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CORPORATE LAW—FREEZE-OUT MERGER—FREEZE-OUT OF MINORITY STOCKHOLDERS MUST HAVE VALID BUSINESS PURPOSE—Singer v. Magnavox Co., 380 A.2d 969 (Del. 1997) and Tanzer v. International General Industries, Inc., 379 A.2d 1121 (Del. 1977)

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CORPORATE LAW—FREEZE-OUT MERGERS—Freeze-out of minority stockholders must have a "valid business purpose"—*Singer v. Magnavox Co.*, 380 A.2d 969 (Del. 1977), and *Tanzer v. International General Industries, Inc.*, 379 A.2d 1121 (Del. 1977).

In two recent cases the Supreme Court of Delaware has granted significantly greater rights to minority stockholders in freeze-out mergers[1] than were previously allowed. The cases represent a significant change in corporate law in Delaware and may be forerunners of a new judicial approach to the investigation of the motives behind corporate mergers.

In *Singer v. Magnavox Co.*,[2] the Supreme Court of Delaware announced a "valid business purpose" test. The test is to be applied in corporate freeze-outs of minority stockholders when publicly held corporations "go private" by merger with another corporation, both corporations being under the control of the same majority[3] stockholder. The "valid business purpose" test requires that there be some acceptable business reason for the merger other than eliminating an unwanted minority.

The principle that majority stockholders have a fiduciary duty to minority stockholders in some situations has long been ac-

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1. In the freeze-out merger, the majority stockholders cause the corporation in which the minority stockholders have an interest to merge with another corporation controlled by the majority stockholders. In the merger the majority receives additional shares in the surviving or resulting corporation while the minority stockholders receive cash for their shares. The final result is that the majority gains all of the equity interest in the corporation while the minority is "frozen-out." In recent years, there has been a significant increase in freeze-out mergers, which are used as a method for corporations to remove their shares from public markets (known as "going private"). In earlier years when stock prices were high many firms "went public" in order to take advantage of capital which was readily available, but with depressed stock prices, the advantage seems to be in buying back those shares, sold to the public at high prices, at the current lower prices through freeze-out mergers or other methods.

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

3. While the court consistently refers to "majority stockholders," there seems no reason to require that the stockholder have over 50% of the outstanding shares of either corporation for the "valid business purpose" test to apply. Since considerably less than 50% will usually give a stockholder operating control of a corporation, a "control" stockholder is assumed to have the same duties and rights as a "majority" stockholder. To conform to the court's language, this article will use the term "majority" but the reader should consider a control stockholder to be in the same position.

cepted.[4] In the merger situation, the duty of majority stockholders prior to *Singer* had been limited to the "entire fairness"[5] of the merger. This meant that as long as the majority had made full disclosure of all facts and results of a proposed merger and had not damaged the minority stockholders by payment of an inadequate price for cancellation of their interests, the majority had discharged its fiduciary duty. As recently as 1971,[6] Delaware courts allowed minority interests to be removed through merger without investigating any underlying corporate purpose. More broadly, the

4. In Zahn v. Transamerica Corp., 162 F.2d 36 (3d Cir. 1947), the majority stockholder caused the board of directors to redeem one class of stock for cash as provided in the corporate charter. Immediately thereafter, the majority caused the corporation to sell assets which were greatly undervalued on the company books. The result was a windfall profit retained entirely by the majority stockholder. The holders of the redeemed class of stock were successful in showing that the majority had breached a fiduciary duty owed to the minority. *See also* Bastian v. Bourns, Inc., 256 A.2d 680 (Del. Ch. 1969), *aff'd*, 278 A.2d 467 (Del. 1970); David J. Greene & Co. v. Dunhill Int'l, Inc., 249 A.2d 427 (Del. Ch. 1968); Sterling v. Mayflower Hotel Corp., 33 Del. Ch. 293, 93 A.2d 107 (1952).

The duty of majority stockholders has developed as an extension of the duty owed to stockholders by directors which was based, in turn, on the majority stockholders' effective control of the board of directors through their power to elect the board.

