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Nelson Ferebee Taylor

EVOLUTION OF CORPORATE COMBINATION LAW: POLICY ISSUES AND CONSTITUTIONAL QUESTIONS

NELSON FEREBEE TAYLOR*

This Article traces, and examines policy issues related to, the evolution of the law concerning corporate combinations in the statutes and case law of Delaware, New Jersey, and North Carolina, and in the provisions of the Model Business Corporation Act. Additionally, on the basis of a detailed reevaluation of the reserved power problem, it examines constitutional questions involved in the issue of whether enabling statutes of recent vintage can be utilized by corporations in existence prior to their enactment in the absence of a right of appraisal for dissenting shareholders.

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* Boshamer Professor Emeritus, School of Law, The University of North Carolina at Chapel Hill. B.A., The University of North Carolina, 1942; LL.B., Harvard Law School, 1949; M.A., Oxford University, 1955; LL.D. (honorary), Duke University, 1977, and U.N.C.-Chapel Hill, 1993. The writer acknowledges, with much gratitude, support from the U.N.C. Law Center, help from students who served as his Research Assistants, and patience from his word processor, Ms. Bonita Summers.

INTRODUCTION

Corporate combinations, entailing the acquisition by one corporation of control of the business of another corporation, have

become commonplace in the modern American economy. This Article examines the evolution of the law concerning each of three means of effecting such a combination: (i) merger of the acquired corporation with the acquiring corporation (or its subsidiary), (ii) purchase by the acquiring corporation (or its subsidiary) of the assets of the acquired corporation, and (iii) acquisition by the acquiring corporation (or its subsidiary) of a controlling interest in the stock of the acquired corporation.[1]

The treatment of the subject is partly comparative, involving the evolution of statutes of three selected states—Delaware, New Jersey, and North Carolina[2]—and provisions of the Model Business Corporation Act. Delaware is included because of its twentieth-century prominence as a state of incorporation; New Jersey, because of its nineteenth-century leadership in the development of corporate law; and North Carolina, because not one but two new versions of its general corporation statute have been enacted since 1950—the most recent based on the 1984 Model Business Corporation Act.

The treatment is also partly historical, involving two distinct periods in the evolution. The first period covers developments in the nineteenth century culminating in enactment by the three subject states—in the six-year span 1896 through 1901—of comprehensive corporation statutes. The second period covers the evolution (including revisions and new versions) of those statutes—as they pertain to corporate combinations—during the twentieth century.

The liberalizing nature of the statutory evolution has required a revisitation (not confined to the three subject states) of the question whether modernizing legislation can be utilized by pre-existing

1. A fourth means of effecting a corporate combination is by way of a consolidation. Because consolidations are infrequent today, and because the legal principles applicable to such transactions are essentially the same as those applicable to mergers, consolidations are not addressed as a separate subject in this Article.

The Model Business Corporation Act Annotated contains the following comment:

> Earlier versions of the Model Act also provided for a "consolidation," which was similar to a merger, except that all corporate parties to the transaction disappeared and an entirely new corporation was created. In modern corporate practice consolidation transactions are obsolete since it is nearly always advantageous for one of the parties in the transaction to be the surviving corporation. (If creation of a new entity is considered desirable, a new entity may be created before the merger and the disappearing entities merged into it.) As a result all references to a statutory "consolidation" have been deleted from the Model Act.

MODEL BUS. CORP. ACT ANN. ch. 11 introductory commentary at 11-2 (1996).

2. These three states are sometimes hereinafter referred to as "the three subject states," "the three states," or "the subject states."

corporations notwithstanding the Constitution's Impairment Clause. The "reserved power question" is still with us and deserves to be better understood.

Throughout, the Article examines the tension between the push for greater corporate flexibility and the need for protection of shareholder rights. Written in the belief that capital formation is still essential to the health of our economy, the Article gives special attention to safeguards for shareholders. Of necessity, heavy emphasis is placed on the statutory right of appraisal for dissenters.

(One significant aspect of current combination law is not addressed herein. It is the matter of state anti-takeover statutes,[3] which impose special requirements for corporate combinations in the contexts to which they apply. This omission is due in part to the fact that those statutes represent a massive subject by themselves and in part to the writer's belief that someday Congress will adopt legislation preempting such state statutes. Accordingly, this Article examines the subject of corporate combinations as if such anti-takeover statutes did not exist.)

