Annual Survey of Massachusetts Law

Volume 1985 Article 6

1-1-1985

Chapter 2: Corporations

William E. Martin

David M. Rievman

Dorothy Whelan

CHAPTER 2

Corporations

SURVEY *Staff*†

§ 2.1. Using Reverse Stock Splits to Eliminate Minority Shareholders.* Since the mid-1970's, many publicly held companies have eliminated public ownership of the company's stock and have continued to conduct business as closely held companies.[1] This process, known as "going private,"[2] is a particular type of "squeeze out" of minority shareholders.[3] Public companies go private for several reasons.[4] The most significant reason of which is to eliminate the cost of compliance with the Securities

---

† William E. Martin, David M. Rievman, Dorothy Whelan.

* William E. Martin, staff member, ANNUAL SURVEY OF MASSACHUSETTS LAW.

§ 2.1. [1] *See generally* Mayerson & Crawford, *Fairness to Minority Shareholders in "Going Private" Transactions: A Growing Concern*, 67 ILL. B.J. 484, 484 (1979); Note, *Going Private: An Analysis of Federal and State Remedies*, 44 FORDHAM L. REV. 796, 796 (1976) [hereinafter Note, *Federal and State Remedies*].

[2] Note, *Going Private*, 84 YALE L.J. 903, 903 (1975).

[3] F. H. O'NEAL & R. THOMPSON, O'NEAL'S OPPRESSION OF MINORITY SHAREHOLDERS § 5:27 (2d ed.). Other types of minority squeeze outs are: (1) squeeze outs in a closely held company; (2) squeeze outs that are a part of a two-step acquisition involving two previously unrelated companies; and (3) a parent corporation's acquisition of minority interests in a long term subsidiary. *Id.*

Commentators distinguish "going private" transactions from other types of minority squeeze outs. *See, e.g.*, Brudney & Chirlstein, *A Restatement of Corporate Freezeouts*, 87 YALE L.J. 1354, 1367 (1978)(the fiduciary principle suggests that "going private" transactions should in all cases be prohibited). The Securities and Exchange Commission also distinguishes "going private" transactions from other squeeze out transactions and has adopted Rule 13e-3 to regulate companies which are going private. 17 C.F.R. § 240.13e-3 (1985). Rule 13e-3 requires a company to disclose information about the transaction and also includes an anti-fraud provision. *Id.* For a discussion of possible relief for minority shareholders under federal securities law see, F. H. O'NEAL & R. THOMPSON, *supra* note 3, at § 5:36.

[4] Mayerson & Crawford, *supra* note 1, at 484.

> By going private a parent company may obtain full control over a subsidiary at a time when the subsidiary's stock is depressed. A corporation may avoid a takeover. Corporate procedures may be simplified. Conflicts of interests between subsidiaries or problems with uncooperative minority shareholders may be eliminated . . . . [T]he majority shareholders may [also] wish to rid the corporation of the expense and formalities of continued public status.
>
> Such transactions may also benefit the minority shareholders who may be given a market for what otherwise would be an illiquid stock.

Id.

and Exchange Act of 1934.[5] By reducing the number of shareholders to below 300, the company's SEC registration under section 12 terminates, and the company no longer need file several reports.[6]

Publicly held companies sometimes use a "reverse stock split" to go private.[7] In a reverse stock split the shareholders amend the company's articles of organization to dramatically reduce the number of authorized and outstanding shares, leaving minority shareholders with only fractional shares.[8] In lieu of issuing fractional shares, the company pays the minority shareholders cash for their fractional shares, and thus effectively eliminates the minority shareholders.[9]

Only two courts have addressed whether state business corporation statutes permit companies to use a reverse stock split to eliminate public ownership. In *Teschner v. Chicago Title & Trust Co.*,[10] the Illinois Supreme Court upheld a corporation's use of a reverse stock split to eliminate a minority shareholder's interest in the defendant corporation.[11] In

---

[5] Dykstra, *The Reverse Stock Split — That Other Means of Going Private*, 53 CHI. [-] KENT L. REV. 1, 2 (1976).

[6] 15 U.S.C. §§ 78(l)(g)(4), 78(o)(d) (1982). *See* Dykstra, *supra* note 5, at 2 & n.5; Note, *Federal and State Remedies, supra* note 1, at 797. By going private, companies can eliminate $75,000 to $200,000 of annual expenses related to compliance with the federal securities laws. *Id.* at 797 n.9.

[7] Dykstra, *supra* note 5, at 2–3. Companies use other tactics to go private more frequently than a reverse stock split. *Id.* In order of probable frequency of use, the methods available to return a public company to private status are:

> (1) A cash tender offer by the issuer, its management, or an affiliated entity; (2) a merger or consolidation of the issuer with, or the sale of its assets to, another corporation controlled by management of the issuer; (3) an exchange offer (almost always involving a debt security) by the issuer, its management or an affiliated entity; and (4) a reverse stock split.

Id.

[8] *Id.* at 3.

> As an illustration [of a reverse stock split], let us assume that a corporation's [articles of organization] authorize[s] the issuance of 1,000,000 shares of common stock, with a par value of $.01 per share, all of which are currently outstanding. Further assume that these shares are held by 750 shareholders, of whom only 15 hold 1000 shares or more. The corporation then amends its [articles of organization] so as to authorize the issuance of only 1000 shares of common stock, with a par value of $10.00 per share. As a result, each share existing before the amendment is reclassified into 1/1000 of a share following the amendment; every shareholder who held fewer than 1000 old shares now will have less than one full share, or a fractional share. Finally, in lieu of issuing fractional shares to these holders, the corporation, as it is permitted to do under most state statutes, pays them cash for their fractional holdings. The result of the amendment, then, is a reduction of the number of the corporation's shareholders from 750 to 15 — it has gone private.

Id. at 3–4.

[9] *Id.*

[10] 59 Ill. 2d 452, 322 N.E.2d 54 (1974), *appeal dismissed*, 422 U.S. 1002 (1975).

[11] *Id.* at 457, 322 N.E.2d at 57. *Teschner*, however, did not involve a "going private"

Clark v. Pattern Analysis and Recognition Corp.,[12] a New York trial court granted a preliminary injunction prohibiting a corporation from issuing a reverse stock split which would have returned the corporation to private status.[13] The New York court held that a majority shareholder must establish a "strong and compelling legitimate business purpose" in order to eliminate minority shareholders by using a reverse stock split.[14] Thus, in New York, while reverse stock splits are not per se invalid, the burden of proof is on the corporation to show a legitimate business purpose for using a reverse stock split.[15]

During the *Survey* year, the Supreme Judicial Court, in *Leader v. Hycor, Inc.*,[16] addressed two issues regarding a reverse stock split. First, the Supreme Judicial Court considered whether a publicly held company, for the purpose of going private, may use a reverse stock split to eliminate minority shareholders.[17] The Court held that a company may use a reverse stock split to go private.[18] The plan at issue in *Leader*, according to the Court, complied with the relevant provisions of the Massachusetts Corporation Law, and, furthermore, approval of the plan by the majority

---

transaction because the majority shareholders had already acquired the shares of all but 95 minority shareholders through an exchange offer. *Id.* at 454, 322 N.E.2d at 55. In *Teschner*, the majority shareholder, Lincoln National Corporation, eventually acquired 99.9% of the outstanding shares of Chicago Title & Trust Co. through an exchange offer and cash purchases of minority shareholders' stock. *Id.* In order to "reduce corporate expenses and simplify and facilitate procedures," the majority used a reverse stock split to eliminate the .01% shareholder. *Id.* at 459, 322 N.E.2d at 58. The plaintiff, Mrs. Teschner, challenged the stock split as a violation of her constitutional right to due process and equal protection of the laws, as well as an unconstitutional impairment of her contractual rights. *Id.* at 458, 322 N.E.2d at 57. The *Teschner* Court dismissed these arguments, noting that the statutes which authorize the making of corporate changes by majority vote have been upheld in many cases. *Id.* at 456–57, 322 N.E.2d at 56–57.

The *Teschner* Court, however, limited its holding to the immediate facts. *Id.* at 457, 322 N.E.2d at 57. The Court stated, "[w]e do not say that under all circumstances minority shareholders will be denied relief when the majority has proceeded under the provisions of the [Illinois Business Corporations Act] . . . ." *Id.* One commentator, who was a member of the law firm representing the defendants in the *Teschner* case, has suggested that Mrs. Teschner would have had a better chance of prevailing if she had alleged that there was no valid business purpose for the reverse stock split or that the price paid for her shares was unfairly low. Dykstra, *supra* note 5, at 19.

[12] 87 Misc. 2d 385, 384 N.Y.S.2d, 660 (1976).

[13] *Id.* at 391, 384 N.Y.S.2d at 665.

[14] *Id.*

[15] *Id.* The *Clark* court distinguished *Teschner* by noting that the plaintiff in *Teschner* did not allege wrongdoing in her complaint and the Illinois Supreme Court did not discover any evidence of an improper purpose in the company's use of the reverse stock split. *Id.* at 389, 384 N.Y.S.2d at 664.

[16] 395 Mass. 215, 479 N.E.2d 173 (1985).

[17] *Id.* at 219–23, 479 N.E.2d at 176–78.