On director's duty, *see* Kaplan v. Fenton, 278 A.2d 834 (Del. 1971) (corporate opportunity usurped by a director); Condec Corp. v. Lunkenheimer Co., 43 Del. Ch. 353, 230 A.2d 769 (1967) (improper stock issue reduced plaintiff's interest in corporation); Dolese Bros. Co. v. Brown, 39 Del. Ch. 1, 157 A.2d 784 (1960) (misuse of corporate funds); Johnston v. Green, 35 Del. Ch. 479, 121 A.2d 919 (1956) (corporate opportunity usurped); Bennet v. Breuil Petroleum Corp.; 34 Del. Ch. 6, 99 A.2d 236 (1953) (plaintiff frozen-out by reorganization and sale of stock at an inadequate price); Brophy v. Cities Service Co., 31 Del. Ch. 241, 70 A.2d 5 (1949) (stock trading on insider information); Italo-Petroleum Corp. v. Hannigan, 40 Del. 534, 14 A.2d 401 (1940) (request for accounting by directors).

5. The "entire fairness" test in an interested merger situation was first set out in Sterling v. Mayflower Hotel Corp., 33 Del. Ch. 293, 298, 93 A.2d 107 109-10 (1952).

6. In David J. Greene & Co. v. Schenley Indus., Inc., 281 A.2d 30 (Del. Ch. 1971), the court said:

> [P]laintiffs . . . fail to recognize that under the law of merger each minority stockholder of Schenley has had at least constructive notice that he may be lawfully eliminated as such a stockholder unless the plan of corporate reorganization designed to absorb his stock interest is so grossly unfair as to be invalid. In short, . . . the rights of plaintiffs . . . are not greater under the present Delaware merger statute here involved [long-form merger] than under the so-called short-merger statute . . . . Thus, if plaintiffs and others are not satisfied with the value placed upon their shares by Glen Alden, and no fraud or blatant over-reaching is demonstrated, their recourse is to an appraisal . . . .

Id. at 35 (citations omitted).

courts regarded judicial scrutiny of corporate motives as inappropriate in most situations.[7]

In the *Singer* case, North American Philips Corporation (North American) decided to attempt to acquire the Magnavox Company (Magnavox) by tender offer and subsequent merger. On August 21, 1974, North American incorporated North American Philips Development Corporation (Development) for the purpose of making a tender offer to the holders of outstanding shares of Magnavox. On August 28, 1974, Development made an offer of eight dollars ($8) per share to Magnavox's stockholders. The offer included full disclosure both of Development's intent to ultimately acquire all equity interest in Magnavox and of the effects of that acquisition on Magnavox stockholders.

The directors of Magnavox opposed the tender offer primarily because of inadequate price and so informed their stockholders. The directors sent a letter to the stockholders which stated, in part, that the " 'Company was shocked at the inadequacy of the offer of $8 per share in relationship to a book value in excess of $11 . . . .' "[8] In September of 1974, Development and Magnavox compromised on an offer of nine dollars ($9) per share with a two year employment contract for each of sixteen officers of Magnavox. The board of Magnavox then withdrew its opposition to the offer. As a result of the tender offer, Development acquired 84.1% of the

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7. While a court of equity should stand ready to prevent corporate fraud and any overreaching by fiduciaries of the rights of stockholders, Bennett v. Breuil, 34 Del. Ch. 6, 99 A.2d 236, by the same token this Court should not impede the consummation of an orderly merger under the Delaware statutes, an efficient and fair method having been furnished which permits a judicially protected withdrawal from a merger by a disgruntled stockholder. . . .

Id. at 36 (citation omitted). Also, in Stauffer v. Standard Brands Inc., 41 Del. Ch. 7, 187 A.2d 78 (1962), the court said:

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

Id. at 10-11, 187 A.2d at 80. In Bruce v. E.L. Bruce Co., 40 Del. Ch. 80, 174 A.2d 29 (1961), the court said: "[T]he reasons for a merger or the business necessity behind it are not matters for judicial determination. . . ." *Id.* at 82-83, 174 A.2d at 30 (citation omitted).

8. 380 A.2d at 971.

Magnavox common shares outstanding, putting it in control of Magnavox.

