holder of record as a credit upon the fair cash value of the shares."⁵⁰

Significantly absent from the Ohio statute detailing the procedure for the exercise of dissent and appraisal rights is an explicit requirement that the corporation give notice to the shareholders that such rights exist. Neither do other Ohio statutes concerning various aspects of the proposed transactions giving rise to dissent and appraisal rights include a requirement that shareholders be notified.⁵¹ The absence of a notice requirement is in contrast to the treatment adopted by other states. For example, several state statutes require that notice of the availability of dissent and appraisal rights be given at the same time shareholders are notified of the meeting called to vote on the proposed transaction.⁵² Because dissent and appraisal rights are procedurally complex, require attention to a number of details, and terminate if the statute is not complied with fully, notice of the availability of these rights is essential to the smooth functioning of the statutory appraisal process. In light of the exclusivity of appraisal in Ohio, notice to shareholders becomes a pivotal

⁴⁷ OHIO REV. CODE ANN. § 1701.85(D)(4) (Baldwin 1990).

⁴⁸ OHIO REV. CODE ANN. § 1701.85(E) (Baldwin 1990).

⁴⁹ *Id.*

⁵⁰ *Id.*

⁵¹ See OHIO REV. CODE ANN. §§ 1701.74-.84 (Baldwin 1990). None of these sections requires that shareholders be given notice of the availability of dissent and appraisal rights.

⁵² See, e.g., DEL. CODE ANN. tit. 8, § 262(d)(1) (1989) ("[T]he corporation not less than 20 days prior to the meeting, shall notify each of its stockholders entitled to such appraisal rights that appraisal rights are available for any and all shares . . . and shall include in such notice a copy of this section."); MASS. GEN. LAWS ANN. ch. 156B, § 87 (West 1990) ("The notice of the meeting of stockholders at which approval of such proposed action is to be considered shall contain a statement of the rights of objecting shareholders."); OKLA. STAT. ANN. tit. 18, §1091 (West 1991) (containing language identical to the Delaware statute quoted above); REVISED MODEL BUSINESS CORP. ACT § 13.20 (1984) ("[T]he meeting notice must state that shareholders are or may be entitled to assert dissenters' rights under this chapter and be accompanied by a copy of this chapter.").

feature of the entire process and should be an explicit requirement within the state corporate law.

For all its confusion, overlapping time limitations, and omission of notice, the appraisal statute is a workable solution for a complex problem. The question becomes one of options: whether the dissatisfied minority shareholder is limited to the appraisal remedy or whether other common-law remedies are available.

2. Common Law Remedy: Breach of Fiduciary Duty

Courts will consider a number of factors in determining whether there has been a breach of fiduciary duty in a going-private transaction. The elements most often singled out by courts include the timing of the merger relative to specific events, the independence of the directors, the procedure used for obtaining a valuation of the company and its stock, and the fairness of the overall procedure used to accomplish the merger.⁵³ Case law from Delaware courts provides a detailed list of permissible and impermissible elements in a merger situation. The courts have gone to great lengths to identify these elements. Wise boards of directors and majority shareholders will take precautions to insure that the merger is characterized by the presence of permissible elements and the absence of impermissible ones. What follows is a compilation of those factors with an analysis of which factors are given more weight by the courts.

Courts tend to focus on procedural fairness when considering a claim by the dissenting shareholder of breach of fiduciary duty. The case that offers the most comprehensive list of factors to consider is *Sealy Mattress Co. v. Sealy, Inc.*⁵⁴ In *Sealy*, the minority shareholders filed a derivative action for a preliminary injunction seeking "to enjoin a proposed cash-out merger of Sealy into a wholly owned subsidiary of . . . Sealy's majority stockholder."⁵⁵ The majority shareholder, whose actions triggered this suit by minority shareholders, owned ninety-three percent of the outstanding stock.⁵⁶ The majority shareholder's conduct was a particular concern of the Delaware Court of Chancery. "Indeed, if one were setting out to write a textbook study on how one might violate as many fiduciary precepts as possible in the course of a single merger transaction, this case would be a good model."⁵⁷ In enjoining the merger, the court enumerated several impermissible factors. These factors included the presence of directors on both sides of the transaction, use of an

⁵³ See *infra* notes 54-83 and accompanying text.

⁵⁴ 532 A.2d 1324 (Del. Ch. 1987).

⁵⁵ *Id.* at 1326.

⁵⁶ *Id.*

⁵⁷ *Id.* at 1335.

outstanding antitrust judgment to manipulate the price of the stock and the book values of affiliated companies, timing of the merger so that valuation of the company was difficult due to pending antitrust judgments, use of a book value two and one-half times lower than the book value determined with reference to offers and valuations submitted by other interested parties within the previous twelve months, absence of meaningful negotiation of the merger stock price, the absence of an independent valuation of the stock, the lack of a requirement that the merger be approved by a majority of the minority shareholders, and a significant amount of nondisclosure.⁵⁸ The court determined that these factors, taken together, indicated action by the defendant board that was so pervasive and so overwhelming that it could not be considered unintentional.⁵⁹