[18] *Id.* at 221, 479 N.E.2d at 177.

shareholders did not constitute a breach of their fiduciary duty to the plaintiff shareholders.[19] Second, the Supreme Judicial Court considered the fairness of the redemption price.[20] On the record before it, the Court could not determine, however, whether the five dollar per share redemption price was fair and reasonable.[21] Accordingly, the Court remanded the case so that the superior court judge could give a more detailed account of the facts on which he based his conclusion that the redemption price was fair and reasonable.[22]

The corporate defendant in *Leader*, Hycor, Inc. ("Hycor") was a Massachusetts corporation organized in 1967 by the five individual defendants who, along with their families, owned the majority shares of Hycor stock.[23] The defendant shareholders also were employed by Hycor and each was a member of its board of directors.[24] Immediately prior to the recapitalization plan at issue in *Leader*, these shareholders owned 81% of the outstanding Hycor stock.[25] Three hundred thirty-one individuals owned the remaining shares of Hycor stock.[26]

On February 4, 1980, the individual defendants, acting as Hycor's Board of Directors, mailed a notice of a special shareholders' meeting scheduled for February 13, 1980, for the purpose of voting on a recapitalization plan.[27] The notice described the terms of the proposal and

---

[19] *Id.* at 219–23, 479 N.E.2d at 176–78. Relying on Clark v. Pattern Analysis and Recognition Corp., 87 Misc. 2d 385, 384 N.Y.S.2d 660 (1976), the Supreme Judicial Court noted that "[d]espite apparent compliance with statutory requirements, a transaction such as the one at issue is still subject to judicial scrutiny [when there is a claim of a breach of fiduciary duty and unfairness]." *Leader*, 395 Mass. at 221, 479 N.E.2d at 177.

[20] *Id.* at 223–24, 479 N.E.2d at 178–79.

[21] *Id.* at 224, 479 N.E.2d at 178.

[22] *Id.*

[23] *Id.* at 216–17, 479 N.E.2d at 174.

[24] *Id.* at 216, 479 N.E.2d at 174.

[25] *Id.* at 218, 479 N.E.2d at 175.

[26] *Id.* The minority shareholders had acquired their interests in Hycor in 1969 when the company conducted a public offering of its stock in order to raise capital. *Id.* at 216–17, 479 N.E.2d at 174. Hycor offered 75,000 shares of common stock at four dollars per share. *Id.* at 216–17, 479 N.E.2d at 174. None of the 331 minority shareholders purchased more than 4000 shares of Hycor stock. *Id.* at 218, 479 N.E.2d at 175. Immediately following the public offering, the defendant shareholders owned 440,000 shares which equaled 85% of the outstanding Hycor stock. *Id.* at 217, 479 N.E.2d at 174. The shares owned by the defendants were not registered under the Securities Act of 1933 and, therefore, sale of this stock was prohibited and a notation to that effect appeared on the stock certificates. *Id.*

The Superior Court granted the plaintiff's motion under Massachusetts Rule of Civil Procedure 23 to have the suit certified as a class action as to the plaintiffs' claims of breach of fiduciary duty and fraud. *Id.* at 218–19, 479 N.E.2d at 175. The Superior Court Judge noted, however, that only those shareholders who had not voted in favor of the recapitalization plan would be proper plaintiffs in the action. *Id.* at 219, 479 N.E.2d at 175.

[27] *Id.* at 217, 479 N.E.2d at 174.

included a letter from defendant Hyram, as president of the company, stating the reasons for the proposal.[28] According to Hyram's letter, the board of directors wanted to recapitalize the company because of "the somewhat disappointing market history of the stock" and because, in the Board's view, past dividends did not represent a significant return on the shareholders' investment.[29]

Under the proposed plan, shareholders would amend the articles of organization to reduce the authorized common stock from two million shares with a par value of one cent to five hundred shares with a par value of forty dollars.[30] Also, under the plan, Hycor would not issue fractional shares.[31] Instead, the company would pay five dollars for each "old" share of stock.[32] At the February shareholders' meeting the minority shareholders voted against both the reverse stock split and the offer to redeem fractional shares.[33] The majority voted in favor of the plan, however, and the plan passed.[34]

The recapitalization plan forced the minority shareholders, who held only fractional shares after the amendment to Hycor's articles of organization, to redeem all of their shares.[35] The Hycor recapitalization plan thus eliminated all minority shareholders.[36] The minority shareholders as a class brought suit against Hycor and five of the majority shareholders who also held seats on Hycor's board.[37] The plaintiff class sought damages or, alternatively, for the court to declare the vote of the shareholders a nullity and to set the vote aside.[38] The trial court judge found in favor of the defendants.[39] The judge concluded that the plaintiffs had failed to demonstrate that there was no legitimate business purpose for the recapitalization plan.[40] The judge also found that the five dollar redemption price was fair and reasonable.[41] The plaintiffs appealed to the Supreme Judicial Court, contending that the trial court judge's conclusions were erroneous.[42]

---

[28] *Id.* at 217–18, 479 N.E.2d at 174–75.
[29] *Id.* at 217, 479 N.E.2d at 175.
[30] *Id.* at 217, 479 N.E.2d at 174–75.
[31] *Id.* at 217, 479 N.E.2d at 175.
[32] *Id.*
[33] *Id.*
[34] *Id.* at 218, 479 N.E.2d at 175.
[35] *See id.* at 217, 479 N.E.2d at 174–75.
[36] *Id.*
[37] *Id.* at 218–19, 479 N.E.2d at 175.
[38] *Id.* at 218, 479 N.E.2d at 175.
[39] *Id.* at 219, 479 N.E.2d at 175.
[40] *Id.*
[41] *Id.* at 219, 479 N.E.2d at 176.
[42] *Id.* at 216, 479 N.E.2d. at 174.

In upholding the Hycor plan, the Supreme Judicial Court first examined the statutory basis for the recapitalization plan and concluded that, on its face, the plan complied with the relevant sections of the Massachusetts Corporations Law.[43] According to the Supreme Judicial Court, the provisions of the Corporations Law are designed to give majority shareholders more flexibility and "to remove what was in effect a power of veto held by a dissenting minority."[44] The Court determined that the plan was an appropriate use of the provisions of the statute to return the company to private status.[45]

Having determined that transactions which "squeeze out" minority shareholders are not per se invalid, the Court next focused on the duty that the majority shareholders owe to minority shareholders in squeeze-out transactions.[46] The Court noted that the lower court had applied the standard established in *Donahue v. Rodd Electrotype Co. of New England* [47] of "utmost good faith and loyalty."[48] Upholding the lower court's standard, the Supreme Judicial Court reiterated the *Donahue* holding that shareholders in a close corporation owe one another a duty of utmost

---

[43] *Id.* at 219, 479 N.E.2d at 176. Chapter 156B, section 28 provides in relevant part:

> Except as otherwise provided in the articles of organization or by-laws, a corporation may issue fractional shares of stock, and may issue in lieu thereof script in registered or bearer form which, depending on how the shares of the corporation are evidenced, shall entitle the holder to receive a certificate for a full share or have an uncertified share registered in his name upon the surrender of such script aggregating a full share . . . . The directors shall fix the terms and conditions and manner of issue of such script, which may include . . . a condition that the shares for which the script is exchangeable may be sold by the corporation and the proceeds thereof distributed to the holders of such script.

G.L. c. 156B, § 28 (1984).

Chapter 156B, section 71 provides in relevant part:

> A corporation may, . . . authorize, at a meeting duly called for the purpose, by vote of two-thirds of each class of stock outstanding and entitled to vote thereon or, if the articles of organization so provide, by vote of a lesser proportion but not less than a majority of each class of stock outstanding and entitled to vote thereon, any amendment of its articles of organization; provided, only, that any provision added to or changes made in its articles of organization by such amendment could have been included in, and any provision deleted thereby could have been omitted from, original articles of organization filed at the time of such meeting.

G.L. c. 156B, § 71 (1984).

[44] *Leader*, 395 Mass. at 221, 479 N.E.2d at 177 (citing *Teschner*, 59 Ill. 2d at 456, 322 N.E.2d at 56). The *Leader* Court relied on the reasoning in *Teschner*, in which the Illinois Supreme Court upheld a similar plan to eliminate the minority shareholders of an Illinois company. *Id.*

[45] *Id.*

[46] *Id.*

[47] 367 Mass. 587, 328 N.E.2d 505 (1975).

[48] *Leader*, 395 Mass. at 222, 479 N.E.2d at 177.

good faith and loyalty.[49] In *Leader*, the Court also reaffirmed the principles of *Wilkes v. Springside Nursing Home, Inc.*[50] in the *Leader* Court's discussion of the majority shareholders' fiduciary duties.[51] The *Leader* Court noted that *Wilkes* stands for the proposition that the *Donahue* strict good faith standard is satisfied by a demonstration of a legitimate business purpose for the majority shareholders' actions.[52] Furthermore, the Court noted, once the majority shareholders advance a valid business purpose, the minority shareholders bear the burden of proving that the majority's goal could have been achieved in a manner less harmful to the minority.[53]

The Court then considered whether in the case before it, the majority shareholders had breached the duty of utmost good faith and loyalty in adopting the recapitalization plan.[54] The Court focused on the testimony of Hycor's president that the majority shareholders decided to go private because the company did not benefit by its public status because of the lack of a ready market for Hycor stock.[55] In addition, the Court also considered and accepted the lower court's finding that the plaintiffs had failed to demonstrate that the company could have terminated compliance with the statutory duties of a public company or improved the marketability of the company's stock using a method other than a reverse stock split.[56] Consequently, the Court concluded that the defendants had met their burden of demonstrating a legitimate business purpose for adopting

---

[49] *Id.* The *Donahue* Court defined a close corporation as having "(1) a small number of stockholders; (2) no ready market for the corporate stock; and (3) substantial majority participation in the management, direction and operations of the corporation." *Donahue*, 367 Mass. at 586, 328 N.E.2d at 511. Because the operation of a closely held company is similar to the operation of a partnership, the *Donahue* Court reasoned, the same fiduciary standard should apply. *Id.* at 592–93, 328 N.E.2d at 515.

