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Going Private—Is It Over? Eliminating Minority Interests After *Singer v. Magnavox*

Much has been written in recent years of the increasingly popular move by corporate majorities to eliminate their minority counterparts from equity participation in a public corporation.[1] Frequently motivated by a desire to "go private," the majority shareholders have relied on various statutorily designed vehicles to reacquire minority interests and thus achieve sole ownership of the corporation. Such concentration of the ownership allows the corporation to return to a private status, therefore avoiding the regulatory and disclosure requirements imposed on public corporations by the Securities Exchange Act of 1934 (1934 Act).[2] Despite the alleged inequities of eliminating minority interests, legislatively designed mergers facilitate a return to private status. Recent decisions by the Delaware courts, however, have caused concern in the corporate community as to the future of such transactions.

In late 1977, the Delaware Supreme Court, the final arbiter of perhaps the most significant American corporate case law, decided *Singer v. Magnavox Co.*[3] In *Singer,* the court imposed strict fiduciary duties upon the majority stockholders in merger transactions designed solely to eliminate the minority. Later that same year, the Delaware court again ruled, in *Tanzer v. International General Industries, Inc.,*[4] that the "entire fairness" of mergers designed to eliminate minority interests would be subjected to increased judicial scrutiny.

Viewed against the background of prior Delaware case law, these decisions indicate a shift in the attitude of the Delaware courts toward going private transactions and the likelihood of increased difficulty and cost to corporations wishing to return to a private status. For the thousands of the nation's leading companies incorporated in Delaware, the shift in the attitude of the Delaware courts is of direct concern. Since Delaware law has traditionally been the benchmark for other state courts in determining the limitations of the maximum flexibility allowed corporate management, the new cases are of broad concern to the corporate bar.

I. Corporate and Insider Objectives in Going Private

A corporation may have several objectives in returning to private status. The primary objective is to eliminate a sufficient number of shareholders to enable the corporation to remove its shares from registration with the Securities and Exchange Commission (SEC) mandated by section 12 of the 1934 Act.[5]

1 Borden, *Going Private—Old Tort, New Tort or No Tort?,* 49 N.Y.U. L. Rev. 987 (1974); Brudney, *A Note on Going Private,* 61 Va. L. Rev. 1019 (1975). *See, e.g.,* Note, *Going Private,* 84 Yale L. J. 903 (1975). *See also* Lynch, *A Concern for the Interest of Minority Shareholders Under Modern Corporation Laws,* 3 J. of Corp. L. 19 (1977).

2 15 U.S.C. § 78 (1976).

3 380 A.2d 969 (Del. 1977).

4 379 A.2d 1121 (Del. 1977).

5 15 U.S.C. § 78(l) (1976). SEC de-registration has to be considered the primary goal of any going private transaction since most companies do not find the supervision of the various exchanges as burdensome as that of the SEC regulations. *See* 84 Yale L.J., *supra* note 1, at 904 n. 7.

A public corporation may de-register its stock when the total number of shareholders is reduced to less than three hundred persons.[6] De-registration affords the corporation the savings in cost otherwise involved in sending proxy statements and annual reports to its public shareholders in conformity with the rigourous disclosure requirements of the 1934 Act.

An ancillary benefit in returning to private status through the elimination of the minority interests is the reduction in the number of shareholders thus increasing the company's book value per share. Although book value is not generally considered a particularly accurate index of a company's worth, it has added significance to a corporation which has gone private. Because its shares are no longer listed on the national securities exchange where the once-public company's shares were traded, the corporation is no longer tied to the exchange for determining the value of its stock. For lack of a readily available measure of value, the corporation's book value assumes a greater role in valuing the remaining stock of the company. The increase in book value, together with the added significance of that index, benefits the company in acquisitions or in granting stock options as a medium of compensation or currency.

A significant advantage in returning to private status is that which accrues to the corporate insiders, *i.e.,* controlling shareholders. The insiders stand to benefit from concentration of the management among the controlling shareholders and the concomitant ability to handle corporate affairs so as to divert rewards to themselves rather than filtering them through the corporation. By removing all of the corporation's stock from the public markets, closely held companies are also protected from the threat of takeover offers. This results in absolute investment protection for the controlling shareholders—a protection that was not afforded the small minority investor who had hoped to retain his investment in anticipation of a rebounding market.

The attainment of these benefits at the cost of eliminating the minority shareholders raises strong countervailing policy arguments. There is strong resentment of those companies that took advantage of the burgeoning stock market of the late sixties and early seventies to gain needed capital by soliciting public shareholders only to dispense with those shareholders at bargain prices as the market subsequently declined. Many commentators have expressed concern that continuation of the going private trend will seriously impair public confidence in securities markets and American corporations.[7]

The Delaware Supreme Court responded, in part, to these concerns with its decision in *Singer v. Magnavox Co.* The policy issues which question the unbridled elimination of minority interests will become increasingly significant as the courts place greater emphasis on the law governing the majority shareholders'

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6 15 U.S.C. § 78(1)(g)(4) (1976).

7 Former SEC Commissioner A.A. Sommer, Jr., one of the most outspoken critics on the issue stated: "What is happening is, in my estimation, serious, unfair, and sometimes disgraceful, a perversion of the whole process of public financing, and a course that inevitably is going to make the individual shareholder even more hostile to American corporate mores and the securities markets than he already is." Address by A.A. Sommer, Jr., "Going Private: A Lesson in Corporate Responsibility," Law Advisory Council Lecture, Notre Dame Law School, Nov. 20, 1974, [1974-1975 Transfer Binder] CCH FED. SEC. L. REP. ¶ 80,010, at 84,695.

fiduciary responsibility in going private transactions.