Though not as exhaustive, the list of factors considered by the Delaware Supreme Court includes concerns similar to those listed in *Rabkin v. Philip A. Hunt Chemical Corp.*⁶⁰ In *Rabkin*, the court considered internal memos indicating an intent to cash out the minority shareholders at a low price, the presence of the same parties on both sides of the transaction, and the absence of independent valuations.⁶¹ In *Rabkin*, the directors intentionally waited for the expiration of a one-year guaranteed price agreement before pursuing the merger transaction so that the price offered to the minority shareholders could be adjusted downward.⁶² As part of an earlier acquisition of over sixty-three percent of Philip A. Hunt Chemical Corporation shares, Olin Corporation agreed to pay twenty-five dollars per share for any additional shares of Hunt purchased within one year of March 1, 1983, the closing date of this earlier acquisition.⁶³ The merger at issue in *Rabkin* was announced on March 28, 1984 at twenty dollars per share.⁶⁴ In addition to the timing of the merger so close to the expiration of the guaranteed price agreement, there was introduced into evidence an internal corporate memo dated September 19, 1983 that advocated a cash out merger of the minority shareholders after the expiration of the guaranteed price agreement in order to accomplish the merger at a much lower price.⁶⁵ A demonstration by the dissenting minority shareholder of a skewed procedure used to pursue a merger transaction that favors the majority shareholders, such as the one employed by the majority shareholder in *Rabkin*, will support a claim for breach of fiduciary duty.

There are a host of other factors that indicate a skewed merger procedure that favors the majority and triggers relief for breach of fiduciary duty. An

⁵⁸ *Sealy*, 532 A.2d 1324, 1327-33 (Del. Ch. 1987).

⁵⁹ *Id.* at 1340.

⁶⁰ 498 A.2d 1099 (Del. 1985).

⁶¹ *Id.*

⁶² *Id.* at 1105-06.

⁶³ *Id.* at 1101.

⁶⁴ *Id.* at 1102.

⁶⁵ *Id.* at 1101-02.

action for breach of fiduciary duty was proper when minority shareholders were misled about the result of a premerger board meeting in *Cede & Co. v. Technicolor, Inc.*⁶⁶ Interlocutory appeal of three motions made during the appraisal proceeding resulted in a determination by the Delaware Supreme Court that the misrepresentation of an unanimous board vote to waive a supermajority requirement for approval of a merger was unfair to the minority.⁶⁷ The misrepresentation of the premerger board meeting was deemed sufficient to support a claim for breach of fiduciary duty, and, as a result of the ruling, the plaintiff pursued both the appraisal remedy and the suit for breach of fiduciary duty.⁶⁸

Another Delaware case grounded on the unfairness of the merger process is *Smith v. SPNV Holdings, Inc.*⁶⁹ The merger in this case was timed so that the minority shareholders were deprived of a dividend that was due and owing, and the majority benefitted by an amount equal to the withheld dividend.⁷⁰

In addition to the cases showing the factors considered impermissible within the pursuit of a merger, there are cases that demonstrate the methodology necessary to avoid breach of fiduciary duty. The defendant may ward off claims of breach of fiduciary duty by taking steps to ensure fair dealing during the course of the merger transaction.⁷¹ Some of the factors that indicate fair dealing are indications that both sides devote substantial resources to prepare for negotiation, that both sides have different objectives in order to encourage negotiation, that the majority shareholder tailors his efforts to meet the requirements of fair dealing as defined by statute and case law, that both sides confer with independent analysts, and that the majority has insured full disclosure and candor flowing to the minority shareholders.⁷² As long as the majority shareholders ensure that the interests of the minority are represented and taken fully into account, then a suit for breach of fiduciary duty can be avoided.

The Delaware Supreme Court's seminal decision in the area of fiduciary duty and appraisal is *Weinberger v. UOP, Inc.*⁷³ Although the court's

⁶⁶ 542 A.2d 1182 (Del. 1988).

⁶⁷ *Id.* at 1185.

⁶⁸ *Id.* at 1188.

⁶⁹ No. 14676, 1987 WL 14676 (Del. Ch. Oct. 28, 1987).

⁷⁰ *Id.* at *2. The retention of corporate dividends equalling approximately \$8,000,000 and the failure to compensate the minority for the use of their money financially injured the minority shareholders. The record date for dividends was June 10th, the next business day after the effective date of the merger, thus indicating that June 7, 1985, the merger date chosen by [the majority shareholder] was an "especially poor time [for the minority shareholders] to be required to liquidate." *Id.* at *4 (citation omitted).

⁷¹ *Rosenblatt v. Getty Oil Co.*, 493 A.2d 929 (Del. 1985).

⁷² *Id.*

⁷³ 457 A.2d 701 (Del. 1983).

definition of fair dealing has been used to measure and define fiduciary duty, the *Weinberger* court found that there was insufficient support for a claim of breach of fiduciary duty.⁷⁴ The court noted the existence of several factors that would indicate unfair dealing, but determined that a liberal appraisal proceeding would be more appropriate.⁷⁵ Some of the factors present included the presence of directors on both sides of the transaction, suppression of a fair value report, a quick timetable for consideration and completion of the merger, the majority's "influence" on the price calculated by an independent analyst, and the majority leading the minority to believe that negotiations had taken place when, in fact, no negotiations had been conducted.⁷⁶ While acknowledging these factors indicated unfair dealing, the court determined that an appraisal remedy would be the most effective remedy. Furthermore, the court held that the factors present were not sufficient to warrant a collateral proceeding for breach of fiduciary duty.⁷⁷

The most important result of the *Weinberger* case is the recognition of the distinction between, and the overlap of, fair dealing and fair price. The *Weinberger* decision created an "entire fairness test," and this test has been used and referred to in many subsequent court decisions.⁷⁸ The entire fairness test is a two prong investigation of the merger transaction. The two parts of the entire fairness test are fair dealing and fair price.⁷⁹ Fair dealing pertains to the procedure leading to the merger and includes timing, structuring, negotiation, and approval.⁸⁰ Fair price pertains to an economic analysis of the merger. The court explained,

[t]he latter aspect of fairness relates to the economic and financial considerations of the proposed merger, including all relevant factors (assets, market value, earnings, future prospects) and any other elements that affect the intrinsic or inherent value of a company's stock. . . . However, the test for

⁷⁴ *Id.* at 714-15.