The Supreme Judicial Court narrowed the *Donahue* holding in Wilkes v. Springside Nursing Home, Inc., 370 Mass. 842, 353 N.E.2d 657 (1976). In *Wilkes*, the Court held that when a minority shareholder brings an action for breach of fiduciary duty, the majority can demonstrate good faith by advancing a business purpose for its actions. *Id.* at 851, 353 N.E.2d at 663. Thus, once the majority advances a business purpose for its actions, the burden of proof shifts to the minority to demonstrate that the legitimate objective could have been achieved in a manner less harmful to the minority's interests. *Id.* at 851–52, 353 N.E.2d at 663.

[50] 370 Mass. 842, 353 N.E.2d 657 (1976).

[51] 395 Mass. at 222, 479 N.E.2d at 177.

[52] *Id.* (citing *Wilkes*, 370 Mass. at 851, 353 N.E.2d at 663).

[53] *Leader*, 395 Mass. at 221, 479 N.E.2d at 177 (citing *Wilkes*, 370 Mass. at 851, 353 N.E.2d at 663).

[54] *Id.*

[55] *Id.* at 222–23, 479 N.E.2d at 177–78.

[56] *Id.* at 223, 479 N.E.2d at 178.

the recapitalization plan and thus had established that they acted in accordance with the *Donahue* standard of utmost good faith and loyalty.[57]

Finally, the Supreme Judicial Court considered the fairness of the five dollar redemption offer.[58] The Court stated that it would not overrule the judgment of the lower court unless the judgment was "clearly erroneous."[59] The Court concluded, however, that the record did not sufficiently detail the reasons for the trial court judge's decision as required by Massachusetts Rule of Civil Procedure 52(a).[60] The Court, therefore, remanded the case solely on the issue of the fairness of price so that the trial judge could detail his findings that the redemption price was fair and reasonable.[61]

The Supreme Judicial Court stated that it continued to approve of the "Delaware block method" for valuing the stock of closely held companies.[62] That method employs a weighted average of the market value, earnings value, and net asset value to determine the fair value of the shares.[63] In *Weinberger v. U.O.P. Inc.*,[64] the Delaware Supreme Court determined that that valuation method was "outmoded" and should no longer "exclusively" control appraisal or other stock appraisal cases.[65] The *Weinberger* Court abandoned the Delaware block method "to the extent that it excludes other generally accepted techniques used in the financial community . . . to value stock."[66]

According to the *Leader* Court, however, the Delaware Supreme Court's decision in *Weinberger* was not inconsistent with the approach taken by the Supreme Judicial Court in *Piemonte v. New Boston Garden Corp.*,[67] reasoning that in *Piemonte*, the Court suggested the Delaware method as one possible approach to valuation.[68] The *Leader* Court

---

[57] *Id.* at 222–23, 479 N.E.2d at 177–78. The Court, therefore, explicitly stated that it need not decide whether the majority shareholders' actions would have been upheld if they acted with only good faith and inherent fairness, the standard applied to non-closely held companies. *Id.* at 223, 479 N.E.2d at 178.

[58] *Id.* at 223–24, 479 N.E.2d at 178–79.

[59] *Id.* at 223–24, 479 N.E.2d at 178.

[60] *Id.* at 224, 479 N.E.2d at 178. According to the *Leader* Court, in all actions tried without a jury, Rule 52(a) requires that the trial court find facts specially and separately state the court's conclusions of law. *Id.*

[61] *Id.* at 224, 479 N.E.2d at 179.

[62] *Id.* at 224, 479 N.E.2d at 178.

[63] Piemonte v. New Boston Garden Corp., 377 Mass. 719, 724, 387 N.E.2d 1145, 1148 (1979).

[64] 457 A.2d 701 (Del. 1983).

[65] *Id.*

[66] *Id.* at 712–13.

[67] 377 Mass. 719, 387 N.E.2d 1145 (1979).

[68] *Leader*, 395 Mass. at 224, 479 N.E.2d at 178.

pointed out, however, that the trial court judge need not follow only the Delaware block method to determine whether the offered price was fair.[69]

The Supreme Judicial Court's decision in *Leader v. Hycor* is significant in three respects. First, the decision supports the use of a reverse stock split together with the mandatory repurchase of fractional shares to eliminate minority shareholders. Second, the *Leader* decision further narrows the strict *Donahue* fiduciary standard for closely held corporations. Lastly, the decision clearly indicates that the Court will continue to accept the use of the Delaware block method for determining the value of closely held stock.

Generally, majority shareholders can terminate the interests of minority shareholders[70] and courts have consistently allowed public companies to return to private status.[71] In assessing these transactions, however, several state courts have required that majority shareholders act in accordance with the fiduciary duty that the majority shareholders owe to the minority shareholders.[72] Consistent with these decisions, the *Leader* Court concluded that the defendants' actions were not a misuse of the relevant statutory provisions unless the defendants had breached the fiduciary duty they owed to the minority shareholders. Thus, the use of a reverse stock split to eliminate minority shareholders is acceptable if the majority shareholders have not breached their fiduciary duty to the minority shareholders.

The *Leader* Court's application of the strict fiduciary duty outlined by the Court in *Donahue* is also noteworthy. In holding that the elimination of public ownership when there is no ready market for the stock is a legitimate business purpose, *Leader* continues the trend of narrowing the *Donahue* standard of utmost good faith and loyalty owed by the majority shareholders to the minority shareholders. The *Donahue* standard was first narrowed by the Court in *Wilkes* when the Court held that the majority shareholders could demonstrate good faith, and thus fulfill the *Donahue* standard, by advancing a business purpose for its actions.[73] The *Leader* Court reaffirmed the principles of *Wilkes* and established that eliminating public ownership in order to eliminate the associated statutory duties when there is no ready market for the stock is a legitimate business purpose.[74]

---

[69] *Id.* at 224, 479 N.E.2d at 179.

[70] *Teschner*, 59 Ill. 2d at 456, 322 N.E.2d at 56. *See generally* H. HENN & J. ALEXANDER, LAW OF CORPORATIONS § 240 (3d ed. 1983).

[71] *See* F.H. O'NEAL & R. THOMPSON, *supra* note 3, at § 3:03.

[72] *E.g.*, *Clark*, 87 Misc. 2d at 390, 384 N.Y.S.2d at 664–65. *See* M. LIPTON & E. STEINBERGER, TAKEOVERS & FREEZEOUTS § 9.01 (1986).

[73] *See supra* note 49.

[74] *Leader*, 395 Mass. at 223, 479 N.E.2d at 178.

Arguably, the *Leader* Court should not have applied the strict fiduciary duty established in *Donahue* to the facts at issue in the *Leader* case. The Court should have applied the lower standard of good faith and inherent fairness which applies to majority shareholders of publicly held companies.[75] The lower court's application of the *Donahue* standard was clearly erroneous. Under the first prong of the *Donahue* test the corporation must have a small number of shareholders to qualify as a close corporation and thus to hold the majority shareholders to the more strict fiduciary duty.[76] Before the recapitalization plan, however, Hycor had over 300 shareholders[77] and thus, arguably was not a close corporation.

By accepting the lower court's application of the *Donahue* standard, the *Leader* Court has suggested that the Court will uphold this type of "going private" transaction regardless of the nature of the corporation involved. Also, by accepting the lower court's application of the *Donahue* standard the Court unnecessarily has restricted its ability to strike down the use of a reverse stock split to eliminate minority shareholders in the future. The Court should have made clear that Hycor was not a closely held corporation, and therefore was not subject to the *Donahue* standard. Instead, the Court's decision may result in the anomalous situation whereby the use of a reverse stock split to eliminate minority shareholders will not violate the lower standard of good faith and inherent fairness, but may violate the strict utmost good faith and loyalty standard established in *Donahue*.

The *Leader* Court's decision clearly indicates that the Supreme Judicial Court will continue to accept the Delaware block method to value stock. However, the Supreme Judicial Court's decision in *Leader* is not entirely consistent with the *Weinberger* decision. The Delaware Court suggested that the trial court's sole use of the Delaware block method where the plaintiff offers evidence using different valuation methods would be unacceptable.[78] The *Leader* Court, on the other hand, suggested that while other methods could be used, a lower court might continue to apply the Delaware block method exclusively to value closely held stock.[79] Al-

---

[75] *Donahue*, 367 Mass. at 586, 328 N.E.2d at 511.

[76] Note, *Contractual Disclaimer of the* Donahue *Fiduciary Duty: The Efficacy of the Anti-*Donahue *Clause*, 26 B.C.L. REV. 215, 215–16 & n.7.

[77] *Leader*, 395 Mass. at 218, 479 N.E.2d at 175.

[78] *Weinberger*, 457 A.2d at 712–13.

[79] *Leader*, 395 Mass. at 224, 479 N.E.2d at 179. The *Leader* decision is consistent with the *Weinberger* decision in that the Massachusetts Supreme Judicial Court had never suggested that the Delaware block method was the only acceptable valuation method. *See Piemonte*, 377 Mass. at 723–24, 387 N.E.2d at 1148 (a judge "might appropriately follow" the Delaware block method for valuing closely held stock). Thus, while not required, the Court indicated that it would allow the use of more modern valuation methods for determining the value of closely held stock. *See Leader*, 395 Mass. at 224, 479 N.E.2d at 179.

though this distinction may appear slight, the ability to rely exclusively on the Delaware block method makes the determination of the stock's value significantly less difficult.