II. The Mechanics of Going Private

Although other techniques for going private are sometimes used,[8] the most common method is the squeeze-out merger. Such mergers are designed to merge the target company with another company controlled by the majority shareholders of the target. The traditional procedure for assimilating shareholders of the target is to convert shares of the target into shares of the surviving corporation. In the squeeze-out mergers, however, the conversion medium is either cash or non-equity securities of the surviving corporation. As a result, the minority interests sought to be eliminated are either cashed-out or reduced to the status of non-participating shareholders.

The successful completion of the squeeze-out merger is predicated on the acquisition of a sufficient number of shares of the target company so that the acquiring group can vote approval of the merger. If the acquiring group already owns a majority interest in the company it seeks to make private, the procedure is simplified. A one-step acquisition of the publicly held shares can be accomplished with the formation of a shell corporation by the majority as the parent of the target and merging the target into the shell. If the acquiring group does not own a sufficient number of shares of the target to approve the merger unilaterally, the group must precede the merger with a tender offer in an attempt to acquire a controlling interest.[9] The merger then serves as a "mop-up" technique to acquire the remaining outstanding shares of the target company. Whatever technique is used the result sought is the same—an elimination of the minority interests. The elimination of the minority interests then allows the corporation to return to private status.[10] Under what circumstances the majority shareholders may enact such mechanical obliterations of the minority interests is the subject of this note's analysis.

III. *Santa Fe Industries v. Green*: The Necessity of a State Remedy for Squeezed-Out Minority Shareholders

The alternative sources of regulatory power over going private transactions are the federal securities laws, enforced by the federal courts and the SEC, and the corporate laws of the individual states. The United States Supreme Court's recent decision in *Santa Fe Industries v. Green*,[11] however, substantially limits

8 Elimination of the minority interests may be accomplished by a variety of techniques including reverse stock splits, sale of assets and dissolution, or bankruptcy. *See generally* Borden, *supra* note 1.

9 Generally, the state merger statutes require either a two-thirds or majority shareholder approval to sustain a merger. *See, e.g.*, Del. Code Ann. tit. 8, § 251 (Cumm. Supp. 1977) (majority); N.Y. Bus. Corp. Law (McKinney) § 903 (Supp. 1977-1978) (two-thirds). Short-form merger statutes, available in most states, further simplify the squeeze-out by allowing inside shareholders controlling a specific amount (generally 90%) of the outstanding stock to effect the merger without submitting it for shareholder approval. *See, e.g.*, Del. Code Ann. tit. 8, § 253 (1974). *See also* Green v. Santa Fe Industries, Inc., 533 F.2d 1283, 1299 n.1 (2nd Cir. 1976), *rev'd*, 430 U.S. 462 (1977), for a summary of statutory percentages of various states.

10 *See* text accompanying note 6 *supra*.

11 430 U.S. 462 (1977).

the availability of a federal remedy for squeezed-out minority shareholders. In *Green* the Supreme Court reversed a decision of the Court of Appeals for the Second Circuit[12] that had allowed an action under section 10(b) of the Securities Exchange Act of 1934 for a merger eliminating the minority interest under the Delaware short-form merger statute. Pursuant to the statutory merger procedure, Santa Fe Industries, which had previously acquired 95% control of the target company, obtained independent appraisals of the target's assets. The appraisals and other financial data were submitted to a reputable investment banking firm for a determination of a fair offer to the minority shareholders. Santa Fe Industries then notified the target's minority shareholders within the time allowed by the statute and offered to pay each of them an amount 20% higher than the independent appraisal. Santa Fe also advised the shareholders of their right to obtain a statutory appraisal if dissatisfied with the offered price. The minority shareholders, however, objected to the merger and alleged that it was undertaken solely to eliminate the minority and therefore lacked any justifiable business purpose.[13] The Second Circuit held that fraud was inherent in the freezing out of a minority interest in a going private transaction that lacked a valid corporate purpose. Thus, the minority shareholders did have a cause of action under Securities and Exchange Commission rule 10b-5.[14] The Supreme Court reversed, holding that a violation of section 10(b) of the 1934 Act or rule 10b-5 could not be sustained on a breach of fiduciary duty alone.[15] The Court held that the provisions of the 1934 Act prohibiting "manipulative or deceptive" conduct were terms of art and required either a material misrepresentation or a material failure to disclose.[16] The Court pointed out that the "fundamental purpose" of the 1934 Act is to achieve full disclosure, hence, "once full and fair disclosure has occurred, the fairness of the terms of the transaction is at most a tangential concern of the statute."[17] The Court left unanswered the question whether a merger transaction effected solely to eliminate the minority interest is in fact a breach of the majority's fiduciary duty. Resolution of that issue was unnecessary inasmuch as the Court held that the federal securities statutes were

12 Green v. Santa Fe Industries, Inc., 533 F.2d 1283 (2nd Cir. 1976), *rev'd,* 430 U.S. 462 (1977).

13 At trial the minority shareholders also alleged that the stock had been fraudulently appraised in an effort to freeze-out the minority stockholders at an inadequate price, in violation of § 10(b) of the Securities Exchange Act of 1934. The district court dismissed that claim concluding that if "full and fair disclosure" is made, transactions eliminating minority interests are beyond the purview of rule 10b-5, and since the complainants did not allege any nondisclosure or misrepresentation they could not sustain an action on the averred basis. That portion of the district court's holding was left undisturbed by the Second Circuit. *See* 430 U.S. at 462, 463.