In May of 1975, Development incorporated T.M.C. Development Corporation (TMC) for the purpose of acquiring the remaining 15.9% of Magnavox common shares through a merger of Magnavox into TMC under the Delaware long form merger statute.[9]

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9. DEL. CODE ANN. tit. 8, § 251 (Michie 1974 & Supp. 1977) provides, in part, as follows:

> (a) Any 2 or more corporations existing under the laws of this State may merge into a single corporation, which may be any 1 of the constituent corporations or may consolidate into a new corporation formed by the consolidation, pursuant to an agreement of merger or consolidation, as the case may be, complying and approved in accordance with this section.
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> (b) The board of directors of each corporation which desires to merge or consolidate shall adopt a resolution approving an agreement of merger or consolidation. The agreement shall state: (1) The terms and conditions of the merger or consolidation; (2) the mode of carrying the same into effect; (3) the amendments or changes in the certificate of incorporation of the surviving corporation as are desired to be effected by the merger or consolidation, or, if no such amendments or changes are desired, a statement that the certificate of incorporation of 1 of the constituent corporations shall be the certificate of incorporation of the surviving or resulting corporation; (4) the manner of converting the shares of each of the constituent corporations into shares or other securities of the corporation surviving or resulting from the merger or consolidation and, if any shares of any of the constituent corporations are not to be converted solely into shares or other securities of the surviving or resulting corporation, the cash, property, rights or securities of any other corporation which the holders of such shares are to receive in exchange for, or upon conversion of such shares and the surrender of the certificates evidencing them, which cash, property, rights or securities of any other corporation may be in addition to or in lieu of shares or other securities of the surviving or resulting corporation; and (5) such other details or provisions as are deemed desirable, including, without limiting the generality of the foregoing, a provision for the payment of cash in lieu of the issuance or recognition of fractional shares, interests or rights, or for any other arrangement with respect thereto, consistent with the provisions of § 155 of this title. The agreement so adopted shall be executed in accordance with § 103 of this title. Any of the terms of the agreement of merger or consolidation may be made dependent upon facts ascertainable outside of such agreement, provided that the manner in which such facts shall operate upon the terms of the agreement is clearly and expressly set forth in the agreement of merger or consolidation.
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> (c) The agreement required by subsection (b) of this section shall be submitted to the stockholders of each constituent corporation at an annual or special meeting for the purpose of acting on the agreement. Due notice of the time, place and purpose of the meeting shall be mailed to each holder of stock, whether voting or nonvoting, of the corporation at his address as it appears on the records of the corporation, at least 20 days prior to the date of the meeting. At the meeting, the agreement shall be considered and a vote taken for its adoption or rejection. If a majority of the outstanding stock of the corporation entitled to vote thereon shall be voted for the adoption of

The Magnavox directors agreed to a merger in which TMC would be the surviving corporation and called a meeting of the stockholders of Magnavox for July 24, 1975 to approve the merger. They sent a proxy statement to the stockholders in June of 1975, again with full disclosure of the ultimate effect of the merger on the stockholders. At the stockholder's meeting the proposed merger was approved.

The minority stockholders filed suit charging that the merger was fraudulent since it lacked any business purpose other than a freeze-out of the minority stockholders at an inadequate price. The offer price was nine dollars ($9) as compared to a book value of ten dollars and sixteen cents ($10.16) per share.[10] The minority also alleged that the board had breached its fiduciary duty by approving the merger at an inadequate price. The minority's final argument was that the proxy statements violated the anti-fraud provision of the Delaware securities act.[11] Specifically, the minority stockholders alleged that the proxy materials contained false and misleading statements and failed to disclose material facts. They pointed out that the proxy materials did not mention the Magnavox directors' initial opposition to Development's tender offer, the substantial difference between the book value of Magnavox shares and the offer price, or the employment contracts offered to sixteen Magnavox officers in return for the Magnavox board's support of the tender offer.[12]

The majority stockholders argued that their actions were fully authorized by the Delaware long form merger statute and fully complied with that act. The majority contended that the minority's

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the agreement, that fact shall be certified on the agreement by the secretary or assistant secretary of the corporation. If the agreement shall be so adopted and certified by each constituent corporation, it shall then, in addition to the execution required by subsection (b) of this section, be executed, acknowledged and filed and shall become effective, in accordance with § 103 of this title. It shall be recorded in the office of the recorder of the county of this State in which the registered office of each such constituent corporation is located; or if any of the constituent corporations shall have been specially created by a public act of the General Assembly, then the agreement shall be recorded in the county where such corporation had its principal place of business in this State. . . .

10. 380 A.2d at 972.

11. While the anti-fraud provisions of DEL. CODE ANN. tit. 6, § 7303 (Michie 1974), which require full disclosure of all material facts in proxy solicitations, were argued in the case, they did not play a major part in the court's decision and are not considered in this discussion.