In summary, in *Leader v. Hycor, Inc.*, the Supreme Judicial Court upheld the use of a reverse stock split in conjunction with a mandatory repurchase of fractional shares to return a public company to private status. In doing so, the Court indicated that the Legislature intended to provide flexibility in corporate decision making. The Court stated, however, that majority shareholders must act consistently with their duty of loyalty and good faith to the minority shareholders. The majority satisfies this duty if it can prove a valid business purpose for its actions. Under *Leader*, the return of the corporation to private status, thus eliminating the SEC reporting requirements, is a valid business purpose. Finally, the Court indicated that it would continue to support the use of the Delaware block method in determining the fair value for the minority shareholders' stock.

§ 2.2. Short Form Mergers — Fiduciary Duty of the Majority to Dissenting Minority Shareholders.* Chapter 156B, section 82 of the General Laws establishes independent procedures for merger of subsidiary corporations into parent corporations.[1] Section 82 is a so-called short-form merger statute, which allows a parent corporation to merge into itself a largely owned subsidiary corporation through an expedited procedure.[2] The majority of states have enacted similar short-form merger statutes, most of which are substantively and procedurally identical to the Massachusetts law.[3]

In order to avail itself of the Massachusetts short-form merger statute, the parent or acquiring corporation must own at least ninety percent of the stock of the subsidiary corporation to be acquired.[4] If the ownership requirement is met, a merger can be effected merely by a vote of the directors of the parent adopting the plan of merger and assuming the subsidiary's obligations.[5] Thus, approval for a section 82 merger is ob-

---

* David M. Rievman, staff member, ANNUAL SURVEY OF MASSACHUSETTS LAW.

§ 2.2. [1] Horizon House-Microwave, Inc. v. Bazzy, 21 Mass. App. Ct. 190, 197, 486 N.E.2d 70, 75 (1985); Joseph v. Wallace-Murray Corp., 354 Mass. 477, 480, 238 N.E.2d 360, 362 (1968); Dickson v. Riverside Iron Works, Inc., 6 Mass. App. Ct. 53, 56–57, 372 N.E.2d 1302, 1305 (1978).

[2] *Bazzy*, 21 Mass. App. Ct. at 196–97, 486 N.E.2d at 75.

[3] *See, e.g.*, ABA-ALI MODEL BUS. CORP. ACT § 75; CAL. CORP. CODE § 1110; CONN. GEN. STAT. ANN. § 33-370 (West 1960); DEL. CODE ANN. tit. 8, § 253 (1974); N.J. STAT. ANN. § 14A:10-5 (West 1969); WEST'S MCKINNEY'S FORMS, BCL § 9:05 (1985); S.C. CODE ANN. § 33-17-50 (Law Co-op. 1987).

[4] G.L. c. 156B, § 82(a).

[5] G.L. c. 156B, § 82(b).

tained far more easily than approval for a merger which must proceed under the general statute regulating corporate consolidations, chapter 156B, section 78. Approval of a merger proposal under section 78 requires notice to the shareholders of the interested corporations,[6] meetings of the shareholders of the corporations,[7] and the vote of the majority of each class of stock of each constituent corporation outstanding and entitled to vote on the question.[8]

In a short-form merger proceeding under section 82, where the parent corporation owns at least ninety percent of the stock of the corporation to be merged, the only right of a non-assenting minority shareholder, in the absence of illegality or fraud as to him, is his right to a determination of the value of his stock.[9] Where close corporations are involved in a section 82 merger, the legality of the deal is subject to the additional requirement that majority shareholders comply with their strict fiduciary duty to deal fairly with minority shareholders.[10] This general duty of loyalty and fairness owed by majority participants in a close corporation to minority shareholders derives from the Supreme Judicial Court's pronouncement in *Donahue v. Rodd Electrotype Co.*[11] As set forth in *Donahue*, majority shareholders in a close corporation may not act out of avarice or self-interest, in derogation of their duty of loyalty to other shareholders in the corporation, or to deprive minority shareholders of the fair market value of their investments.[12] Thus, the validity of a short form merger transaction between close corporations may come under scrutiny in two distinct analyses. First, the merger must be in technical compliance with section 82. Second, the merger must meet the tests of fairness and fiduciary dealing with respect to minority shareholders established in *Donahue*.

During the Survey year, in *Horizon House-Microwave, Inc. v. Bazzy*,[13] the Massachusetts Appeals Court held that where the conditions for section 82 are met, its procedures govern the merger between two close corporations rather than the more onerous technical procedures of section 78.[14] In addition, the court held that absent unfair tyrannization of the minority, or a breach of fiduciary duty by the majority to the dissenting minority shareholders in the subsidiary, the exclusive remedy for

---

[6] G.L. c. 156B, § 78(c)(i).

[7] G.L. c. 156B, § 78(c)(ii).

[8] G.L. c. 156B, § 78(c)(iii).

[9] *Joseph*, 354 Mass. at 480, 238 N.E.2d at 362.

[10] *See Bazzy*, 21 Mass. App. Ct. at 198–99, 486 N.E.2d at 76; Donahue v. Rodd Electrotype Co., 367 Mass. 578, 593, 328 N.E.2d 505, 515 (1975).

[11] *Donahue*, 367 Mass. 578, 328 N.E.2d 505.

[12] *Id.* at 593, 328 N.E.2d at 515.

[13] 21 Mass. App. Ct. 190, 486 N.E.2d 70.

[14] *Id.* at 196–98, 486 N.E.2d at 75.

the dissenting shareholder is a demand for appraisal and payment on his shares.[15]

In *Bazzy*, the Appeals Court decided the claims of Emil Bazzy against his brother, William Bazzy, and the close corporations in which the two brothers were interested. The brothers' legal disputes resulted from their interests in a corporation, Horizon House, Inc. (Horizon), organized by them in 1958 to pursue a magazine publishing venture.[16] Horizon issued 420 shares of voting common stock to William and 410 shares to Emil.[17] Horizon's immediate purpose was to publish a trade magazine about microwave technology, and the corporation agreed with Theodore S. Saad, a specialist in that field, that if the venture proved successful, the magazine would be placed in a separate corporation in which Saad would receive stock.[18] The magazine did in fact prove successful, and in 1962 the Bazzy brothers organized Horizon House-Microwave, Inc. (Microwave), and issued 3000 shares of Microwave stock to William, 1000 shares to Emil, and 1000 shares to Saad.[19] After the organization of Microwave, Horizon's functions were reduced to providing bookkeeping, administrative, and landlord services to Microwave.[20]

By 1974, Emil and William were entangled in multiple lawsuits.[21] In addition, Saad was agitating for the termination of the services rendered by Horizon to Microwave, since that arrangement drained cash from Microwave, in which Saad had an interest, to Horizon, in which he did not.[22] In June, 1974, the disparate parties struck a deal to assuage the grievances of Saad and the Bazzy brothers.[23] Microwave was to buy Emil's shares in Horizon for book value plus $10,000.[24] William's shares in Horizon were then to be acquired by Microwave for book value, without a premium, in exchange, solely, for shares of Microwave.[25] As the result of this proposal, Microwave would own Horizon as a wholly owned subsidiary, thus putting to rest Saad's concern about cash flowing

---

[15] *Id.* at 200, 486 N.E.2d at 77.

[16] *Id.* at 191–92, 486 N.E.2d at 72.

[17] *Id.* at 192, 486 N.E.2d at 72.

[18] *Id.*

[19] *Id.*

[20] *Id.* Microwave, and two other operating companies organized by Saad and the Bazzy brothers, paid rent and fees to Horizon for its provision of these services. *Id.* at 192 & n.3, 486 N.E.2d at 72 & n.3.

[21] *Id.* at 192, 486 N.E.2d at 72. The court did not specify the nature of the earlier legal disputes or identify the claims at issue in the prior lawsuits. In any event, the precise nature of the prior claims was not relevant to this action.

[22] *Id.*

[23] *Id.*

[24] *Id.* Twenty-eight percent of the amount due Emil was to be paid in cash, with seventy-two percent payable in the form of a note payable by Dedham.

[25] *Id.* at 192–93, 486 N.E. 2d at 72–73.

away from Microwave.[26] When the time came to close the deal in November of 1974, however, Emil refused to execute it.[27] As the statutory scheme then stood, a two-thirds vote of each class of stock of each constituent corporation was necessary to approve a merger agreement between Microwave and Horizon.[28] Since William owned only a simple majority in Horizon, he could not effect the merger agreement without Emil's support.[29]

In 1976, however, a way out of the stockholders' deadlock developed when the Legislature amended chapter 156B, section 78(c)(1)(iii) to permit authorization of merger agreements by vote of a majority, rather than two-thirds, of each class of stock entitled to vote on the question.[30] A decisive vote was now possible for Horizon, and as far as the record disclosed, for Microwave as well.[31] Since Saad's grievance about money flowing from Microwave to Horizon continued to grow, to the point where he threatened to initiate a stockholder's derivative suit against Microwave, Microwave continued to have a good business reason to close down Horizon's operations.[32]

In June of 1977, Microwave adopted a triangular merger as a means to that end.[33] First, it effected the formation of a wholly-owned subsidiary, Horizon House-Dedham, Inc. (Dedham).[34] Second, Dedham, by vote of its sole stockholder (Microwave), and Horizon, by a vote of a majority of shares issued and outstanding, entered into a merger agreement pursuant to which Horizon would be merged into Dedham.[35] The surviving corporation, Dedham, would exchange $29,901.26 in cash, and $76,888.97 in a note of Dedham for Emil's stock in Horizon.[36] For William's Horizon stock, Dedham would exchange 5,475 shares of voting common stock of Microwave.[37] Third, Dedham would change its name to Horizon House,

---

[26] *Id.* at 193, 486 N.E.2d at 73.