14 533 F.2d at 1290.

15 The Court distinguished those decisions cited by the Second Circuit as standing for the proposition that the majority stockholders' breach of fiduciary duty alone constitutes a cause of action under SEC rule 10b-5. The Court stated that in each of the decisions cited for that proposition by the Second Circuit there were elements of deceptive conduct on behalf of the majority stockholders. 430 U.S. 475. *See, e.g.,* Schlick v. Penn-Dixie Cement Corp., 507 F.2d 374 (2nd Cir. 1974), *cert. denied,* 421 U.S. 976 (1975); Drachman v. Harvey, 453 F.2d 722 (2nd Cir. 1972); Pappas v. Moss, 393 F.2d 865 (3rd Cir. 1968); Schoenbaum v. Firstbrook, 405 F.2d 215 (2nd Cir. 1968), *cert. denied,* 395 U.S. 906 (1969).

16 430 U.S. at 476, 477.

17 *Id.* at 478.

not designed to "regulate transactions which constitute no more than internal corporate mismanagement."[18] Thus, without deciding whether the majority had breached their fiduciary obligation the Court held that the issue whether a cause of action exists for an alleged breach of fiduciary duty, without more, was to be relegated to state law.[19]

The Supreme Court's decision in *Green* renders unlikely any significant amount of future litigation under the 1934 Act by dissident minority shareholders squeezed out by a going private transaction. It will be extremely difficult for the minority shareholders to prove a material misrepresentation or nondisclosure in a going private transaction, as most acquiring groups in these transactions are careful to disclose their intent to acquire the entire equity interest of the target company.[20] The unfairness inherent in going private transactions generally is not due to a misrepresentation or failure to disclose; rather, it results from compelling a minority shareholder to liquidate his investment in a transaction designed solely to eliminate him from participation in the company's future growth. For that reason, these transactions are best analyzed under the law governing corporate fiduciaries. In light of the Court's decision in *Green,* which precludes a federal remedy for breaches of fiduciary duty in the absence of material non-disclosure or material misrepresentation, the burden will be upon the state courts to effect regulation of going private transactions.

IV. *Singer v. Magnavox*: A State Remedy for Squeezed-Out Minority Shareholders

Due to the refined body of corporate case law, companies that incorporate in Delaware are often able to predict accurately the legal effect of a certain course of action. In *Singer v. Magnavox Co.,* however, the Delaware Supreme Court blurred the law in a sensitive area and thus raised questions about the reliability of the old case law concerning mergers.

The *Singer* court held that a valid corporate purpose must exist in order to uphold an otherwise statutorily valid merger. More significantly, the court held further that even a merger with the requisite corporate purpose will be subject to judicial scrutiny to determine the "entire fairness" of the transaction. The Delaware court responded to the Supreme Court's admonition in *Green* that if going private transactions are to be regulated, the primary responsibility would fall to the states. An examination of the *Singer* decision, viewed in the context of prior Delaware case law, is therefore important to an analysis of the future of going private transactions. The influence of the Delaware court on the uncertain body of law surrounding going private transactions is likely to be formidable.

A. *Pre-*Singer *Remedy for Minority Shareholders in Delaware*

In *Singer,* the Delaware court was faced with the same obstacle that other state courts had confronted in responding to allegations of unfairness from share-

18 *Id.* at 479.
19 *Id.*
20 *See, e.g.,* 380 A.2d at 971.

holders squeezed-out in going private transactions: the apparent legislative approval of mergers designed to eliminate the minority. Section 251, the general merger statute of the General Corporation Law of Delaware, allows two Delaware corporations to merge pursuant to a majority vote of the shareholders entitled to vote.[21] The statute further provides that the minority shareholders of the merged company may be paid cash for their shares rather than stock in the surviving corporation.[22]

The statute does not require a legitimate corporate purpose to effect a valid merger. The sole statutory remedy available to a dissenting shareholder is his appraisal right—*i.e.*, the right to request the court to determine a fair value for his shares.[23] Implicit in the merger statute is the legislature's confidence in the fairness of the appraisal remedy. As a corollary, the statute negates any inference of a shareholder's vested right in the form (to be distinguished from the value) of his investment.

Similarly, section 253, the so-called "short form merger" statute, allows for the elimination of the minority by "cash-out."[24] The short form statute is available to corporations owning 90% or more of the outstanding stock of the target company, and allows them to accomplish the proposed merger without first submitting the question of merger for shareholder approval. A resolution of the board of directors is all that is necessary to effect the merger. As in section 251, the short form statute neither expressly requires a valid business purpose for the merger nor specifies a remedy other than the dissenters' appraisal right.

Prior to the decision in *Singer,* the Delaware courts were reluctant to inquire into the nature or existence of the business purpose underlying an otherwise valid merger.[25] The Delaware merger statutes were held to have "independent legal significance." Under this interpretation of the statute, an otherwise valid merger was not subject to collateral attack.[26] Thus, action that might otherwise be impermissible was apparently allowed if accomplished in accordance with the merger statutes. In *Federal United Corporation v. Havender,*[27] for example, accrued dividends owed on preferred stock were successfully eliminated by means of a merger. The use of a charter amendment, however, was held to be an im-

21 Del. Code Ann. tit. 8, § 251 (Cumm. Supp. 1977).

22 *Id.* The predecessor of section 251 did not allow shareholders of the target to be involuntarily excluded from an equity position in the surviving corporation. As originally enacted section 251 required that shareholders of the target company receive shares of stock in the surviving corporation.