⁷⁵ *Id.* at 714.

⁷⁶ *Id.* at 704-08.

⁷⁷ *Id.* at 715.

⁷⁸ See *Cede & Co. v. Technicolor, Inc.*, 542 A.2d 1182 (Del. 1988) (discussed at *supra* notes 66-68 and accompanying text); *Armstrong v. Marathon Oil Co.*, 513 N.E.2d 776 (Ohio 1987), *cert. denied*, 111 S. Ct. 1076 (1991); *Smith v. SPNV Holdings, Inc.*, No. 14676, 1987 WL 14676 (Del. Ch. Oct. 28, 1987) (discussed at *supra* notes 69-70 and accompanying text); *Sealy Mattress Co. of New Jersey v. Sealy, Inc.*, 532 A.2d 1324 (Del. 1987) (discussed at *supra* notes 54-59 and accompanying text); *Jedwab v. MGM Grand Hotels, Inc.*, 509 A.2d 584 (Del. Ch. 1986); *Rabkin v. Philip A. Hunt Chem. Corp.*, 498 A.2d 1099 (Del. 1985) (discussed at *supra* notes 60-65 and accompanying text); *Rosenblatt v. Getty Oil Co.*, 493 A.2d 929 (Del. 1985) (discussed at *supra* notes 71-72 and accompanying text); *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985).

⁷⁹ *Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (Del. Sup. 1983).

⁸⁰ *Id.*

fairness is not a bifurcated one as between fair dealing and price. All aspects of the issue must be examined as a whole since the question is one of entire fairness. However, in a non-fraudulent transaction . . . price may be the preponderant consideration outweighing other features of the merger.⁸¹

While an appraisal proceeding will address the final value of the stock, the suit for breach of fiduciary duty will address the process used to arrive at the final value of the stock.

The distinction between fair value and fair dealing is one of substantive valuation and procedural valuation. Substantive valuation encompasses actual calculations and factors considered in computing a value for the stock, while procedural valuation encompasses the methods used by the majority shareholder to influence or manipulate the process for determining a price to be paid to the minority shareholders. The procedural valuation is a function of the majority shareholder's position of control, rather than the majority's methodology for determining price. This distinction is implicit in a number of cases; however, it is rarely explicitly acknowledged by courts when determining an appropriate remedy.

The reluctance of courts to distinguish substantive and procedural valuation probably results, in part, from the dissenting minority shareholder's tendency to include a claim of "grossly inadequate price" in complaints alleging breach of fiduciary duty.⁸² Such a claim will blur any possible distinction between substance and procedure. Recently, the Ohio Supreme Court seems to have acknowledged the distinction between substantive and procedural valuation by establishing the exclusivity of the appraisal remedy in *Stepak v. Schey*.⁸³

3. Exclusivity of the Appraisal Remedy

The Ohio Supreme Court's decision in *Stepak* clarifies the interaction between the appraisal statute and the claim of breach of fiduciary duty. The relationship between the statutory and common law remedies was suggested in *Armstrong v. Marathon Oil Co.*⁸⁴ In *Armstrong*, the Ohio Supreme Court set out the proposition that "[p]rovable injury under whatever theory asserted is compensable so long as it does not seek to overturn or modify the fair cash value determined."⁸⁵ The holding in *Stepak* reasserts and clarifies the holding

⁸¹ *Id.* (citations omitted).

⁸² *Cede & Co. v. Technicolor, Inc.*, 542 A.2d 1182 (Del. 1988); *Singer v. Magnavox Co.*, 380 A.2d 969 (Del. 1977); *Walter J. Schloss Assoc. v. Chesapeake & Ohio Ry. Co.*, 536 A.2d 147 (Md. App. 1988).

⁸³ 553 N.E.2d 1072 (Ohio 1990).

⁸⁴ 513 N.E.2d 776 (Ohio 1987).

⁸⁵ *Id.* at 798.