12. 380 A.2d at 980 n.13.

only available remedy was appraisal as provided by Delaware law,[13]

13. DEL. CODE ANN. tit. 8, § 262 (Michie 1974 & Supp. 1977) provides in part, as follows:

> (a) Appraisal rights under this section shall be available only for the shares of any stockholder who has complied with subsection (b) of this section and has neither voted in favor of the merger nor consented thereto in writing pursuant to § 228 of this title. When used in this section, the word "stockholder" means a holder of record of stock in a stock corporation and also a member of record of a non-stock corporation; the words "stock" and "share" mean and include what is ordinarily meant by those words and also membership or membership interest of a member of a nonstock corporation.
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> (b) Appraisal rights under this section shall be determined as follows:
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> (1) If a proposed merger or consolidation for which appraisal rights are provided under this section is to be submitted for approval at a meeting of stockholders, the 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 or all of the shares of the constituent corporations, and shall include in such notice a copy of this section. Each stockholder electing to demand the appraisal of his shares under this section shall deliver to the corporation, before the taking of the vote on the merger or consolidation, a written demand for appraisal of his shares. Such demand will be sufficient if it reasonably informs the corporation of the identity of the stockholder and that the stockholder intends thereby to demand the appraisal of his shares; provided, however, that such demand must be in addition to and separate from any proxy or vote against the merger. Within 10 days after the effective date of such merger or consolidation, the surviving corporation shall notify each stockholder of each constituent corporation who has complied with this subsection and has not voted in favor of or consented to the merger or consolidation of the date that the merger or consolidation has become effective; or
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> (2) If the merger or consolidation was approved pursuant to § 228 or § 253 of this title, the surviving corporation, either before the effective date of the merger or within 10 days thereafter, shall notify each of the stockholders entitled to appraisal rights of the effective date of the merger or consolidation and that appraisal rights are available for any or all of the shares of the constituent corporations. A copy of this section shall be included in the notice. The notice shall be sent by certified or registered mail, return receipt requested, addressed to the stockholder at his address as it appears on the records of the corporation. Any stockholder entitled to appraisal rights may, within 20 days after the date of mailing of the notice, demand in writing from the surviving corporation the appraisal of his shares. Such demand will be sufficient if it reasonably informs the corporation of the identity of the stockholder and that the stockholder intends thereby to demand the appraisal of his shares.
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> . . . .
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> (f) After the determination of the stockholders entitled to an appraisal, the Court shall appraise the shares, determining their fair value exclusive of any element of value arising from the accomplishment or expectation of the merger. Upon application by any stockholder entitled to participate in the appraisal proceeding or by the corporation, the Court may, in its discretion, permit discovery or other pretrial proceedings and may proceed to trial upon the appraisal prior to the final determination of those other stockholders who

which allows a stockholder, dissatisfied with the price he receives for his or her shares, to demand a judicial appraisal of the fair value of the shares. The majority denied any violation of the Delaware anti-fraud statute and argued that even if it had made any misrepresentations in the proxy materials the minority did not rely on any such misrepresentations.

Since the board of Magnavox was not disinterested[14] and would benefit personally from employment contracts and stock options, the court could have used conventional principles to find a violation of the board's fiduciary duty, unless the board was able to prove the "entire fairness" of the merger.[15] Instead, the court took this opportunity to announce that a corporate merger controlled on both sides by the majority stockholders, even though fully in compliance with the merger provisions of Delaware law, must have some "valid business purpose" other than the freeze-out of an unwanted minority.[16] The court admitted that this test is undefined and "leads to questions such as, 'Whose purpose?' and 'What business?,' "[17] but it did not answer those questions. As a concurring opinion stated, "[t]he opinion waffles in its attempt to establish guidelines for future merger litigation with emphasis on the coined

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have complied with this section. Any stockholder whose name appears on the list filed by the corporation pursuant to subsection (d) of this section and who has submitted his certificates of stock to the Register in Chancery, if such is required, may participate fully in all proceedings until the Court shall determine that he is not entitled to appraisal rights under this section.

(g) The court shall direct the payment of the appraised value of the shares, together with interest, if any, by the surviving or resulting corporation to the stockholders entitled thereto upon the surrender to the corporation of the certificates representing such stock. . . .