23 Del. Code Ann. tit. 8, § 262 (Cumm. Supp. 1977).

24 Del. Code Ann. tit. 8, § 253 (Cumm. Supp. 1977).

25 *See, e.g.,* MacCrone v. American Capital Corporation, 51 F. Supp. 462 (D. Del. 1943); Bruce v. E.L. Bruce, 40 Del. Ch. 80, 174 A.2d 29 (Del. Ch. 1961) (reasons for merger or the business necessity behind the merger are not matters for judicial inquiry). *See also* Grimes v. Donaldson, Lufkin & Jenrette Inc., 392 F. Supp. 1393 (N.D.Fla. 1974) (applying Delaware law); E. Folk, The Delaware General Corporation Law 332 (1972) (the 1967 revision of the Delaware corporation statutes "in particular reflects the continuing legislative approval of mergers and the avoidance of their disruption by protesting stockholders"). *But see* note 39 *infra.*

26 *See* 51 F. Supp. 462; Orzeck v. Englehart, 41 Del. Ch. 361, 195 A.2d 375 (Del. Sup. Ct. 1963). *See also* text accompanying note 28 *infra.*

27 24 Del. Ch. 318, 11 A.2d 331 (Sup. Ct. 1940). In *Havender* the Delaware Supreme Court upheld a merger between a parent and an existing, but inactive, subsidiary for the purpose of eliminating accrued dividends on preferred stock.

permissible method of eliminating the same arrearages.[28]

Another presumed corollary to the merger law prior to the *Singer* decision was that the only remedy for a shareholder who objected to a statutorily valid merger was to be paid the fair value of his stock as determined in an appraisal proceeding.[29] In fact, the Delaware Supreme Court had held that "the very purpose of the [short form merger] statute is to provide the parent corporation with a means of eliminating the minority shareholders' interest in the enterprise."[30] That holding clearly negated any inference that a shareholder had a vested right in the form of his investment.

In *Singer,* the Delaware Supreme Court removed the underpinnings of each of these pillars in Delaware corporate law.

B. *The* Singer *Decision*

The litigation in *Singer* centered on a merger in July, 1975, of the Magnavox Company (Magnavox) with T.M.C. Development Corporation (T.M.C.), a wholly-owned subsidiary of North American Philips Corporation (North American). Apparently, T.M.C.'s sole function was to assist North American in the acquisition of Magnavox. In August, 1974, T.M.C. made a tender offer of $8.00 per share for the Magnavox common shares. The tender offer included a statement informing Magnavox shareholders of T.M.C.'s intention to acquire the entire equity interest of Magnavox and advised them of the possible effects of this action, including (1) delisting of present or future Magnavox shares by the New York Stock Exchange, (2) creation of an unfavorable market for the shares, (3) loss of information rights granted under rules of the Exchange and under the federal securities law, and (4) depending on the number of shares acquired, employment of some "mop up" device such as a merger to acquire the remaining shares.

The directors of Magnavox opposed the offer, arguing that the offer of $8.00 per share was grossly inadequate since the book value was in excess of $11.00. The directors voiced their disapproval of the proposed merger in a letter to their shareholders in August, 1974.

28 Keller v. Wilson & Co., 21 Del. Ch. 391, 190 A. 115 (Sup. Ct. 1936) (an elimination of accrued dividends could not be accomplished by a charter amendment).

29 392 F. Supp. at 1403; Stauffer v. Standard Brands Incorporated, 40 Del. Ch. 202, 178 A.2d 311 (Del. Ch. 1962), *aff'd,* 41 Del. Ch. 7, 187 A.2d 78 (Sup. Ct. 1962); Coyne v. Park & Tilford Distillers Corporation, 37 Del. Ch. 558, 146 A.2d 785, (Del. Ch. 1958), *aff'd,* 38 Del. Ch. 514, 154 A.2d 893 (Sup. Ct. 1959). *See also* 430 U.S. at 474 n.14 (under Delaware law an appraisal is the sole remedy for any alleged unfairness in the terms of a merger).

30 187 A.2d at 80. The *Stauffer* decision concerned a section 253 short form merger. At the time the *Stauffer* decision a section 251 long form merger did not provide for compensating shareholders of a target corporation with cash. The *Stauffer* court noted that since section 251 did not allow a "cash-out", a means of eliminating the minority shareholders could not be held to be the purpose of the long form merger statute. Section 251 has since been amended (1967) and allows for the "cash-out" of the target's shareholders. (*See* text accompanying note 23 *supra.*) In that sections 251 and 253 are now substantively the same it can be presumed that the legislature has approved cash mergers accomplished under section 251 for the very purpose of freezing-out the minority. *See* David J. Green & Co. v. Schenley Industries, Inc., 281 A.2d 30 (Del. Ch. 1971) (rights of minority shareholders under a section 251 merger are no greater than those under a section 253 merger); Balotti, *The Elimination of the Minority Interests by Mergers Pursuant to Section 251 of the General Corporation Law of Delaware,* 1 DEL. J. OF CORP. LAW 63, 77 (1976).