[27] *Id.*

[28] *Id.*

[29] *Id. See* G.L. c. 156B, § 78(c)(1)(iii) as appearing in St. 1969, c. 392, § 19.

[30] *Id. See* St. 1976, c. 327. In 1981, however, the legislature raised the vote required to approve a merger back to a two-thirds majority, unless a lesser proportion, but not less than a majority, is provided for in the articles of organization. *See* St. 1981, c. 298 § 4. *Id.*

[31] *Id.* at 193, 486 N.E.2d at 73.

[32] *Id.* at 194, 486 N.E.2d at 73–74.

[33] *Id.* at 194, 486 N.E.2d at 74.

[34] *Id.*

[35] *Id.* at 194–95, 486 N.E.2d at 74.

[36] *Id.* at 195, 486 N.E.2d at 74. The note was payable in five equal annual installments with a floating rate of interest on the unpaid balance of two percent above the prime rate. *Id.*

[37] *Id.* Microwave had earlier prepared for this exchange by issuing 5475 shares of its stock to Dedham. *Id.* at n.9.

Inc.[38] Articles of merger to this effect were filed June 27, 1977.[39] A fourth step, outside the merger agreement between Horizon and Dedham, occurred on November 25, 1977, when the directors of Microwave, acting under chapter 156B, section 82 of the General Laws, voted to merge into Microwave this new wholly-owned subsidiary which had acquired the stock of Horizon.[40] Thus, only Microwave survived.[41]

While this lawsuit was technically initiated by Microwave against Emil Bazzy, at issue in the appellate proceedings were Emil's counterclaims directed at William Bazzy, Horizon, and Microwave.[42] Basically, Emil's grievance was that he was "cashed-out" of Horizon, while his brother William wound up with a larger equity interest in the surviving corporation, Microwave.[43] Thus, Emil's complaint was with the end result of the triangular merger, and his counterclaim attacked both the technical legality of the merger, and charged that William, Microwave, and Horizon breached the common law fiduciary duties they owed to him, as a minority stockholder in a close corporation.[44] As Emil's counsel conceded on closing argument, Emil did not wish to unravel the merger, but to be given parity with William in what was exchanged for his Horizon stock, that is, shares of Microwave rather than cash.[45]

Emil directed all of his allegations of deviation from statutory requirements at Microwave.[46] First, he asserted that in violation of chapter 156B, section 78(c)(1)(ii), Microwave failed to give each stockholder of record thirty days notice of a meeting to approve the merger agreement.[47] Second, Emil alleged that in violation of section 78(c)(1)(iii), the merger agreement between Horizon and Dedham was not approved by the stockholders of Microwave.[48] Finally, Emil alleged that in violation of section 78(c)(2)(ii), the merger agreement was not approved by the stockholders of Microwave.[49]

The court found these allegations wholly without merit, holding that since Microwave was never a party to a section 78 merger agreement,

---

[38] *Id.* at 195, 486 N.E.2d at 74.

[39] *Id.*

[40] *Id.* Under G.L. c. 156B, § 82(a), a corporation owning at least ninety percent of the outstanding shares of each class of stock of another corporation, may merge into itself that corporation merely by a vote of its directors. G.L. c. 156B § 82(a).

[41] *Bazzy*, 21 Mass. App. Ct. at 195, 486 N.E.2d at 74.

[42] *Id.*

[43] *Id.*

[44] *Id.* at 195–200, 486 N.E.2d at 74–77.

[45] *Id.* at 196, 486 N.E.2d at 74.

[46] *Id.* at 196, 486 N.E.2d at 75.

[47] *Id.*

[48] *Id.*

[49] *Id.*

none of the procedures or requirements of section 78(c) applied to Microwave.[50] The only parties to the section 78 merger agreement of which Emil complained, the court held, were Horizon and Dedham.[51] Since the merger of Horizon and Dedham proceeded pursuant to a majority vote of the stockholders of each corporation,[52] as was then required by statute,[53] the court found the technical legality of that merger certain. The court held that neither the issuance of 5475 shares of stock by Microwave to Dedham, nor Microwave's ultimate absorbtion of Horizon involved section 78.[54] The latter merger, the court recognized, proceeded under section 82, a statute which provides independent procedures for the merger of subsidiary corporations into parent corporations.[55] The court noted that a section 82 merger does not require approval of stockholders, and that any attempt to read the requirements of subsection (c) of section 78 into section 82 is clearly erroneous.[56] Elimination of minority shareholder interests without a stockholder vote, the court added, is an acknowledged objective of short-form merger statutes such as section 82.[57]

The Appeals Court then turned to a consideration of the policy aspects underlying the triangular merger device. The court conceded that the triangular merger clearly permits an acquiring corporation to outflank the requirement of stockholder approval which attends a straight merger under section 78.[58] The court, however, balanced this potential negative against the great business and income tax benefits of the triangle technique,[59] and held that unless technical adherence to corporate form is used to inflict gross inequity, injury or fraud, compliance with corporate form will be recognized and tolerated.[60] Short of a showing of fraud, gross inequity, or injury, the court held, it would not encumber proce-

---

[50] *Id.*

[51] *Id.*

[52] *Id.* at 194, 486 N.E.2d at 74.

[53] *See supra* note 30 and accompanying text.

[54] *Bazzy*, 21 Mass. App. Ct. at 197, 486 N.E.2d at 75.

[55] *Id. See Joseph* 354 Mass. at 480, 238 N.E.2d at 362.

[56] *Bazzy*, 21 Mass. App. Ct. at 197, 486 N.E.2d at 75.

[57] *Id. See also* Burgman and Cox, *Reappraising the Role of the Shareholder in the Modern Public Corporation*: Weinberger's *Procedural Approach to Fairness in Freezeouts*, 1984 WIS. L. REV. 597, 600 (1984).

[58] *Bazzy*, 21 Mass. App. Ct. at 197, 486 N.E.2d at 75.

[59] *Id.* The court counted among the benefits of the triangle merger technique relief from expensive proxy solicitations, insulation from business risks taken by the acquired corporation, and the ability to achieve a tax-free reorganization under federal income tax law. *Id.*

[60] *Id. See* My Bread Baking Co. v. Cumberland Farms, Inc., 353 Mass. 614, 618 & n.6, 619–20, 233 N.E.2d 748, 751 (1968); M. McDonough Corp. v. Connelly, 313 Mass. 62, 65–66, 46 N.E.2d 576, 579 (1943).

dures which the statute expressly authorizes to provide desired flexibility.[61]

Next, the court addressed Emil's claims of breach of fiduciary duty of the majority to a minority shareholder in a close corporation. Citing *Donahue*,[62] the court stated that the mere facts that a corporate action is permitted by the statutory scheme and that the majority has the votes to approve the action, are not alone sufficient to secure judicial approval of the action.[63] Rather, a corporation's transactions are subject to the additional condition, particularly in a close corporation, that majority stockholders "may not act out of avarice, expediency, or self-interest in derogation of their duty of loyalty to the other stockholders and to the corporation."[64] The majority shareholders, the court reiterated, may not unfairly tyrannize the minority.[65]

Analyzing Emil's complaints of oppression at the hands of the majority, the court opined that the oppression complained of was oppression of a very limited sort.[66] The court distinguished the *Donahue* case on the grounds that in that case the majority shareholders arranged the sale of their shares in a close corporation on favorable cash terms and left the minority holding shares for which there was a doubtful market.[67] The instant case, the court held, presented a nearly opposite situation.[68] In *Bazzy*, the majority gave the minority shareholder cash for his shares, based on an appropriate measure of the stock's book value.[69] In finding that Emil had not been unduly oppressed, the court reasoned, first, that the triangular merger of 1977 effectively carried out the economic objectives of the 1974 arrangement, in which Emil had accepted almost identical terms for disposition of his Horizon stock.[70] Second, the court stated, on the record it appeared that Emil's cash settlement for his Horizon shares was as valuable share per share as William's settlement paid in shares of Microwave.[71] Thus, the court concluded, the cash and note paid to Emil reflected fairly the value of his holdings in Horizon.[72]

---

[61] *Bazzy*, 21 Mass. App. Ct. at 198, 486 N.E.2d at 75. *See* Leader v. Hycor, Inc., 395 Mass. 215, 221, 479 N.E.2d 173, 177–78 (1985).

[62] *Donahue*, 367 Mass. at 593, 328 N.E.2d at 515.

[63] *Bazzy*, 21 Mass App. Ct. at 198, 486 N.E.2d at 76.

[64] *Id.*

[65] *Id. Leader*, 395 Mass. at 221–22, 479 N.E.2d at 177; *See Wilkes*, 370 Mass. at 849, 353 N.E.2d at 662.

[66] *Bazzy*, 21 Mass. App. Ct. at 198, 486 N.E.2d at 76.

[67] *Id.* at 199, 486 N.E.2d at 76.

[68] *Id.*

[69] *Id.* at 199, 486 N.E.2d at 76.