“that an action for breach of fiduciary duty may be brought outside the appraisal statute.”⁸⁶

Under the reasoning of the *Stepak* case, a minority shareholder dissenting from any merger transaction in which dissent and appraisal rights are available may maintain a separate common law cause of action provided the relief sought has no connection whatsoever to the fair cash value of the shares at issue. “[W]e hold that an action for breach of fiduciary duty may be maintained notwithstanding R.C. 1701.85; however, such action may not seek to overturn or modify the fair cash value determined in a cash-out merger.”⁸⁷ The Ohio Supreme Court’s rationale is grounded on the recognition that “valuation questions are the traditional subjects of appraisal.”⁸⁸ By extension, the court is indicating that the valuation questions are not the proper subject of an action for breach of fiduciary duty, and the action for breach of fiduciary duty should focus on issues wholly distinct from the determination of fair cash value. This holding indicates that a dissenting minority shareholder dissatisfied with the price in a cash-out merger must avail herself of the appraisal remedy set forth in O.R.C. 1701.85. The mandatory nature of the appraisal remedy relative to issues of price is established by the Ohio Supreme Court’s holding admonishing the use of a breach of fiduciary duty action to challenge the price offered in a merger transaction.⁸⁹

The effect of this holding is well illustrated by the facts of *Stepak*. Barnett Stepak was a minority shareholder in Scott & Fetzer Company. Scott & Fetzer Company and Berkshire Hathaway, Inc. entered into a merger agreement whereby Berkshire Hathaway, Inc. would become the sole holder of Scott & Fetzer Company shares. Stepak brought suit for breach of fiduciary duty against Scott & Fetzer Company, officers and directors of Scott & Fetzer, and Berkshire Hathaway.⁹⁰ Stepak objected to the inclusion of a lock-up option in the merger agreement.⁹¹ He claimed that this lock-up option was illegal for want of consideration, prevented competitive bidding for the stock, and was

⁸⁶ *Stepak*, 553 N.E.2d at 1074.

⁸⁷ *Id.* at 1074.

⁸⁸ *Id.* at 1075 (citing *Rabkin v. Philip A. Hunt Chem. Corp.*, 498 A.2d 1099, 1105 (Del. 1985)).

⁸⁹ *Id.* at 1074.

⁹⁰ *Id.* at 1073.

⁹¹ The “lock-up option” in *Stepak* was structured to allow Berkshire Hathaway, Inc. to purchase common shares of Scott & Fetzer Co. at a price specified in the option agreement. The option would be triggered if a company other than Berkshire Hathaway became the sole shareholder of Scott & Fetzer. The competing company would be forced to acquire the additional shares now held by Berkshire Hathaway, thus raising the cost of the merger to a potential competing bidder. Stepak claimed that this lock-up option worked to discourage competing bids for Scott & Fetzer Co., thereby denying shareholders of a higher price for their shares.

structured to benefit Scott & Fetzer executives.⁹² The benefit to the executives was the structuring of the merger so as to trigger thirty million dollars in deferred compensation and golden parachute agreements.⁹³ The lock-up option prevented competing bids, and the Scott & Fetzer executives were guaranteed that the beneficial structuring agreed on would not be upset.

The thrust of Stepak's claim was that the thirty million dollar payment, "[b]ut for the unfair dealing and manipulation committed by the defendants, . . . would have been conferred upon Scott & Fetzer shareholders as additional consideration resulting from the merger."⁹⁴ Stepak apparently believed that a different merger structuring would not have triggered the golden parachutes, the Scott & Fetzer assets would not have gone toward the thirty million dollar payout, and a competing bidder would have paid a higher price per share to obtain the greater assets.

On its face, the complaint appeared to set forth a valid claim for breach of fiduciary duty. The Ohio Supreme Court, however, determined that the complaint was simply a challenge to the fair cash value, and such a claim is limited to resolution under the appraisal statute:

Plaintiff does not allege that his shares were undervalued. Rather, he alleges that he should have received more money for his shares. Plaintiff, in essence, challenges the value paid for his shares in the cash-out merger. Such action, merely asking for more money, . . . must be brought under the appraisal statute, R.C. 1701.85.⁹⁵

The facts in *Stepak* are similar to those in *Smith v. SPNV Holdings, Inc.*⁹⁶ In *SPNV*, the merger was timed in such a way that the defendant directors and executives benefitted by the amount of a dividend that was not paid to the shareholders.⁹⁷ The manipulation of the procedure leading to the merger was found to be sufficient to support the claim for breach of fiduciary duty, and the defendants' motion to dismiss for failure to state a claim upon which relief could be granted was denied.⁹⁸ The Chancery Court of Delaware in *SPNV* relied on the reasoning and analysis contained in *Jedwab v. MGM Grand*

⁹² *Id.*.

⁹³ *Id.* at 1079 (Brown, J., dissenting). A golden parachute agreement is a type of deferred compensation frequently offered to high-level executives and officers in corporations. The compensation is triggered by certain changes in corporate control that result in firing or replacing of current executives and officers.

⁹⁴ *Id.* at 1073.

⁹⁵ *Id.* at 1075.

⁹⁶ No. 14676, 1987 WL 14676 (Del. Ch. Oct. 28, 1987).

⁹⁷ *Id.* at *4; see *supra* note 70 and accompanying text.

⁹⁸ *Id.* at *4.

*Hotels, Inc.*⁹⁹ to support the finding of a “majority shareholder’s breach of fiduciary duty through unfair dealing to the minority shareholders:”¹⁰⁰

Although not finding the timing to be manipulative, the [Chancery] Court [of Delaware] set forth a “prototype instance in which the timing of a merger would itself likely constitute a breach of a controlling shareholder’s duty.” The Court held that a breach of duty would exist if the Court found that the minority shareholders showed “(1) that the minority was financially injured by the timing (i.e. from their point of view it was an especially poor time to be required to liquidate their investment) and (2) that the controlling shareholder gained from the timing of the transaction what the minority lost.”¹⁰¹

The claim in *Stepak* is analogous once “timing of the transaction” is replaced with “structuring of the transaction.” The minority shareholder contended that the payment of thirty million dollars to executives would have been paid to the shareholders in the form of a higher price per share had the executives not manipulated the structuring of the merger transaction so as to trigger the golden parachute agreements. The Ohio Supreme Court, however, viewed this challenge as one attempting to “overturn or modify the fair cash value determined”¹⁰² rather than one attempting to establish a violation of the duty of loyalty owed by the majority to the minority. The court reduced the claim to its essence and focused on the character of the relief sought. The court characterized this relief as “essentially a complaint regarding the price which he received for his shares”¹⁰³ and determined that appraisal was the exclusive remedy available for resolution of this claim.