(h) The costs of the proceeding may be determined by the Court and taxed upon the parties as the Court deems equitable in the circumstances. Upon the application of any party in interest, the Court shall determine the amount of interest, if any, to be paid upon the value of the stock of the stockholders entitled thereto. In making its determination with respect to interest, the Court may consider all relevant factors, including the rate of interest which the corporation has paid for money it has borrowed, if any, during the pendency of the proceeding. Upon application of a stockholder, the Court may order all or a portion of the expenses incurred by any stockholder in connection with the appraisal proceeding, including, without limitation, reasonable attorney's fees and the fees and expenses of experts, to be charged pro rata against the value of all of the shares entitled to an appraisal.

14. At the time of the merger vote, four of the Magnavox directors were also on the North American board and three more had employment contracts and options on North American stock as of the effective date of the merger.

15. Sterling v. Mayflower Hotel Corp., 33 Del. Ch. 293, 93 A.2d 107 (1952).

16. 380 A.2d at 978-79.

17. *Id.* at 976.

phrase 'business purpose' which standing alone connotes nothing magic or definitive."[18]

The earlier decisions which enunciated the "entire fairness" standard[19] are still good law. They are supplemented by, but do not conflict with, the new "valid business purpose" test. As the "entire fairness" test developed, the parties objecting to the merger were required to prove such unfairness in the merger as to amount to constructive fraud.[20] Later, the courts required the parties proposing the merger to prove the "entire fairness" of the merger when they were in control on both sides.[21] By requiring that some identifiable benefit must be gained by the freeze-out merger process other than the elimination of an unwanted minority interest, the "valid business purpose" test appears to be a further development of the duty imposed upon majority stockholders to deal fairly with minority stockholders.[22] "Entire fairness" and "valid

18. Singer v. Magnavox Co., 422 SEC. REG. & L. REP. (BNA) E1, E8 (Del. 1977) (McNeilly, J., concurring) (quoted paragraph omitted from *Atlantic Reporter*).

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

20. MacCrone v. American Capital Corp., 51 F. Supp. 462 (D. Del. 1943).

21. Bastian v. Bourns, Inc., 256 A.2d 680 (Del. Ch. 1969), *aff'd*, 278 A.2d 467 (Del. 1970); David J. Greene & Co. v. Dunhill Int'l, Inc., 249 A.2d 427 (Del. Ch. 1968).

22. The result reached in *Singer* is the same result that the Court of Appeals for the Second Circuit reached both in Marshel v. A.F.W. Fabric Corp., 533 F.2d 1277 (2d Cir. 1976), *vacated*, 429 U.S. 881 (1976), and in Greene v. Santa Fe Indus., Inc., 533 F.2d 1283 (2d Cir. 1976), *rev'd*, 430 U.S. 462 (1977), by using rule 10(b)(5) (17 C.F.R. 240.10(b)(5) (1975)) and § 10(b) of the Securities Exchange Act of 1934 (15 U.S.C.A. 78(j)(b) (1970)). The court held that rule 10(b)(5) was broad enough to reach the breach of a fiduciary duty in the absence of any actual fraud. In *Marshel*, which involved a cash-out merger under New York law, the court held that it was a violation of § 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10(b)(5) to consummate a cash-out merger with no corporate purpose other than removal of the minority, since it involved a forced sale at a price determined by the majority and funded from the corporate treasury, regardless of appraisal rights and specifically did not decide the state law issues.

Greene involved a short form merger under DEL. CODE ANN. tit. 8, § 253 (Michie 1974 & Supp. 1977), where all statutory requirements were met. The court held that rule 10(b)(5) regards a freeze-out merger without a justifiable business purpose and with low stock valuation and no notice to the minority as a fraud regardless of misrepresentation or lack of disclosure, which need not be proven. On appeal the Supreme Court held that rule 10(b)(5) does not regulate the standard of fiduciary conduct because the area of corporate responsibility of majority stockholders is properly regulated by the states. The Supreme Court concluded that rule 10(b)(5) does not apply in the absence of "manipulative or deceptive" practices which are terms of art referring to practices intended to mislead investors by artificially affecting market activity. Santa Fe Indus., Inc. v. Greene, 430 U.S. 462 (1977). For other cases interpreting rule 10(b)(5) in this area, see Popkin v. Bishop, 464 F.2d 714 (2d Cir. 1972);

business purpose" now represent a two-step test which must be satisfied to justify a freeze-out merger.