In September, 1974, the corporate management of Magnavox and North American compromised their differences over the terms of the offer and agreed to a price of $9.00 per share. The compromise included two-year employment contracts for sixteen officers of Magnavox at existing salary levels. The directors of Magnavox withdrew their opposition to the offer, whereupon T.M.C. acquired approximately 84% of Magnavox's outstanding common stock. Thereafter, in July, 1975, the directors of Magnavox unanimously agreed to a proposed section 251 "long form" merger with T.M.C.[31] In accordance with that statute, the shareholders were given notice of a special meeting to vote on the plan and were told that approval of the merger was assured since T.M.C.'s holding alone was large enough to provide the requisite statutory majority.[32] The merger was accomplished, all outstanding common stock of Magnavox was exchanged for cash, and Magnavox became part of a wholly-owned subsidiary of North American.

The minority shareholders filed a complaint in the Court of Chancery alleging that: (1) the merger was fraudulent because it did not serve any business purpose other than the forced removal of public minority shareholders from an equity position in Magnavox at a grossly inadequate price in order to enable North American, through T.M.C., to obtain sole ownership of Magnavox, and (2) T.M.C., as the majority shareholder, had breached its fiduciary duty to the minority shareholders by approving the merger at a cash price per share to the minority which it knew to be grossly inadequate.

The Chancery Court granted a motion to dismiss,[33] ruling that: (1) the merger was not fraudulent merely because it was accomplished without any business purpose other than to eliminate the Magnavox minority shareholders, and (2) in any event, plaintiff's remedy for dissatisfaction with the merger was to seek an appraisal. The court admitted the inequity of the transaction and stated: "[P]erhaps a use of the Delaware statutes should not be permitted which would allow those with controlling interests who originally sought public participation to later kick out public investors for the sole reason that they have outlived their utility to those in control. . . ."[34] Nonetheless, the court held that the mechanically flawless tender offer and merger transaction were, under the present status of the law, entirely permissible even though the sole purpose of the actions was to eliminate the minority shareholders.

In reversing, the Delaware Supreme Court's principal consideration was the obligation owed by majority shareholders in control of the corporate process to minority shareholders in a merger under section 251. The court first denied that the merger statutes had independent legal significance, holding that even complete compliance with the statute did not insulate the merger from judicial

31 Four of the nine Magnavox directors were also directors of North American, and three others had employment contracts (referred to above) with the surviving corporation and an option to purchase five thousand of North American's common shares, effective on the date of the merger.

32 The proxy statement accompanying the notice informed the Magnavox shareholders that the book value of their stock was $10.16. The proxy statement also alerted the Magnavox shareholders of their right to an appraisal under section 262.

33 Singer v. Magnavox Company, 367 A.2d 1349 (Del. Ch. 1976).

34 Id. at 1358.

review. Citing its decision in *Guth v. Loft, Inc.*,[35] the court stated that the issue was not to be decided solely upon technical grounds, but rather upon broad considerations of corporate duty and loyalty. The court then focused its analysis on the restraint that the duty to minority shareholders placed on a corporation's statutory right to effect a merger. The *Singer* court quoted from its opinion in *Sterling v. Mayflower Hotel Corp.*,[36] which stated that the dominant corporation, as a majority shareholder standing on both sides of a merger transaction, has "the burden of establishing its entire fairness" to the minority stockholders in order to "pass the test of careful scrutiny by the courts."[37] As support for this proposition the court cited its prior decisions holding that controlling shareholders owe their corporation and its minority shareholders a fiduciary obligation of good faith and fairness.

The essence of the *Singer* decision, however, is not that the majority owes the minority a fiduciary duty. Rather, of concern to the corporate community after the *Singer* decision is that conformity with the merger statute will no longer assure that the majority shareholder's fiduciary duty is fulfilled. In analyzing the fiduciary standard, the court indicated that a corporate purpose, or lack thereof, is relevant to a determination of good faith.[38] Further, the court intimated that the fairness of the transaction is tied to the shareholder's vested right in the form of his investment. Either of these propositions indicates a departure from prior decisions interpreting Delaware law.

C. *The Necessity of a Valid Corporate Purpose and the Role of the Appraisal Remedy*

The *Singer* court avoided direct confrontation with the definitional question of what constitutes a valid corporate purpose. Instead, it merely alluded to two recent unpublished opinions of the Delaware Chancery Court that suggested the necessity of showing such a purpose to sustain the validity of a section 251 merger.[39] Thus, without addressing the definitional difficulties of the "corporate

35 23 Del. Ch. 255, 5 A.2d 503, 511 (Sup. Ct. 1939).
36 33 Del. Ch. 293, 93 A.2d 107 (Sup. Ct. 1952).
37 380 A.2d at 976.
38 *See* text accompanying note 40 *infra*.
39 Tanzer v. International General Industries, Inc., Del. Ch. C.A. 4945 (December 23, 1975), *reprinted in* 1 DEL. J. CORP. L. 444 (1976), *aff'd*, 379 A.2d 1121 (1977), an unpublished opinion of the Delaware Chancery Court, intimated the necessity of a valid corporate purpose in a section 251 merger. In *Tanzer* the court stated:

> The question presented is whether the merger should be enjoined because the purpose is to serve the interest of the parent. It should be noted in this regard that [the parent] has a legitimate and present and compelling business reason to be the sole owner of [the subsidiary-target]. [The parent] is not freezing out the minority just for the purpose of freezing out the minority.