In so holding, the Ohio Supreme Court has taken a giant step toward making appraisal the exclusive remedy in most merger transactions. This step is particularly important in light of previous Delaware decisions that are roughly analogous and allow minority shareholders to pursue suits for breach of fiduciary duty.

The Ohio Supreme Court’s determination that *Stepak* was limited to the statutory appraisal remedy for the resolution of his disagreement with the merger of Scott & Fetzer with Berkshire Hathaway is a groundbreaking decision. The dissatisfied shareholder can no longer ignore the procedure for preserving the rights to dissent and seek appraisal. In the absence of specific allegations by the minority shareholder and proof of fraud, ultra vires acts, or

⁹⁹ 509 A.2d 584 (Del. Ch. 1986).

¹⁰⁰ *Smith v. SPNV Holdings, Inc.*, No. 14676, 1987 WL 14676, at *4 (Del. Ch. Oct. 28, 1987).

¹⁰¹ *Id.* at *3 (quoting *Jedwab v. MGM Grand Hotels, Inc.*, 509 A.2d 584, 599 (Del. Ch. 1986)).

¹⁰² *Stepak*, 553 N.E.2d at 1075.

¹⁰³ *Id.*

illegality on the part of the directors or controlling majority shareholders, the dissatisfied minority shareholder is limited to appraisal. The implication of the holding in *Stepak* is that an allegation of unfair or manipulative structuring of a proposed merger is insufficient to support a claim for breach of fiduciary duty. The Ohio Supreme Court is of the opinion that such an allegation, when coupled with the shareholder's prayer for a higher per share price, amounts to a disagreement over the valuation of the corporation as an ongoing enterprise and is a dispute best resolved through appraisal.

The shareholder alleged that the fair cash value should have reflected an additional thirty million dollars in assets, the amount paid out in golden parachutes to Scott & Fetzer executives, while the corporation argued that the price paid per share reflects the fair value of the minority shares. The appraisal remedy is best suited for the resolution of this disagreement provided the court-appointed appraisers are given sufficient power and authority in their orders of appointment¹⁰⁴ to consider factors such as valuation of deferred compensation plans.

The concept of a "more liberalized appraisal proceeding" that takes "into account all relevant factors" was first suggested by the Delaware Supreme Court in *Weinberger v. UOP, Inc.*¹⁰⁵ and was the result of the Delaware Supreme Court's interpretation of the appraisal statute. "Clearly, there is a legislative intent to fully compensate shareholders for whatever their loss may be, subject only to the narrow limitation that one can not take speculative effects of the merger into account."¹⁰⁶ Because the Ohio statute is subject to a similar "narrow limitation,"¹⁰⁷ the appraisal proceeding should encompass the same "liberalized" scope. It should be noted that the liberalized appraisal proceeding will not be available for every dissenting minority shareholder. For those shareholders dissenting from mergers involving corporations with actively traded stock, the appraisal proceeding will be used to determine solely the appreciation or depreciation in the market value of the stock attributable to the merger proposal itself.¹⁰⁸ The liberalized appraisal proceeding will be of the greatest value in situations involving corporations with inactive markets for their stock and will be ideal for the going-private merger transaction. The Ohio Supreme Court must be prepared to instruct and guide lower courts toward granting substantial power and authority to their court-appointed appraisers so that the exclusive appraisal remedy becomes the most effective remedy.

¹⁰⁴ OHIO REV. CODE ANN. § 1701.85(B) (Baldwin 1990); *see supra* note 33 and accompanying text.

¹⁰⁵ 457 A.2d 701 (Del. 1983).

¹⁰⁶ *Id.* at 714.

¹⁰⁷ *See supra* notes 38-42 and accompanying text.

¹⁰⁸ *See supra* notes 36-42 and accompanying text.

III. A HYPOTHETICAL APPLICATION

A. Construction

June Shrub started a small brewery in the 1960s and was sufficiently successful at a local level to take her brewery public under Ohio law in 1974. June Shrub took her brewery public, in part, because of the importance and prestige of the public corporation. The brewery maintained a steady growth through 1986 and then slowed. The steady growth was attributable to the quality and distinctive flavor of the beers produced by the local brewery. The slumping sales since 1986 may be attributable to a number of factors including a decline in the market for beer, wine, and liquor as a result of a vigorous campaign by the local community against drinking and driving, and a significant price increase due to higher ingredient costs.

June grew tired of the headaches associated with having outside shareholders and annual meetings, so she has decided to take the company private. In addition to seeking a simpler way of making decisions and doing business, June noted recent industry trends toward regional microbreweries. A microbrewery is usually a smaller brewery with a limited market. The popularity of distinctive, flavorful beers seems to have propelled the microbrewery to the forefront of the brewing industry in the areas of growth and profit. June analyzed these trends and saw a chance to take full advantage of her unique regional niche.