Although the Delaware Code authorizes appraisal of the shares of a minority stockholder who is dissatisfied with the price offered, the statute does not say that appraisal is an exclusive remedy for frozen-out minority stockholders. The courts have, however, applied the appraisal remedy as though it were exclusive.[23] In some of the earlier appraisal cases the courts differentiated between mergers under the Delaware long form merger statute and the short form merger statute[24] on the basis of the statutory lan-

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Albright v. Bergendahl, 391 F. Supp. 754 (D. Utah 1974); Levine v. Biddle Sawyer Corp., 383 F. Supp. 618 (S.D.N.Y. 1974); Bryan v. Brock & Blevins Co., 343 F. Supp. 1062 (N.D. Ga. 1972), *aff'd*, 490 F.2d 563 (5th Cir. 1974).

23. David J. Greene & Co. v. Schenley Indus., Inc., 281 A.2d 30 (Del. Ch. 1971) (appraisal held adequate remedy in freeze-out merger); Stauffer v. Standard Brands, Inc., 40 Del. Ch. 202, 178 A.2d 311, *aff'd*, 41 Del. Ch. 7, 187 A.2d 78 (1962) (short form merger); Sterling v. Mayflower Hotel Corp., 33 Del. Ch. 293, 93 A.2d 107 (1952) (question of valuation in a "stock for stock" merger); Federal United Corp. v. Havender, 24 Del. Ch. 318, 11 A.2d 331 (1940) (appraisal applied to loss of dividend rights by preferred stockholder in merger).

24. DEL. CODE ANN. tit. 8, § 253 (Michie 1974 & Supp. 1977) provides, in part, as follows:

> (a) In any case in which at least 90% of the outstanding shares of each class of the stock of a corporation or corporations is owned by another corporation and 1 of the corporations is a corporation of this State and the other or others are corporations of this State or any other state or states or the District of Columbia and the laws of the other state or states or the District permit a corporation of such jurisdiction to merge with a corporation of another jurisdiction, the corporation having such stock ownership may either merge the other corporation or corporations into itself and assume all of its or their obligations, or merge itself, or itself and 1 or more of such other corporations, into 1 of the other corporations by executing, acknowledging and filing, in accordance with § 103 of this title, a certificate of such ownership and merger setting forth a copy of the resolution of its board of directors to so merge and the date of the adoption; provided, however, that in case the parent corporation shall not own all the outstanding stock of all the subsidiary corporations, parties to a merger as aforesaid, the resolution of the board of directors of the parent corporation shall state the terms and conditions of the merger, including the securities, cash, property, or rights to be issued, paid, delivered or granted by the surviving corporation upon surrender of each share of the subsidiary corporation or corporations not owned by the parent corporation. If the parent corporation be not the surviving corporation, the resolution shall include provision for the pro rata issuance of stock of the surviving corporation to the holders of the stock of the parent corporation on surrender of the certificates therefor, and the certificate of ownership and merger shall state that the proposed merger has been approved by a majority of the outstanding stock of the parent corporation entitled to vote thereon at a meeting duly called and held after 20 days notice of the purpose of the meeting mailed to each such stockholder at his address as it appears on the records of the corporation. A certified copy of the certifi-

guage. The courts reasoned that the short form merger statute authorized the freeze-out merger while the long form statute did not and, therefore, that appraisal was the exclusive remedy only for short form mergers.[25] In 1968, the Delaware legislature amended the long form merger statute, effectively eliminating this difference.[26] The amendment to the Delaware long form merger statute indicates a legislative intent to facilitate payment of cash for minority shares at the discretion of the boards of directors controlling the merger. The court in *Singer*, however, apparently chose to ignore the legislative intent behind the 1968 amendment. The court held that the payment of cash for shares is not solely at the discretion of the board and added the restriction of a "valid business purpose" to the usual restriction that the price paid for shares be fair.

The result in *Singer* is beneficial to minority stockholders who frequently consider the appraisal remedy inadequate since their purpose for owning shares is defeated by a cash payment even if the price received is fair. For instance, some stockholders believe that the stock will rise in value and that a cash payment deprives them of future gains. Others count on their shares for retirement income from dividends. A forced cash payment means the end of that income and possible future hardship.

The *Singer* decision clearly indicates that the appraisal remedy, long thought to be exclusive, is merely one among many available to the courts. The court specifically said that it "may grant such relief as it deems appropriate under the circumstances."[27] Since the action involved in a suit by minority stockholders to vindicate their rights in an unfair merger is equitable in nature,

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cate shall be recorded in the office of the recorder of the county in this State in which the registered office of each constituent corporation which is a corporation of this State is located. . . .