3. Following Congress's enactment of the Williams Act, Pub. L. No. 90-439, 82 Stat. 454 (1968) (codified at 15 U.S.C. §§ 78m(d)-(e), n(d)-(f) (1994)), many states adopted statutes further regulating tender offers for the benefit of target company managements and shareholders. In 1977, for example, North Carolina adopted its Tender Offer Disclosure Act. Act of June 28, 1977, ch. 781, § 1, 1977 N.C. Sess. Laws 1018, 1018-25 (codified at N.C. GEN. STAT. §§ 78B-1 to -11 (1985)). However, the decision in *Edgar v. MITE Corp.*, 457 U.S. 624 (1982), brought into question the constitutionality of such statutes. Later state statutes, instead of attempting to regulate tender offers, proceeded on the theory of regulating the internal affairs of target corporations—an approach upheld in *CTS Corp. v. Dynamics Corp. of America*, 481 U.S. 69 (1987). In 1986, New Jersey adopted the initial version of its Shareholders' Protection Act. Act of Aug. 5, 1986, ch. 74, 1986 N.J. Laws 523 (effective Jan. 23, 1986) (codified as amended at N.J. STAT. ANN. §§ 14A:10A-1 to -6 (West Supp. 1997)). In 1987, North Carolina adopted the initial version of its Shareholder Protection Act. Act of Apr. 23, 1987, ch. 88, § 1, 1987 N.C. Sess. Laws 84, 84-88 (codified as amended at N.C. GEN. STAT. §§ 55-9-01 to -05 (1990 & Supp. 1996)). Later in the same year, North Carolina adopted the initial version of its Control Share Acquisition Act. Act of May 13, 1987, ch. 182, § 1, 1987 N.C. Sess. Laws 205, 205-10 (codified as amended at N.C. GEN. STAT. §§ 55-9A-01 to -09 (1990 & Supp. 1996)). In 1988, Delaware amended its General Corporation Law by adding a new section 203 titled Business Combinations with Interested Stockholders. Act of Feb. 2, 1988, ch. 204, § 1, 66 Del. Laws 422, 422-25 (1987) (codified as amended at DEL. CODE ANN. tit. 8, § 203 (1991 & Supp. 1996)).

The 1997 Supplements to chapter 55 of the North Carolina General Statutes and title 8 of the Delaware Code Annotated had not been received by the cut-off date for this Article (October 24, 1997). Hence, citations in this Article are to the 1996 Supplements for North Carolina and Delaware.

PART ONE: DEVELOPMENT OF COMBINATION LAW IN THE NINETEENTH CENTURY

I. COMMON-LAW RESTRICTIONS

Corporate combinations, as we know them today, were not permitted at common law. They became possible only by virtue of state enabling statutes.

A. Merger

It has often been stated by courts and commentators that, at common law, a corporate merger could not be effected without the unanimous consent of shareholders.[4] It was probably more accurate to say that, in the absence of enabling legislation, a corporation lacked the legal capacity to enter into a merger.[5] From this, it followed that a single shareholder could move successfully, on ultra

4. *See* New Jersey & Hudson River Ry. & Ferry Co. v. American Elec. Works, 81 A. 989, 991 (N.J. 1911) ("It is, of course, familiar and well-settled law that a majority of the stockholders of a corporation cannot effect a consolidation with another corporation without unanimous consent, unless the right of consolidation has been conferred by legislation that may be read into the contract of incorporation."); Armstrong v. Marathon Oil Co., 513 N.E.2d 776, 781-82 (Ohio 1987) ("[T]he courts of that [early] time viewed the relationship between shareholder and corporation as a vested property right, and the vote of a shareholder owning a single share of stock was sufficient, by the common-law rule, to block any merger, sale of major assets or other organic change."); James Vorenberg, *Exclusiveness of the Dissenting Stockholder's Appraisal Right*, 77 HARV. L. REV. 1189, 1194 (1964) (referring to "the veto which previously [i.e., before enactment of appraisal statutes] the holder of even one share could exercise against mergers, sales of all assets, and other basic corporate changes"); Elliott J. Weiss, *The Law of Take Out Mergers: A Historical Perspective*, 56 N.Y.U. L. REV. 624, 627 (1981) ("At common law, one shareholder in a corporation could block all others from making any fundamental change in the corporation's business or charter . . . .").

5. *See* Clearwater v. Meredith, 68 U.S. (1 Wall.) 25, 39 (1863) ("The power of the legislature to confer such [merger] authority cannot be questioned, and without the authority, railroad corporations organized separately, could not merge and consolidate their interests."); Garrett v. Reid-Cashion Land & Cattle Co., 270 P. 1044, 1049 (Ariz. 1928) ("The right to consolidate or merge two or more corporations into one ... is governed by statute or charter provisions."); Chicago Title & Trust Co. v. Doyle, 102 N.E. 790, 791 (Ill. 1913) ("As a corporation must be created originally by statutory authority, any consolidation, purchase, or merger by which it acquires the franchises of another corporation must also have statutory authority."); Colgate v. United States Leather Co., 72 A. 126, 128-29 (N.J. 1909) ("It is entirely well settled that the power of corporations to consolidate and merge is not to be implied, and exists only by virtue of plain legislative enactment."); Carolina Coach Co. v. Hartness, 198 N.C. 524, 528, 152 S.E. 489, 491 (1930) ("Legislative sanction is essential, not only to the creation, but to the merger or consolidation of corporations."); Jones v. Rhea, 107 S.E. 814, 824 (Va. 1921) ("[T]his proposition that the right to merge must be plainly afforded by law ... is abundantly sustained by authority.").