[70] *Id.*

[71] *Id.*

[72] *Id.*

Furthermore, the court held that there were important business purposes for giving Emil cash for his Horizon holdings rather than equity in Microwave.[73] Taking into account the past history of hostility and deadlock between the brothers, the court reasoned that if both Emil and William were to increase their stakes in Microwave, there would be a considerable liklihood that the brothers would continue to quibble and thwart each other in the future, to the detriment of the corporate enterprise.[74] The court thus concluded that Microwave and William had a legitimate business purpose for structuring the merger as they did, in order to allow Microwave to function effectively in the best interests of all concerned.[75]

Finally, the court held that Emil would have done better to avail himself of the appraisal remedies provided under chapter 156B, sections 86 through 98 of the General Laws.[76] Indeed, the court explained, section 98 provides that a demand for appraisal is the exclusive remedy for a stockholder who dissents from a merger, except that a stockholder may bring an appropriate proceeding to obtain relief on the ground that the corporate action was illegal or fraudulent as to him.[77] Such a demand for appraisal, the court noted, would have focused attention on the core of Emil's grievance, the inadequacy of the settlement he received in exchange for his interest in Horizon, without the added burden he assumed in this action of proving illegal or fraudulent conduct.[78]

In *Bazzy*, the Appeals Court analyzed the challenged triangular merger between Horizon, Microwave, and Dedham on two levels. First, the court scrutinized the transactions for technical compliance with section 82, and differentiated the legal requirements applicable to mergers between parent and subsidiary corporations from those bearing upon mergers between unrelated corporations. Second, the court examined whether the majority dealt fairly with minority shareholders in effecting the merger agreements, in the context of the duties devolving upon it under *Donahue*.

In *Bazzy*, the Appeals Court refused to read the strictures of chapter 156B, section 78(c), the statute generally governing mergers, into section 82, the short-form merger statute.[79] In holding that section 82 provides independent procedures for merging subsidiary corporations into a parent, and in refusing to encumber its operation with the more onerous

---

[73] *Id.*

[74] *Id.* at 199–200, 486 N.E.2d at 76–77.

[75] *Id.* at 200, 486 N.E.2d at 77. *See also Leader*, 395 Mass. at 222, 479 N.E.2d at 177.

[76] *Bazzy*, 21 Mass. App. Ct. at 200, 486 N.E.2d at 77.

[77] *Id.*

[78] *Id.*

[79] *Id.* at 196–97, 486 N.E.2d at 75.

technical requirements of section 78, the court upheld the integrity of the statute.[80] It is well recognized in both Massachusetts and other jurisdictions that short-merger statutes serve useful and expeditious purposes in corporate enterprise.[81] Similarly, the courts are in general agreement that where a transaction complies with the technical parameters of a short-form merger statute, the sole remedy of complaining minority shareholders is an appraisal and payment of the fair value of their shares.[82] Absent gross inequity or fraud as to a dissenting minority shareholder opposed to the merger of parent and subsidiary, the minority shareholder has no right other than to fair payment for his sharehold.[83] Minority shareholders do not have a vested right to a continuation of their investment.[84] Unless corporate form is used to unfairly tyrannize a minority shareholder, the court held, it will be tolerated so long as it complies with statutory parameters.[85]

The court's holding that a minority shareholder has no remedy for breach of duty when he receives an adequate cash settlement for his investment, despite his preference to receive payment in the form of shares in the acquiring corporation, is consistent with the Supreme Judicial Court's pronouncements on the fiduciary duties of co-venturers in a close corporation. The rule of *Donahue* is simply that a majority shareholder may not sell his or her own interest in a close corporation on advantageous terms if by doing so he or she traps the minority shareholders into a situation in which they have no outlet to receive a fair value for their shares.[86] *Donahue* does not expressly or impliedly create a right of a minority shareholder to a continuation of his or her investment.[87]

The Appeals Court, then, in finding that William Bazzy and Microwave did not breach their fiduciary duties to Emil Bazzy in effecting a triangular

---

[80] *Id.*

[81] *See supra* note 3 and accompanying text.

[82] *See id.* at 197, 486 N.E.2d at 75. *See also* Beloff v. Consolidated Edison Co., 300 N.Y. 11, 19–20, 87 N.E.2d 561, 564–65 (1949); Weinberger v. U.O.P., 457 A.2d 701 (Del. S. Ct. 1983); David J. Greene & Co. v. Schenley Indus., Inc., 281 A.2d 30, 35 (Del. Ch. 1971); Wilcox v. Stern, 18 N.Y.2d 195, 201–02, 273 N.Y.S.2d 38, 43, 19 N.E.2d 401, 404 (1966).

[83] *Bazzy*, 21 Mass. App. Ct. at 198–99, 486 N.E.2d at 75–77; Coyne v. Park & Tilford Distillers Corp., 38 Del. Ch. 514, 521–22, 154 A.2d 893, 897–98 (1959); Bove v. Community Hotel Corp. of Newport, 105 R.I. 36, 55, 249 A.2d 89, 98 (1969).

[84] *Id.*

[85] *Bazzy*, 21 Mass. App. Ct. at 196–97, 486 N.E.2d at 75.

[86] *Id.* at 198–99, 486 N.E.2d at 76; *Donahue*, 367 Mass. at 593, 328 N.E.2d at 515.

[87] Indeed, it is the near reverse situation which characterized the shareholder's plight in *Donahue*. In that case, the Court held that the majority shareholders violated their fiduciary duty to the minority by "trapping" them into their investment, leaving the minority with no outlet to recoup the fair cash value of their shares. *Donahue*, 367 Mass. at 592–93, 328 N.E.2d at 514–15. *See also* cases cited *supra* note 83.

merger, properly applied the law of close corporations in this Commonwealth. *Donahue* merely requires that minority shareholders be given an opportunity to receive the fair cash value for their shares. It does not also guarantee the reverse; an indefinite and interminable right to continuation of their investment. Thus, the court's holding in *Bazzy*, that where a minority shareholder is cashed-out of his shares in a merger transaction, and receives a fair cash value for those shares, he has no remedy for breach of duty, is consistent with the current state of the law on the fiduciary duties owed to participants in a close corporation.[88] The Massachusetts Appeals Court's holding in *Bazzy*, then, is consistent with the statutory schemes erected by the legislature to regulate corporate mergers, and with the current state of the law in Massachusetts concerning the fiduciary obligations of co-venturers in close corporations.

§ 2.3. Rescission of Mergers Effected in Violation of Chapter 156B, Sections 78(c)(1)(ii) and (iii).* Most jurisdictions generally agree that some statutory provisions governing corporate behavior are designed to protect shareholders of the corporation.[1] Examples of shareholder protection provisions include the requirement of shareholder approval for certain types of corporate transactions,[2] and the anti-fraud provisions of the Securities and Exchange Act of 1934 regulating proxy solicitation.[3] Corporate transactions undertaken without complying with such provisions, however, are not necessarily void.[4] Instead, courts have held that if a corporation fails to comply with the requirements of a shareholder pro-

---

[88] *See Donahue*, 367 Mass. at 592–93, 328 N.E.2d at 514–15. Indeed, the *Bazzy* court noted, the exclusive remedy of a shareholder who dissents from a merger is a demand for appraisal, so as to ensure that the shareholder receives the fair value of his investment. *Bazzy*, 21 Mass. App. Ct. at 200, 486 N.E.2d at 77; G. L. c. 156B, § 98.

* Dorothy P. Whelan, staff member, ANNUAL SURVEY OF MASSACHUSETTS LAW.

§ 2.3. [1] Royal Indem. Co. v. American Bond & Mortgage Co., 289 U.S. 165, 171 (1933); Greene v. Reconstr. Fin. Corp., 100 F.2d 34, 36 (1st Cir. 1938); Mid-Continent Tel. Corp. v. Home Tel. Co., 319 F. Supp. 1176, 1195 (N.D. Miss. 1970); George H. Gilbert Mfg. Co. v. Goldfine, 317 Mass. 681, 686–87, 59 N.E.2d 461, 464 (1945) (dictum).

[2] *Royal*, 289 U.S. at 170–71 (Maine statute forbidding transfer, except in usual course of business, of franchises or assets of corporation, without assent of stockholders); *Greene*, 100 F.2d at 35, 36 (Delaware statute forbidding sale, lease, or exchange of all of corporation's property and assets without consent of majority of stockholders); *Gilbert*, 317 Mass. at 686–87, 59 N.E.2d at 464 (Massachusetts statute forbidding sale, lease, or exchange of all of corporation's property and assets without consent of two-thirds of stockholders).

[3] Securities and Exchange Act of 1934, § 14(a), 15 U.S.C. § 78n(a) (1986). *See* Mills v. Electric Auto-Lite Co., 396 U.S. 375, 388 (1970).

[4] *Mills*, 396 U.S. at 386–88. *See also Mid-Continent*, 319 F. Supp. at 1195. For example, corporate transactions undertaken without complying with the requirements of shareholder protection provisions are valid as against creditors and other third parties, who have no standing to protest violations of statutory provisions not designed for their protection. *Royal*, 298 U.S. at 171; *Greene*, 100 F.2d at 36–37.

tection provision, an injured shareholder has the option of rescinding the transaction.[5] Courts will grant rescission if it is equitable to do so under the circumstances.[6]

Chapter 156B, section 78(c)(1)(iii) of the Massachusetts General Laws provides that corporate mergers require the approval of two-thirds of the outstanding shares of each corporation participating in the merger.[7] Section 78(c)(1)(ii) provides that notice of the meeting called for the purpose of voting on the merger proposal must be sent to the shareholders of each corporation participating in the merger.[8] Neither provision, however, specifies the consequences of a corporation's failure to comply with its requirements.