. . . .

(d) In the event all of the stock of a subsidiary Delaware corporation party to a merger effected under this section is not owned by the parent corporation immediately prior to the merger, the stockholders of the subsidiary Delaware corporation party to the merger shall have appraisal rights and the surviving corporation shall comply with paragraph (2) of subsection (b) of § 262 of this title. Thereafter, the surviving corporation and the stockholders shall have such rights and duties and shall follow the procedures set forth in subsections (c) to (j), inclusive, of § 262 of this title.

25. *See* Stauffer v. Standard Brands, Inc., 40 Del. Ch. 202, 178 A.2d 311, *aff'd*, 41 Del. Ch. 7, 187 A.2d 78 (1962). At the time the chancery court decided *Stauffer*, § 251 allowed for payment of cash "in lieu of issuance of fractional shares of the resulting or surviving corporation." *See* 50 Del. Laws ch. 467, § 4 (effective July 18, 1955).

26. 56 Del. Laws ch. 186, § 16 (effective Jan. 2, 1968).

27. 380 A.2d at 980.

possible remedies include injunction or unraveling an accomplished merger. On the other hand, if the merger has a "valid business purpose," or if the unfairness found in the merger relates solely to price paid to frozen-out stockholders, the appraisal remedy is adequate and is presumed to be exclusive.

One month after its decision in *Singer*, the Delaware Supreme Court reviewed the "valid business purpose" test in *Tanzer v. International General Industries, Inc.*[28] There, International General Industries (IGI) owned 81% of the outstanding common stock of Kliklok Corporation (Kliklok). On September 30, 1975, IGI formed KLK Corporation (KLK) in order to merge KLK with Kliklok. The boards of each of the corporations approved the merger plan and stockholder approval was obtained as required under the Delaware long form merger statute. Minority stockholders, dissenting from the propsed merger, asked the court of chancery for a preliminary injunction, arguing that the sole purpose of the merger was to serve the interest of IGI by freezing-out the minority. The majority responded that the merger was proposed because it would facilitate long-term financing of IGI and that facilitation of financing was a sufficient "business purpose." The court of chancery[29] refused the injunction and a motion by the defendants for summary judgment. The minority appealed. By the time the case reached the Supreme Court of Delaware, the merger had been accomplished. The Supreme Court of Delaware stated the issue to be decided:

> Plaintiffs' argument amounts to this: a freeze-out merger imposed on a subsidiary corporation by a parent, and designed solely for the purpose of benefiting the parent, is impermissible under Delaware law. Defendants, on the other hand, contend that the merger was for a valid business reason and is permissible under [the Delaware long form merger statute]; in addition, they say that the price offered in connection with the merger is intrinsically fair.[30]

In *Tanzer*, the court reviewed the *Singer* decision noting that "*Singer* determines that a cash-out of minority stockholders, when that is the sole purpose of a merger, is a violation of a fiduciary duty owed to them by a majority stockholder."[31] The court then turned to the *Singer* court's "valid business purpose" language and found

28. 379 A.2d 1121 (Del. 1977).
29. *Id.* at 1122.
30. *Id.* at 1123.
31. *Id.*

it ambiguous. The *Tanzer* court observed that the phrase "valid business purpose" is not descriptive of the actual interest-weighing test to be applied.[32] It suggested that what is really involved is a balancing of the right of majority stockholders to vote their own interest against the duty of those same stockholders to minority stockholders.[33] After balancing IGI's interest in facilitating long-term debt financing against its duty to Kliklok's minority stockholders, the court stated that the purpose established by IGI was a bona fide purpose for the merger.[34]

While the court in *Tanzer* moved away from the "valid business purpose" language of *Singer*, *Tanzer* nevertheless supports the view that corporate motives underlying freeze-out mergers are to be subjected to judicial scrutiny. Once the concept of a "valid business purpose" has been more clearly defined through case law, that test will become more focused. The "valid business purpose" concept should then be a helpful clarification of the fiduciary duty of a majority stockholder in the merger situation.