1 DEL. J. CORP. L. 444, 445. The *Tanzer* court allowed the merger to be carried out noting that the merger was necessary to facilitate the long-term debt financing of the parent. The *Tanzer* decision was affirmed by the Delaware Supreme Court after its decision in *Singer*. *See* text accompanying note 50 *infra*.

In Pennsylvania Mutual Fund, Inc. v. Todhunter International, Inc., Del. Ch. C.A. 4845 (August 5, 1975) *reprinted in* 1 DEL. J. CORP. L. 229 (1976), an unpublished opinion of the Delaware Chancery Court, an order was granted temporarily restraining the accomplishment of a merger which the plaintiff alleged constituted an unlawful freeze-out of its interest as a stockholder. The Chancellor stated:

> I have some doubt as to whether or not the merger under attack has a valid busi-

purpose" requirement, the *Singer* court held that whatever the proper criteria might be for determining the validity of a corporate purpose, at the least the sole purpose must not be a "freeze-out" of the minority shareholders. The *Singer* court agreed with the Chancery Court that an act so motivated would not be fraudulent because it was accomplished without any purpose other than elimination of the minority stockholders, rather such an act would violate the fiduciary duty owed by the majority to the minority shareholders.[40]

To the extent that the *Singer* decision mandates inquiry into the business purpose of a merger, it creates new Delaware law. Previous Delaware decisions had held that "the reasons for a merger or the business necessity behind it are not matters for judicial determination."[41] Further, the policy of the Delaware courts was to permit corporations to take advantage of statutory devices for corporate consolidation and mergers in the absence of a showing of fraud or gross unfairness as to the terms of the transaction.[42] Judicial interference was considered inappropriate in most instances of merger because an efficient and fair method was provided through the appraisal remedy to protect those shareholders dissatisfied with the terms of the offer.[43] The *Singer* decision, however, overrules such precedent and mandates an inquiry into the corporate purpose underlying such mergers.

A necessary corollary to the *Singer* decision is that the shareholder's right in his investment is not limited to its value, but also extends to its form. Hence, a shareholder can neither be forced to accept cash for his investment nor be compelled to exercise his appraisal right. Relating the minority shareholders' rights to the majority's fiduciary duty, the *Singer* court held: "In our view, defendants cannot meet their fiduciary obligations to the plaintiffs simply by relegating them to a statutory appraisal proceeding."[44] The court thus departed

> ness purpose . . . there is some possibility on further argument and development of the case of a showing of illegality of this plan by reason of its being a possible manipulation of corporate control for private purposes with no proper business purpose in mind.

1 DEL. J. CORP. L. 229, 230.

The Chancery Court in *Singer* rejected the *Todhunter* decision as requiring an inquiry into the purpose of a merger, stating that three factors mitigated against relying on the decision for that proposition:

> First, the matter arose upon the eve of a stockholder's meeting and the exigencies of the situation prevented an in-depth examination of the problem by the court and counsel alike. I think the Chancellor's language fairly indicates that there were other matters to consider. This never occurred because the case was apparently resolved by the parties without further participation by the court. No doubt this had something to do with the fact that the decision was not reported.

367 A.2d at 1357.

Perhaps the best explanation of the *Tanzer* and *Todhunter* decisions is that they merely raised the question whether an inquiry into the purpose of a merger was justified. *See* Balotti, *supra* note 31, at 77. The "valid business purpose" issue was treated as one of first impression by the Delaware Supreme Court in *Singer*. 380 A.2d at 976.

40 380 A.2d at 980.

41 *See* text accompanying note 26 *supra*.

42 *See* 174 A.2d at 30 (citations).

43 *Id. See also* 367 A.2d at 1355.

44 380 A.2d at 977. With that statement, the *Singer* court was essentially distinguishing between the right to take and the power to take. The court cited an unpublished decision of the California Superior Court for the minorities' non-monetary interest in its investments. Jutkowitz v. Bourns, C.A. 000268 (Cal. Super. Ct. Nov. 19, 1975). The *Jutkowitz* decision indicated that although money might satisfy some shareholders, others may have different investment goals, tax problems, and a belief in the ability of management to make them rich.

from the tone of previous Delaware decisions that had indicated the exclusiveness of the appraisal right as a remedy to a shareholder dissatisfied with an otherwise statutorily valid merger.[45]

In *Stauffer v. Standard Brands Incorporated,*[46] the Delaware Supreme Court approved of the Chancery Court's statement that "[i]f a stockholder is dissatisfied with the value placed upon his shares he may, failing an agreement upon value, proceed to an appraisal. The dissenting stockholder is thus provided with an adequate and complete remedy. That it is also . . . an exclusive remedy is evident. . . ."[47] The *Stauffer* decision illustrates the apparent perception of the Delaware courts, prior to *Singer,* of the appraisal right as the sole vehicle for determining fair compensation to shareholders removed from equity participation in a statutorily valid merger. The right to be paid the fair value of his shares in such transactions was thought to be the only right the shareholder had in his investment. The merger statutes, which provide shareholder compensation with cash rather than securities of the surviving corporation, further foster this perception. The *Singer* court, however, apparently viewed the appraisal remedy as exclusive only when the merger transaction is "entirely fair," notwithstanding complete statutory compliance. Although the standard to be used for determining the "entire fairness" of the transaction was not defined, the *Singer* court held, in part, that even if a court finds the requisite corporate purpose, the fiduciary obligation is not necessarily discharged.[48] Every aspect of the transaction is to be scrutinized for its "entire fairness" to the eliminated shareholders.[49]

V. *Tanzer v. International General Industries, Inc.*: The Delaware Supreme Court Mollifies the Effect of the Singer Decision?