During the *Survey* year, in *Pitts v. Halifax Country Club, Inc.*,[9] the Massachusetts Appeals Court held that sections 78(c)(1)(ii) and (iii) were designed to protect the shareholders of the corporations involved in the merger.[10] Thus, the court held that a merger accomplished without complying with the requirements of sections 78(c)(1)(ii) and (iii) is voidable at the request of an injured shareholder, unless the shareholder is estopped by his or her own conduct from rescinding the merger.[11] The court refused to rescind the merger in *Pitts* because the merger did not adversely affect the shareholder's economic interests, and because the shareholder had previously entered into an oral agreement, although legally unenforceable under the Statute of Frauds, to sell his shares to the corporation in order to allow the corporation to complete the merger. *Pitts* is significant because it demonstrates that failure to comply with sections 78(c)(1)(ii) and (iii) may not be fatal to a merger. Moreover, *Pitts* illustrates circumstances under which a court will refuse to rescind a

---

[5] *Mills*, 396 U.S. at 387–88 (contracts made in violation of § 14(a) of Securities and Exchange Act of 1934 and Rule 14a–9 are void as against violator, but are voidable at option of innocent party).

[6] *Id.* at 386.

[7] G.L. c. 156B, § 78(c)(1)(iii) states in pertinent part:

> [T]he vote of two-thirds of the shares of each class of stock of each constituent corporation outstanding and entitled to vote on the question, or, if the articles of organization so provide, the vote of a lesser proportion but not less than a majority of each class of stock of each constituent corporation outstanding and entitled to vote on the question, shall be necessary for the approval of such [merger] agreement.

[8] G.L. c. 156B, § 78(c)(1)(ii) states in pertinent part:

> Notice of the time, place and purpose of such meeting [at which the merger proposal is submitted] shall be given to each stockholder of record, whether or not entitled to vote thereat, of each such corporation [participating in the merger] . . . at least thirty days prior to the date of such meeting.

[9] 19 Mass. App. Ct. 525, 476 N.E.2d 222 (1985).

[10] *Id.* at 532, 476 N.E.2d at 227.

[11] *Id.*

merger effected in violation of sections 78(c)(1)(ii) and (iii), despite a shareholder's objections.

The defendant corporation in *Pitts*, the Halifax Country Club, was a golf course and club formed in 1965 by two colleagues, Henrich and Wyman, each of whom contributed land and $50,000 in return for forty-nine of the corporation's 300 authorized capital shares.[12] In 1967, the corporation's authorized capital stock increased to 5300 shares, and the corporation bought back Wyman's shares.[13] Thereafter, Henrich ran the corporation as his own company.[14]

In 1968, Henrich attempted to raise capital for the corporation by attracting additional investors.[15] Henrich offered to sell each investor Halifax shares at $100 per share, with the promise that each investor could return his or her shares at any time for $100 per share plus six percent interest.[16] The plaintiff, Pitts, responded to the offer.[17] Pitts, a professional golf player with extensive experience operating golf courses, offered his services in return for Halifax stock.[18]

In March, 1968, Henrich (representing the corporation) and Pitts executed a written agreement whereby Pitts would receive 100 shares of stock and a three year option to purchase up to 750 shares at $100 per share.[19] In return, Pitts would provide the club with his services as director of club operations and management consultant on a part-time basis for one year.[20] In May, 1968, Pitts purchased twenty shares for $2,000 and in November, 1968, Pitts received the 100 shares promised under his contract.[21] By the end of 1968, therefore, Pitts held 120 shares,[22] making him the majority shareholder in the corporation. Henrich, however, continued to run the corporation.[23]

The Halifax corporation lost money during its first two years of oper-

---

[12] *Id.* at 527, 476 N.E.2d at 225. Another party, Sullivan, who had furnished legal services to the corporation and acted as the corporation's clerk, received two shares. *Id.* at 527–28, 476 N.E.2d at 225.

[13] *Id.* at 528, 476 N.E.2d at 225.

[14] *Id.* At some point, Sullivan had transferred one of his shares to the corporation and one to Henrich, *id.*, leaving Henrich the sole shareholder.

[15] *Id.* Henrich planned to use the additional funds to expand the golf course. *Id.*

[16] *Id.*

[17] *Id.*

[18] *Id.*

[19] *Id.* The option was exercisable beginning on October 1, 1968. *Id.*

[20] *Id.*

[21] *Id.* The court noted that it was unclear whether Pitts purchased the twenty shares pursuant to the option agreement. *Id.*

[22] *Id.* at 528–29, 476 N.E.2d at 225. Henrich held only fifty shares. *Id.* at 529, 476 N.E.2d at 225. Pitts, however, may have been unaware that he, and not Henrich, was the majority shareholder. *Id.* at 536 n.11, 476 N.E.2d at 229 n.11.

[23] *Id.* at 528–29, 476 N.E.2d at 225.

ation.[24] Consequently, in 1969 Henrich decided to merge Halifax with two financially secure corporations which he owned in order to raise additional capital for Halifax.[25] To effect the merger, Henrich offered each shareholder $100 per share plus six percent interest in return for selling the shares back to the corporation.[26] All of the shareholders except Pitts agreed to sell.[27] Henrich then explained the merger plans to Pitts and began to negotiate, on behalf of Halifax, for Pitts' shares.[28] By February, 1969, Henrich and Pitts had reached an oral agreement whereby Pitts agreed *inter alia* to sell his shares to the corporation for $18,000 and to surrender his stock purchase option.[29] The only point which remained to be settled was the form in which Pitts was to receive the $18,000.[30]

Relying on Pitts' oral promise to sell his shares, Henrich called a stockholders' meeting at which the merger was approved, with Henrich and the corporation's clerk in attendance.[31] Notice of the meeting was never sent to Pitts, nor did Pitts participate in the vote on the merger proposal,[32] in violation of what is now chapter 156B, sections 78(c)(1)(ii) and (iii), respectively. Subsequently, the oral agreement which Henrich and Pitts had reached collapsed, and in 1971 Pitts commenced an action in superior court to rescind the merger or to exercise appraisal rights.[33]

Pitts argued that the merger was void because the corporation failed to give him notice of the meeting at which the merger was approved and because two-thirds of the corporation's outstanding shares did not ap-

---

[24] *Id.* at 529, 476 N.E.2d at 226.

[25] *Id.*

[26] *Id.* It is unclear why Henrich decided to repurchase all of the corporation's outstanding shares in order to effect the merger, rather than convening a shareholders' meeting for a vote on the merger.

[27] *Id.* One other shareholder, holding one share and not involved in the litigation, also did not accept Henrich's offer. *Id.*

[28] *Id.*

[29] *Id.* at 529–30, 476 N.E.2d at 226. Pitts also agreed to enter into a noncompetition agreement and long-term Halifax membership and consulting arrangement, and retained a right of first refusal in the event that a third party made an offer for the club and its grounds. *Id.*

[30] *Id.* at 530, 476 N.E.2d at 226. The $18,000 would either be attributed entirely to Pitts' 120 shares or would be apportioned between the shares and the noncompetition agreement. *Id.* See *supra* note 29.

[31] *Id.* at 530, 476 N.E.2d at 226. Articles of merger were then filed with the Secretary of the Commonwealth. *Id.*

[32] *Id.*

[33] *Id.* at 525, 530, 476 N.E.2d at 224, 226. Under G.L. c. 156B, §§ 85–98, a minority shareholder who objects to a merger has the right to have his or her shares appraised, and to demand payment from the surviving corporation for the shares. It is unclear why Pitts, who was the majority shareholder, sought to exercise appraisal rights. It is possible that Pitts was unaware that he was the majority shareholder. *See supra* note 22.

prove the merger, in violation of sections 78(c)(1)(ii) and (iii), respectively.[34] Pitts also asserted that the oral agreement for the sale of his shares should be disregarded because the Statute of Frauds, expressed in chapter 106, section 8–319 of the Massachusetts General Laws, bars enforcement of oral agreements for the sale of securities.[35] Pitts contended that he was entitled to have Halifax's assets segregated from the assets of the other merged corporations and to receive for his stock a percentage of Halifax's segregated assets equal to the percentage of Halifax stock he owned prior to the merger.[36] This amounted to 70.18% of Halifax's segregated assets, for a total of $711,453.[37] Additionally, Pitts sought compensation for the stock purchase option he had, representing an additional $241,984.[38] Pitts' total demands amounted to 94.46% of Halifax's segregated assets.[39]

Six years after commencing the initial action, Pitts filed a motion for summary judgment on the issue of the corporation's liability for violating sections 78(c)(1)(ii) and (iii).[40] The superior court granted Pitts' motion and one year later appointed a master to make findings relating to the issue of remedy.[41] The master's report contained both general and subsidiary findings.[42] Pitts objected to the subsidiary findings, but the superior court overruled his objections.[43] Pitts then appealed.[44]

The appeals court analyzed the remedy issue in three steps. First, the court considered Pitts' argument that the oral agreement for the sale of

---

[34] *Id.* at 530–31, 476 N.E.2d at 226–27.

[35] *Id.* at 531–32, 476 N.E.2d at 227. G.L. c. 106, § 8–319 provides in pertinent part:

> A contract for the sale of securities is not enforceable by way of action or defense unless: (a) there is some writing signed by the party against whom enforcement is sought . . . sufficient to indicate that a contract has been made for sale of a stated quantity of described securities at a defined or stated price . . . .