Going private should not have been too difficult since she and her family own eighty-eight percent of the outstanding shares. June used her majority shareholder position to initiate a cash-out or "going-private" merger¹⁰⁹ of the remaining twelve percent. The stock in the company was thinly traded in the over-the-counter market, and the market in the stock cannot be considered active.¹¹⁰ The board of directors consisted of five inside directors and two outside directors, and the board voted unanimously to recommend approval of the merger to shareholders. At the shareholders' meeting called to vote on the merger, sixty-two percent of the minority shareholders eligible to vote actually voted, and eighty-nine percent of those minority shareholders voting voted in favor of the merger. No minority shareholder attempted to enjoin the merger, and only four minority shareholders dissented from the merger and sought appraisal. The over-the-counter price of the stock for the twelve-month period prior to the merger averaged \$14 per share, and the stock was purchased for \$25.40 per share pursuant to a valuation and fairness opinion by the company's

¹⁰⁹ See A. BORDEN, GOING PRIVATE § 1.02 at 1-3 (1982).

¹¹⁰ The market information indicates that the market price is not an accurate reflection of the value of the stock. Were the market in the stock active, the fair cash value of the stock would be the market price on the day prior to the merger per *Armstrong* and *Stepak*.

regular investment banker. The dissenting shareholders made a written demand upon the corporation for \$36 per share within the ten day period required by the statute.¹¹¹ The corporation then sent a request to the dissenting shareholders for return of the shares for endorsement.¹¹² The shareholders, acting on their own behalf and unaware of the time limits involved, failed to submit the shares within fifteen days of the date of the corporation's request.¹¹³ The corporation then notified the dissenting shareholders of the corporation's intent to terminate the shareholders' rights of dissent and appraisal.¹¹⁴ The corporation offered to redeem the shares for \$27.00 per share. The dissenting minority shareholders refused and brought suit claiming breach of fiduciary duty.

The shareholders' claim alleged that (1) \$25.40 per share was grossly inadequate, (2) the valuation was not independent (it had been prepared by the corporation's regular investment banker), (3) the valuation of the company was based on historical growth and earnings data and understated the value of the shares in light of the planned conversion to a microbrewery, (4) the board did not adequately and carefully consider the merger proposal and their approval was uninformed, and (5) there was no requirement that a majority of the minority shareholders approve the merger. These allegations are based on the fact that the board reviewed the valuation reports prepared by their investment banker, renewed the investment banker's contract, and voted to approve the merger with limited discussion (as evidenced by the corporate minutes) and without the benefit of an independent negotiating committee to represent minority interests. The meeting took less than one hour.

B. Analysis

The claim for breach of fiduciary duty seems to have merit, particularly when compared to the *Sealy Mattress Co. of New Jersey v. Sealy, Inc.*,¹¹⁵ *Rabkin v. Philip A. Hunt Chemical Corp.*,¹¹⁶ and *Cede & Co. v. Technicolor, Inc.*¹¹⁷ cases in Delaware. On analogous facts, the Delaware courts have permitted suits for breach of fiduciary duty to proceed. In Ohio, however, the shareholders are likely to have squandered their only opportunity for relief by failing to comply with the requirements of the appraisal statute or seek injunctive relief prior to the merger.

Using the reasoning espoused in *Armstrong* and reiterated in *Stepak*, the shareholders in this hypothetical are foreclosed from maintaining a suit for

¹¹¹ See OHIO REV. CODE ANN. § 1701.85(A)(2) (Baldwin 1990).

¹¹² See OHIO REV. CODE ANN. § 1701.85(A)(5) (Baldwin 1990).

¹¹³ OHIO REV. CODE ANN. § 1701.85(A)(5) (Baldwin 1990).

¹¹⁴ *Id.*

¹¹⁵ 532 A.2d 1324 (Del. Ch. 1987); see *supra* notes 54–59 and accompanying text.

¹¹⁶ 498 A.2d 1099 (Del. 1985); see *supra* notes 60–65 and accompanying text.

¹¹⁷ 542 A.2d 1182 (Del. 1988); see *supra* notes 66–68 and accompanying text.

breach of fiduciary duty because their complaint boils down to a complaint about the price to be paid for their shares. There is no doubt that the holder of eighty-eight percent of the outstanding shares has the power to approve the going-private merger and may do so without additional approval from the minority shareholders. The plaintiffs claim that the violation of the fiduciary duty in the form of nonrepresentation of the minority shareholders' interests adversely affected the price paid per share. In the hypothetical situation described, the minority shareholders seek a higher price per share. The claim for breach is not supported by specific allegations of breach of fiduciary duty. The slight deviations from the standard of due care are not substantial enough to trigger a common law cause of action for breach of fiduciary duty under the reasoning in *Stepak*. No matter how the hypothetical claim is stated, the relief sought is a higher price per share. Once the complaint is reduced to a complaint about price paid per share, the remedies are reduced to one—the appraisal statute.

While earlier Delaware case law indicated that the dissatisfied minority shareholders have an apparently valid claim for breach of fiduciary duty, the dissatisfied minority shareholder will be limited to appraisal in Ohio. Because the shareholders couched their prayer for relief in terms of damages measured by the price of the stock, they set off warning bells indicating the appropriate remedy was appraisal. If, in fact, the shareholders were interested in contesting the procedure leading to the merger, then they should have acted in a timely manner. Timeliness would have been assured by raising the issues of breach associated with valuation and board action at the time of the merger through preliminary injunction, rather than at a point when appraisal was extinguished due to noncompliance with the Ohio appraisal statute.