Now that the Delaware courts have articulated the "valid business purpose" test, one must attempt to predict what the courts will find acceptable as "valid business purposes." In *Tanzer*, although the court did not define what purposes other than facilitation of long-term debt financing will be acceptable, any bona fide purpose of the majority should be sufficient to support the majority's right to vote its own interest even if minority interests are damaged. Valid purposes would include streamlining of the corporate structure in order to eliminate duplication of jobs and thereby increase profits, mergers to gain tax benefits, and any other purpose which can be shown to have a beneficial effect on either corporation involved in the merger. Some purposes clearly will not support that right.[35] Where a majority seeks to justify its actions on

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32. *Id.*

33. For cases discussing the right of a majority stockholder to vote her own interest, see Ringling Bros.-Barnum & Bailey Comb. Shows, Inc. v. Ringling, 29 Del. Ch. 610, 53 A.2d 441 (1947); Heil v. Standard Gas & Elec. Co., 17 Del. Ch. 214, 151 A. 303 (1930); Allied Chem. & Dye Corp. v. Steel & Tube Co., 14 Del. Ch. 1, 120 A. 486 (1923).

34. 379 A.2d at 1125. The court then remanded the case for an "entire fairness" hearing as required by Sterling v. Mayflower Hotel Corp., 33 Del. Ch. 293, 93 A.2d 107 (1952).

35. In recent years the literature has suggested a number of possible purposes, some of which may be invalid in the future. Borden, *Going Private—Old Tort, New Tort, or No Tort?*, 49 N.Y.U. L. REV. 987 (1974); Comment, *Protection of Minority Shareholders from Freeze-outs Through Merger*, 22 WAYNE L. REV. 1421 (1976);

the basis of one purpose while its real purpose is either to eliminate a dissident minority or to enrich itself at the expense of a minority stockholder, the courts will undoubtedly look to the true motive. Even if the use of the business purpose language disappears through judicial disapproval in cases like *Tanzer*, the concept of a "valid business purpose" is sound as long as the courts remain concerned with the underlying reasons for freeze-out mergers.

The rule of *Singer* and *Tanzer* is more demanding than the "business judgment" rule,[36] which provides only that if corporate boards act in good faith the courts will not question the wisdom of the boards' decisions. In practice, this often leads courts to take a hands-off attitude towards the boards' actions. The more intensive review required by *Singer* and *Tanzer*, although developed and discussed in the context of freeze-out mergers, can be applied to other methods by which corporations "go private," such as reverse stock splits, short form mergers,[37] stock repurchase programs, and asset sales.

While the final effect of the *Singer/Tanzer* rule is not yet clear, it is safe to say that it will be significant. Forty percent of the corporations listed on the New York Stock Exchange are incorporated in Delaware, and therefore subject to Delaware law. It has been estimated that over 200 of the FORTUNE 500 Largest Industrial Corporations are incorporated in Delaware.[38] Since the *Singer/Tanzer* rule grew out of the tension between the common law fiduciary duty of directors and control stockholders and the right of those same directors and control stockholders to vote their own interests when voting their shares, application of the rule should not be limited to Delaware corporations. If other states adopt the *Singer/Tanzer* rule as a way of balancing the competing

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Note, *Going Private*, 84 YALE L.J. 903 (1975). Some purposes, such as escape from disclosure requirements, are objectionable on policy grounds, while others, such as removal of pressure from management to show high profits in spite of long range negative effects, are more valid. Only time, and a case by case development in the courts, will tell.

36. 379 A.2d at 1124.

37. The court, in both *Singer* and *Tanzer*, was concerned with the Delaware long form merger statute, DEL. CODE ANN. tit. 8, § 251 (Michie 1974 & Supp. 1977). Although the *Singer* decision was specifically restricted to long form mergers, the Delaware Court of Chancery has since held that the *Singer/Tanzer* rule also applies to short form mergers, DEL. CODE ANN. tit. 8, § 253 (Michie 1974 & Supp. 1977). Kemp v. Angel, 381 A.2d 241 (Del. Ch. 1977).

38. Jennings, *Federalization of Corporate Law: Part Way or All the Way*, 31 BUS. LAW. 991 (1976).

interests of majority and minority shareholders when public corporations "go private," the "valid business purpose" approach may soon become the majority rule.[39]

Allan A. Campbell, Jr.

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39. The Court of Appeals for the Second Circuit reached the same result in Greene v. Santa Fe Indus., Inc., 533 F.2d 1283 (2d Cir. 1976), *rev'd*, 430 U.S. 462 (1977). This indicates a judicial belief that the *Singer/Tanzer* rule is equitable. The Supreme Court, in reversing the Second Circuit, did not find the result incorrect. The Court instead criticized the method of reaching the result. *See* note 22 *supra*.