[36] 19 Mass. App. Ct. at 531, 476 N.E.2d at 227.

[37] *Id.*

[38] *Id.* Pitts determined this figure by measuring the difference in value between the 70.18% of Halifax, worth $711,453, to which Pitts asserted he was entitled, and the portion of Halifax he would have owned (94.46%) if he had been able to exercise the option, and then subtracting the cost of exercising the option from the difference. *Id.*

[39] *Id.*

[40] *See id.* at 526 n.2, 476 N.E.2d at 224 n.2.

[41] *Id.*

[42] *Id.* at 526, 476 N.E.2d at 224. The Appeals Court did not describe the master's findings.

[43] *Id.* The superior court judge never explicitly adopted the master's report. *Id.* He disagreed with the master's general findings and submitted his own independent findings based on the reported evidence. *Id.* at 526 n.2, 476 N.E.2d at 224 n.2. The Appeals Court, however, treated the judge's action in overruling Pitts' objections to the master's subsidiary findings as an adoption of the master's report with the general findings excised. *Id.* at 526, 476 N.E.2d at 224. The Appeals Court stated that the master's subsidiary findings provided an adequate basis for entering judgment. *Id.* at 527, 476 N.E.2d at 224.

[44] *See id.* at 526–27 & n.2, 476 N.E.2d at 224 & n.2.

his shares was unenforceable under chapter 106, section 8–319. The court agreed with Pitts, noting that the specific language of section 8–319 bars the enforcement of oral agreements for the sale of securities.[45] Thus, the oral agreement was not legally binding on Pitts.[46]

The court next considered whether the corporation's failure to send Pitts notice and to obtain a two-thirds vote prior to effecting the merger, in violation of chapter 156B, sections 78(c)(1)(ii) and (iii), rendered the merger void. The court held that a corporation's failure to comply with the requirements of sections 78(c)(1)(ii) and (iii) does not void the merger, but instead makes it voidable at the request of a shareholder, unless the shareholder's conduct estops him or her from rescinding the merger.[47] In so holding, the court explained that the purpose of sections 78(c)(1)(ii) and (iii) is to protect the rights of shareholders.[48] The court noted that in general shareholders may elect to waive provisions designed for their protection, so that corporate actions effected without complying with the requirements of shareholder protection provisions will be enforceable unless the shareholders object.[49] Therefore, the court reasoned, because sections 78(c)(1)(ii) and (iii) are shareholder protection provisions, Halifax's failure to observe their requirements rendered the Halifax merger voidable at Pitts' option.[50]

Finally, the court considered whether it would be inequitable to allow Pitts to rescind the Halifax merger. The court ruled that under the circumstances of this case rescission would be inequitable.[51] The court reasoned that because rescission was an equitable remedy, the court had to determine whether the merger had harmed Pitts and whether rescission would be unjust to Halifax and the shareholders of the corporations merged into Halifax.[52] Regarding whether Pitts was harmed, the court noted that the merger did not impair the value of Pitts' shares because the two corporations merged into Halifax received for their assets shares of Halifax on the same $100 per share basis for which Pitts had obtained his shares within one year of the merger.[53] Thus, both before and after the merger Pitts held 120 shares of Halifax stock worth a total of

---

[45] *Id.* at 532, 476 N.E.2d at 227.

[46] *Id.*

[47] *Id.*

[48] *Id.*

[49] *Id.* at 532–33, 476 N.E.2d at 227–28. The court noted that this was particularly true where the rights of creditors and other third parties were not involved. *See id.* at 532–33, 476 N.E.2d at 228.

[50] *See id.* at 532–33, 476 N.E.2d at 227–28.

[51] *See id.* at 536, 476 N.E.2d at 229.

[52] *Id.* at 533–34, 476 N.E.2d at 228.

[53] *Id.* at 534–35, 476 N.E.2d at 229.

$12,000.[54] On the other hand, the court found that awarding Pitts the 70.18% of Halifax's segregated assets which he sought would substantially drain Halifax of its assets, thus defeating the purpose of the merger,[55] and would leave the shareholders of the two corporations merged into Halifax with nothing.[56] Therefore, the court refused to rescind the merger.[57]

In reaching its decision on the rescission issue, the court was particularly influenced by the fact that although Pitts complained he did not receive notice of the meeting at which the merger proposal was voted on and did not vote to approve it, Pitts had actual knowledge of the impending merger because Henrich had told him about it.[58] In addition, the court observed that after learning of the merger plans, Pitts orally agreed to sell his shares to the corporation on terms giving him a substantial profit, knowing Henrich and the corporation would rely on the agreement in carrying out the merger.[59] The court reasoned that even though the oral agreement for the sale of Pitts' shares was legally unenforceable, it nevertheless would be inequitable to disregard its existence for the purposes of determining whether to rescind the merger because to do so would give Pitts an undeserved windfall.[60] The court explained that its position was not inconsistent with the Statute of Frauds' prohibition on the oral sales of securities because the court was not enforcing the oral agreement.[61] The court, however, then ruled that because the corporation had relied on the oral agreement in opposing rescission, Pitts should now have the option of selling his shares to the corporation on the terms of the agreement.[62]

The court's holding in *Pitts* that noncompliance with sections 78(1)(c)(ii) and (iii) renders a merger voidable, rather than void, indicates a general willingness to disregard corporate formalities where shareholders have actual knowledge of the merger proposal and informally approve

---

[54] *See id.* Pitts, however, did lose his stock purchase option because the court ruled that he failed to tender the option price, "in court or otherwise," before the option expired in 1971. *Id.* at 536 n.12, 476 N.E.2d at 230 n.12.

[55] *Id.* at 535, 476 N.E.2d at 229. The purpose of the merger was to raise additional capital for Halifax and would be defeated if Pitts were to receive 70.18% (or 94.46%, if the stock option is included) of Halifax's segregated assets. *Id.*

[56] *Id.*

[57] *See id.* at 535–36, 476 N.E.2d at 229.

[58] *See id.* at 533, 535–36, 476 N.E.2d at 228, 229–30.

[59] *Id.* at 535–36, 476 N.E.2d at 229. The court also observed that Henrich, on behalf of the corporation, dealt openly and fairly with Pitts during the negotiations for the sale of Pitts' shares. *Id.*

[60] *Id.* at 536, 476 N.E.2d at 230.

[61] *Id.*

[62] *Id.* at 537, 476 N.E.2d at 230.

it. This is consistent with previous Massachusetts decisions in other areas of corporate law where corporate actions taken without complying with corporate formalities were nevertheless held to be enforceable.[63] Because it is unlikely that actual shareholder knowledge and an opportunity for informal approval will be present in large, publicly held corporations, the practical effect of *Pitts* will probably be confined to small, closely held corporations.

The court's refusal to rescind the Halifax merger is important because it illustrates circumstances under which Massachusetts courts will uphold a merger effected in noncompliance with sections 78(c)(1)(ii) and (iii), despite a shareholder's objections. *Pitts* indicates that a court is unlikely to grant rescission where the shareholder knew about the impending merger and implicitly approved it by agreeing to sell his or her shares to the corporation, rendering technical compliance with sections 78(c)(1)(ii) and (iii) superfluous. In addition, *Pitts* demonstrates that the shareholder urging rescission cannot rely on formalistic arguments such as noncompliance with the Statute of Frauds when asking a court to exercise its equitable powers. Finally, *Pitts* shows that a court is unlikely to grant rescission where the shareholder cannot demonstrate that he or she has suffered adverse economic consequences as a result of the merger.

In summary, in *Pitts v. Halifax Country Club, Inc.*, the appeals court held that a merger accomplished without complying with the requirements of sections 78(c)(1)(ii) and (iii) is voidable at the request of an injured shareholder, unless the shareholder is estopped by his or her own conduct from rescinding the merger. The court in *Pitts* refused to rescind the merger because the objecting shareholder did not suffer adverse economic consequences as a result of the merger. In deciding not to rescind the merger, the court considered it significant that prior to seeking rescission, the shareholder had entered into an oral agreement, subsequently unenforceable under the Statute of Frauds, to sell his shares to

---

[63] *See* Trager v. Schwartz, 345 Mass. 653, 658–59, 189 N.E.2d 509, 512 (1963) (waiver of stock transfer restrictions on stock of small family corporation having three directors enforceable, despite absence of recorded vote by directors, where trust agreement stating plaintiff–director's intent to transfer stock to second director signed by plaintiff and third director); Samia v. Central Oil Co. of Worcester, 339 Mass. 101, 109, 158 N.E.2d 469, 474 (1959) (deceased brother became shareholder in small family corporation prior to death, despite fact that stock certificates never issued to him and stock paid for by transfer of assets in which he had no interest, where family members agreed to issue him stock as gift); Anderson v. K.G. Moore, Inc., 6 Mass. App. Ct. 386, 390–91, 376 N.E.2d 1238, 1241–42 (1978) (contract providing for plaintiff's resignation as officer and director of small family corporation in return for corporation's promise to repurchase his shares enforceable, despite absence of formal board approval, where all directors knew of contract and acquiesced in it).

the corportation in order to effect the merger. The *Pitts* decision is significant because it demonstrates that noncompliance with sections 78(c)(1)(ii) and (iii) may not be fatal to a merger, and because it illustrates circumstances under which a court will refuse to rescind a merger effected in violation of sections 78(c)(1)(ii) and (iii), despite a shareholder's objections.