In order to be successful in their pursuit of a higher price for their stock, it is crucial that the dissatisfied minority shareholders recognize what relief they seek. Seeking a higher price per share for the stock automatically confines the shareholder to the appraisal statute, and any attempt to “backdoor” the claim into a cause of action for breach of fiduciary duty will fail. “[R]emedy beyond the statutory procedure is not available where the shareholder’s objection is essentially a complaint regarding the price which he received for his shares.”¹¹⁸

Stepak does not completely foreclose the maintenance of claims for breach of fiduciary duty; however, the holding does severely restrict the number of claims that can crossover from appraisal into common law suits for breach of fiduciary duty. This is a much needed restriction on challenges to corporate action to pursue merger. Once the minority shareholder complains of inadequate price, prays for a higher price, and offers no specific, substantive

¹¹⁸ *Stepak*, 553 N.E.2d at 1075 (citation omitted).

evidence of abuse of the position of control by the majority, the appropriate remedy is appraisal.

This is true regardless of any minor deviations from the standard of due care in similar business situations. If, in a closely held or thinly traded corporation, the shareholder disagrees with the valuation techniques, the suppositions, the assumptions, the projections, the numbers, or the methodology, then the appropriate forum is the appraisal statute. No amount of creativity in couching these disagreements in terms of fiduciary duty will succeed so long as the essence of the complaint is dissatisfaction with the amount paid for the stock.

Perhaps the more intriguing angle within the *Stepak* case is the commentary in the concurring opinion of Justice Holmes.¹¹⁹

[T]o allow an action claiming breach of fiduciary duty, subsequent to a merger, where there has been no prior action to enjoin a merger nor a proceeding pursuant to [the appraisal statute], nor a showing of unlawfulness, ultra vires acts, fraud, or non-disclosure would result in defeating the statutory purpose and intent of Ohio's corporate takeover and merger chapter.¹²⁰

The hypothetical board may not have acted with the highest degree of attention to detail, but nothing in the shareholder's complaint is tantamount to unlawfulness, ultra vires acts, fraud or nondisclosure. While the hypothetical complaint sets out a valid claim for breach of fiduciary duty—as, arguably, did *Stepak*—the timing of the claim, the structuring of the claim, and the type of relief sought render the complaint untenable.

In addressing the facts in the case sub judice, I conclude that *Stepak* has sufficiently stated a cause of action for breach of fiduciary duties by the appellants. However, I believe that *Stepak*'s untimeliness in asserting certain claims and his failure to request the proper remedy as to other claims precludes his recovery.¹²¹

Thus, a valid post-merger claim for breach of fiduciary duty will seek relief unrelated to the price per share, will be the logical extension of a premerger suit for injunction, or will come forward with viable support for claims of fraud, ultra vires acts, or nondisclosure.¹²² Without any of these elements the shareholder is limited to appraisal.

¹¹⁹ *Id.* at 1079 (Holmes, J., concurring).

¹²⁰ *Id.*

¹²¹ *Id.* at 1078.

¹²² While the Ohio Supreme Court suggests that the shareholder must come forward as early in the proposed merger transaction process as possible, there is case law to suggest that a suit for breach of fiduciary duty may be maintained as a result of fraud, *ultra vires* acts, or illegality discovered after the fact. *See Cede & Co. v. Technicolor, Inc.*, 542 A.2d

IV. IMPLICATIONS AND OUTLOOK

When the procedure leading to a going-private merger does not rise to the level of fraud, unfair dealing, or ultra vires acts, allegations of inadequate price will be insufficient to support a cause of action for breach of fiduciary duty. The reasons appraisal is the exclusive remedy for disagreements over price revolve around the goals of the minority shareholder, the available forums, the nature of the proceedings, and the nature of the relief. Because the exclusivity of appraisal over a common law action for breach of fiduciary duty depends on the facts and circumstances and because appraisal can be easily lost if the procedures are not followed to the letter, dissenting minority shareholders must be prepared to pursue the remedy best suited to their goals and resources.

Commentators are split on the value of the appraisal remedy. Some view appraisal as a means of promoting the shift of power from majority to minority shareholders,¹²³ while others view appraisal as a means of freeing corporate management and allowing boards of directors to pursue their own agendas.¹²⁴ Whether appraisal results in power enhancement for the minority or extension of board power is immaterial from a practical standpoint relative to the shareholder. The determination that appraisal is the exclusive remedy for disagreements over the price per share determined in a merger is the only important fact.

The holding in *Stepak* limits the dissenting minority shareholder to the statutory appraisal remedy when the thrust of the dissenting minority shareholder's claim is inadequate or unfair price. In the absence of specific allegations of fraud, ultra vires acts, illegality, or breach of fiduciary duty supported by evidence and timely action by minority shareholders, the complaint of inadequate price—no matter the alleged cause—will be relegated to appraisal. The decision to make appraisal the exclusive remedy in these situations represents thoughtful and responsive development of Ohio corporate law in light of the reality of modern business practice and the sophistication of corporate valuation techniques.