The *Singer* court did not define the nature of the corporate purpose necessary to sustain an inquiry into the validity of a merger which results in the elimination of the minority interests. The Delaware court's subsequent decision in *Tanzer v. International General Industries, Inc.*[50] necessitated a decision on that issue. In *Tanzer,* the squeezed-out minority shareholders alleged that the

In recognizing this expanded perception of a shareholder's right in his investment the *Singer* court struck a balance between the prior common law right of a single minority shareholder to veto a merger and the present statutory power of the majority under section 251. The compromise thus struck neither allows the minority to thwart a merger without cause, nor permits the majority to cash out the minority without a valid corporate purpose. *See also* Vorenburg, *Exclusiveness of the Dissenting Stockholder's Appraisal Right,* 77 HARV. L. REV. 1189 (1964).

45 *See* note 30 *supra.*
46 187 A.2d 78 (1962).
47 178 A.2d at 314.
48 380 A.2d at 980.
49 *Id.* The *Singer* court leaves open the possibility that proof of a proper business purpose might insulate the merger from scrutiny under the stricter "entire fairness" standard. The court simply stated that proof of such purpose, without more, will not necessarily discharge the fiduciary obligation of the majority. In requiring that the sole purpose of the merger be found not to be the elimination of the minority, rather than stating its holding in terms of an affirmative obligation upon the majority to show valid business purpose, the *Singer* court effectively leaves the burden of persuasion on the eliminated minority shareholders to show the lack of a valid business purpose.
50 379 A.2d 1121 (1977), *rev'g,* No. 4945 (Del. Ch., Dec. 23, 1975), *reprinted in* 1 DEL. J. CORP. L. 444 (1976).

majority shareholders had violated their fiduciary obligation because the sole purpose of the merger was to serve the interest of the parent. The *Tanzer* controversy involved the merger of a subsidiary into its parent and the subsequent elimination of the minority interests, facilitating the parent's long-term debt financing. Without discussing the adequacy of that particular purpose, the court emphasized the trial court's finding that the *sole* purpose of the merger was *not* the elimination of the minority interests. By comparison, the trial court's finding in *Singer* was that the *sole* purpose of the transaction was the elimination of the minority interests.[51] In rejecting the minorities' contention that the majority shareholders had breached their fiduciary obligation, the *Tanzer* court held that a merger made primarily to advance the business purpose of the majority stockholder is *not* a violation of the fiduciary relationship espoused in *Singer*.[52] The *Tanzer* decision thus ends the uncertainty created by the *Singer* decision whether it is the target corporation or the acquiring corporation that must benefit from the alleged corporate purpose supporting the merger. Although the *Tanzer* court allows the corporate purpose to benefit the acquiring corporation alone, its holding is not inconsistent with the implicit rationale supporting the *Singer* court's decision. That rationale is apparently the same rationale underlying the original merger statutes, *i.e.*, it is economically beneficial to promote combinations of corporations if such combinations are financially beneficial to the resulting entity and the business community as a whole.

Hence, when a benefit to either corporation is alleged in support of the combination, such a merger, if otherwise fair, should not be enjoined. Only where the *sole* purpose is an elimination of the minority interests will the transaction be held violative.

Still unsupplied by the Delaware court are the criteria for determining the legitimacy of an additionally averred purpose, *i.e.*, the purpose alleged to avoid the conclusion that the *sole* purpose is to eliminate the minority. It would be consistent with the implied rationale of the *Singer* and *Tanzer* decisions for a relatively liberal view of an alleged corporate purpose to be adopted by the Delaware court. Since the corporate purpose test is to establish the good faith component of the fiduciary obligation, any plausible business purpose beyond the majority's desire to enlarge their own stockholdings should sustain judicial scrutiny. A factor that is likely to be considered in the determination of business purpose is the structure of the constituent companies prior to the transaction. It would appear less difficult for corporations in an operating parent-operating subsidiary relationship to legitimize a purpose for taking the subsidiary private

51 380 A.2d at 972.

52 379 A.2d at 1124. The *Tanzer* court found the "business purpose" test ambiguous and thus focused instead upon the rights and powers of the majority not only as a director but as a stockholder. The court cited other decisions in which it held that the majority stockholder has a fundamental right to vote its shares in its own interest. *E.g.*, Ringling Bros.-Barnum & Bailey Com. Shows v. Ringling, 53 A.2d 441 (Del. 1947). The *Tanzer* court then held that the majority may exercise its right to vote its shares in its own interest while fulfilling its fiduciary obligation as a majority shareholder and director if its purpose in causing the merger was *bona fide*. *See* 379 A.2d at 1124. The purpose must not be suspect as a subterfuge, the real purpose of the merger being to rid the majority of unwanted minority shareholders in the subsidiary. *Id.* And, in any event, a *bona fide* purpose notwithstanding, the majority must be prepared to show that it has met its duty of "entire fairness" imposed by *Singer*. *Id.*

as there are many economies to be achieved in the combination of parent and subsidiary, particularly where both corporations are in the same or related business. Less certain to withstand an inquiry into legitimacy of corporate purpose is a transaction involving two previously unrelated corporations. Typically, as in *Singer,* the previously unrelated acquiring corporation will follow a tender offer with a squeeze-out merger to acquire the entire control of the corporate enterprise. In those situations, the length of time that the parent holds a controlling majority of the subsidiary before eliminating the minority may be a factor. A longer holding period, although not necessary to find a valid corporate purpose, might negate any inference that the acquiring corporation's sole objective for merging was to eliminate the minority shareholders. Any indicia implying a purpose other than a mere desire to consolidate control among the majority will be an aid to the acquiring company. In any event, those benefits inherent in eliminating the minority, such as the savings of cost in servicing shareholders, should not alone be a sufficient purpose to legitimize the transaction.