Businesses that have decided to pursue merger, either combining with another or going private, will be concerned with all the costs associated with the proposed merger. Naturally, these businesses will be driven by the profit motive and will try to put together the most advantageous deal. A major

1182 (Del. 1988) (shareholders not "foreclosed from asserting a later-discovered claim of fraud in the merger").

¹²³ See Dierdre A. Burgman & Paul N. Cox, *Reappraising the Role of the Shareholder in the Modern Public Corporation: Weinberger's Procedural Approach to Fairness in Freezeouts*, 1984 WIS. L. REV. 593 (1984).

¹²⁴ See Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L.J. 223 (1962).

element in an advantageous deal is the reduction of transaction costs. One way to reduce the transaction costs is to eliminate costly merger litigation expenses. One way to ensure the minimization of litigation expenses is to heed the fiduciary duty court cases and employ the recommended safeguards for protection of the minority shareholders' interests. Use of these safeguards—full disclosure, independent valuations and fairness opinions, negotiating committees, outside directors and advisors—will reduce (although probably not eliminate) the threat of preliminary injunction. In addition, such “fair dealing” will foreclose any minority shareholder from stepping forward with claims of fraud, ultra vires acts, or illegality. Once these claims are rendered untenable by the majority's structuring of the procedure leading to the merger, the lone forum for resolution of any disagreements over price will be the appraisal proceeding.

From the corporation's standpoint, the appraisal proceeding is preferable and less expensive than the class action suit for breach of fiduciary duty based on a claim of grossly inadequate price. The appraisal proceeding will require minimal preparation since the evidence of the corporation's valuation methodology, suppositions, techniques, and numbers will be already on hand. The disagreement will be resolved by court-appointed appraisers familiar with valuation techniques and will be settled quickly and efficiently. All dissenting shareholder claims can be settled in one forum. The corporation knows within a time certain after the merger the number and extent of claims filed by dissenting shareholders. Efficiency, however, is not the sole advantage of the exclusivity of appraisal.

Valuation of a corporation as a going concern is a complicated process and will involve a number of calculations based on a greater number of assumptions and suppositions. These assumptions and suppositions range from determining the appropriate methodology—cash flow analysis, discounted cash flow analysis, or capitalized earnings analysis—to determining the value of parameters within the methodology—interest rates, asset values, industry trends, projected earnings, and growth. All in all, the valuation process is a sophisticated one and will employ economic analyses specific to the type of business. Minority shareholders and corporations may disagree over the suppositions about projected earnings. A specialized appraisal proceeding will be a far better forum within which to resolve such disputes. A judge, unless well-schooled in advanced corporate valuation techniques, might have difficulty overseeing these complex proceedings. A lay jury would be even less effective in the face of such specialized evidence if suits for breach of fiduciary duty could be maintained on the basis of inadequate price.

The exclusivity of appraisal is a welcome concept in corporate law. In order to be fully effective and responsive, the appraisal remedy must also go beyond the numbers, techniques, and methodology and must be able to resolve all disputes as to value. A “more liberalized appraisal proceeding” such as the

one suggested in *Weinberger v. UOP, Inc.*¹²⁵ should be the model for the exclusive appraisal remedy for corporations without a “reasonably suitable, active market” for their stock.¹²⁶ Such an appraisal would be versatile enough to resolve disputes rising from disagreements over the calculation of discounted cash flow to a minority shareholder’s concern over the corporation’s use of its regular—and, therefore, arguably, not independent—investment banker to author a fairness opinion recommending the approval of the proposed merger.

V. CONCLUSION

Exclusivity of the appraisal remedy is an important step forward in Ohio corporate law. Granted, there may be occasions when the common law cause of action for breach of fiduciary duty is the more appropriate remedy. Extreme instances of fraud, ultra vires acts, or illegality lend themselves to preliminary injunction prior to the merger vote or breach of fiduciary duty actions upon later discovery of such acts.¹²⁷ However, in any case based on minority dissatisfaction with the price paid per share, appraisal is, and should be, the exclusive remedy. This is true even if there is the possibility that some misstep by the majority—directors on both sides of the transaction or absence of a negotiating committee—is alleged as the cause of the inadequate price. Once the minority shareholder’s complaint is reduced to dissatisfaction with the money received in a merger transaction, regardless of slight deviations by the majority from the appropriate standard of care, the dispute should be resolved by an appraisal proceeding. The Delaware Supreme Court closed their decision in *Weinberger* by indicating that the assignment of a dissenting minority shareholder’s claim to appraisal was a “return to well established principles . . . mandating a stockholder’s recourse to the basic remedy of appraisal.”¹²⁸ As did the Delaware Supreme Court in *Weinberger*, the Ohio Supreme Court in *Stepak* establishes appraisal as the primary remedy for minority shareholders dissatisfied with the price paid per share in a merger transaction. And though exclusivity of the appraisal remedy may be a “return to well established principles,” it is also a step forward in Ohio corporate law.

Steven D. Gardner

¹²⁵ 457 A.2d 701, 714 (Del. 1983); see *supra* notes 105–08 and accompanying text.

¹²⁶ See *supra* notes 36–42 and accompanying text for a discussion of *Armstrong v. Marathon Oil Co.* and the narrower focus of the appraisal remedy when used to determine the fair cash value of dissenting shares in a merger transaction involving a corporation with an active market for its stock.

¹²⁷ See *supra* note 120 and accompanying text.

¹²⁸ *Weinberger*, 457 A.2d at 715.