VI. Conclusion

All the implications of the *Singer* decision are not entirely clear.[53] In any event, the decision contributes significantly to the law governing going private transactions. The essence of the *Singer* decision is the Delaware Supreme Court's view that the fiduciary obligation of the majority shareholders in a going private transaction involves two implied components. The first component is good faith, determined with a view toward the existence and nature of a corporate purpose. The second is fairness. Although the court left the latter component rather ill-defined, it intimated that every aspect of the transaction will be scrutinized for its entire fairness to the eliminated shareholders. Such an inquiry into the fairness extends beyond the adequacy of the appraisal remedy.[54]

The Delaware court's bifurcated approach to the fiduciary duty concept provides a workable framework for analysis of transactions designed to eliminate a minority interest. Courts adopting the Delaware approach will, in addition to

53 Shortly after the *Singer* decision the Delaware Supreme Court applied the "entire fairness" standard of *Singer* in a tender offer case. Lynch v. Vickers Energy Corp., 383 A.2d 278 (Del. 1978). Together, the *Singer, Tanzer,* and *Vickers* decisions demonstrate the Delaware court's response to the increasing pressure in recent years for a federal fiduciary standard. Delaware would undoubtedly like to prevent federal standards for corporate conduct which could be imposed through either federal chartering of corporations or through added federal securities regulations. *See* SEC, *Going Private Transactions by Public Companies of Their Auxiliaries,* 42 FED. REG. 60,090, 60,092 n.24 (1977) (to be codified in 17 CFR, Part 290).

54 One commentator has suggested that one condition of "entire fairness" will be whether the dominant shareholder is using its own funds for the acquisition of total control or whether it is using its control of the corporation to obtain funds to finance the acquisition. Herrmann, *Changes in the Merger Provisions of the Delaware General Corporation Law Since 1967,* 3 DEL. J. CORP. L. 307, 311 (1978). There are Delaware decisions which might support this proposition. *See, e.g.,* Bennet v. Propp, 41 Del. Ch. 14, 187 A.2d 405 (Sup. Ct. 1962); Petty v. Penntech Papers, Inc., 347 A.2d 140 (Del. Ch. 1975). *But cf.* Cheff v. Mathes, 41 Del. Ch. 494, 199 A.2d 548 (Sup. Ct. 1964) (use of corporate funds to purchase treasury stock to resist takeover by outsiders held proper because motivated by business judgment that the outsiders would mismanage the corporation, and not motivated solely by desire to perpetuate existing management).

requiring statutory compliance, view such transactions with two questions in mind:

(1) Is there a legitimate corporate purpose in effecting the transaction, other than a desire to accrue the inherent benefits of concentrating ownership among the majority shareholders?[55]
(2) Is every aspect of the transaction "entirely fair" to the eliminated minority shareholders?

A negative response to either of these questions is a breach of the majority's fiduciary duty to the minority.

Undoubtedly some courts will conclude that *Singer* provides for an unwarranted judicial intrusion into corporate management. Nevertheless, the ostensible result of the *Singer* decision is to bring the law governing corporate mergers nearly full-circle. The old common law requirement of unanimity did not allow corporate mergers without the approval of every shareholder. Statutory modifications subsequently allowed such transactions with a simple majority approval. The *Singer* decision mitigates the effect of those statutory modifications by subjecting every statutorily valid merger to judicial scrutiny as to its good faith and fairness to all shareholders.

The *Singer* decision presents obstacles to those corporations going private. Those obstacles will make it costly and difficult to effect the desired result in many situations. Not only must the corporations have sound business reasons for future "freeze-outs," but they must also insure that every aspect of the transaction is fair to the eliminated minority.

Finally, *Singer* raises the question whether the Delaware Supreme Court has veered off on a reformist course. Perhaps the court was responding to recent criticism of Delaware corporate law,[56] or reacting to increasing pressure for some form of federal intervention into corporate matters.[57] In any event, it is doubtful that the court will jeopardize the prominence of Delaware in the corporate community by stricter inquiry into traditional management prerogatives. If the court continues on the path of such strict inquiry, the Delaware legislature may reverse the *Singer* decision. As one commentator has stated: "There is much to be said for painless tax revenues, and something to be said too for a grand old tradition that has made the Delaware corporation as familiar a phrase in the American lexicon as the Manhattan skyscraper and the Philadelphia lawyer."[58]

—*James P. Kelley*

55 The *Tanzer* decision allows this purpose to be solely that of the acquiring corporation. *See* text accompanying note 52 *supra*.
56 *See* Cary, *A Proposed Federal Corporate Minimum Standards Act*, 29 Bus. Law. 1101 (1974).
57 *See* note 53 *supra*.
58 Smith, *Delaware Works Hard to Stay a Corporate Home Sweet Home*, Fortune, Feb. 13, 1978, at 134.

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