vires grounds, to enjoin the consummation of a corporate merger not authorized by statute.[6]

B. Purchase/Sale of Assets[7]

One of the basic characteristics of a corporation is its capacity, as a legal entity, to acquire and hold real and personal property. Thus, there could be little doubt that, at common law, a corporation had the legal capacity to purchase all of the assets of another corporation (except when the purpose was to eliminate competition[8]). For this reason, state statutes authorizing such purchases have not generally been thought necessary.[9]

The situation was different when the perspective was that of a corporation selling all of its assets.[10] At common law, a corporation, unless in a failing condition, could not dispose of all of its assets without the unanimous consent of its shareholders.[11] However, this

6. *See* William B. Riker & Son Co. v. United Drug Co., 82 A. 930, 931 (N.J. 1912) ("[A]ny stockholder who refuses to consent [to a proposed merger not authorized by statute] is entitled to the aid of a court of equity to prevent its being carried into execution.").

7. The term "sale of assets" is used herein to denote the sale by a corporation of all or substantially all of its assets otherwise than in the ordinary course of business.

There can, of course, be difficult questions as to what constitutes "substantially all" of a corporation's assets. *See* Thorpe *ex rel.* Castleman v. CERBCO, Inc., 676 A.2d 436, 444 (Del. 1996); Katz v. Bregman, 431 A.2d 1274, 1275-76 (Del. Ch. 1981); Gimbel v. Signal Cos., 316 A.2d 599, 605-07 (Del. Ch.), *aff'd per curiam on limited grounds*, 316 A.2d 619 (Del. 1974); Stiles v. Aluminum Prods. Co., 86 N.E.2d 887, 888-89 (Ill. App. Ct. 1949); Good v. Lackawanna Leather Co., 233 A.2d 201, 210 (N.J. Super. Ct. Ch. Div. 1967).

8. *See* Elkins v. Camden & Atl. R.R. Co., 36 N.J. Eq. 5, 13-14 (Ch. 1882).

9. Nonetheless, there were nineteenth-century examples of special acts authorizing a named railroad corporation to purchase the railroad of another company. *See, e.g.*, Act of Feb. 22, 1849, [no chapter number], 1849 N.J. Laws 90; Act of Mar. 17, 1854, ch. 216, § 3, 1854 N.J. Laws 524, 525; *see also infra* text accompanying notes 123 (discussing the 1849 act) and 127 (discussing the 1854 act).

10. This subject is discussed in the following: Richard G. Elliott, Jr., Comment, *Corporations—Disposition of Corporate Assets*, 43 N.C. L. REV. 957 (1965); and Note, *Corporations—Power of Majority Stockholders to Authorize the Sale of All of the Corporate Property*, 14 MINN. L. REV. 58 (1929).

11. *See* American Seating Co. v. Bullard, 290 F. 896, 899 (6th Cir. 1923) ("The law is settled without apparent conflict that neither the directors nor a majority of the stockholders of a solvent going corporation have power to sell all its property and assets, thereby disabling itself from achieving the objects of its creation, against the dissent of a single stockholder."); Garrett v. Reid-Cashion Land & Cattle Co., 270 P. 1044, 1049 (Ariz. 1928) ("Under the common law, neither the board of directors nor a majority of the stockholders could dispose of all the property and assets of a prosperous and going concern and put it out of business before the expiration of the time for which it was incorporated ...."); Butler v. New Keystone Copper Co., 93 A. 380, 383 (Del. Ch. 1915) ("The general rule as to commercial corporations seems to be settled that neither the

restriction could hardly be based on lack of corporate capacity. Rather, it was based on the view that a sale of assets by a solvent corporation, without the unanimous consent of its shareholders, would constitute a breach of an implied contract among the

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directors nor the stockholders of a prosperous, going concern have power to sell all, or substantially all, the property of the company if the holder of a single share dissent."); Forrester v. Boston & Montana Consol. Copper & Silver Mining Co., 55 P. 229, 233 ("At common law, neither the directors nor a majority of the stockholders have power to sell or otherwise transfer all the property of a going, prosperous corporation, able to achieve the objects of its creation, as against the dissent of a single stockholder."), *reh'g denied*, 55 P. 353 (Mont. 1898); Good v. Lackawanna Leather Co., 233 A.2d 201, 211 (N.J. Super. Ct. Ch. Div. 1967) ("At common law unanimous shareholder consent was required in order for a corporation to sell all of its assets. Any attempt by the corporation to dispose of its assets without such unanimous consent was void and could be set aside upon the application of a dissenting shareholder."); Kean v. Johnson, 9 N.J. Eq. 401 (Ch. 1853); Eisenberg v. Central Zone Property Corp., 115 N.E.2d 652, 655 (N.Y. 1953) ("At common law neither the majority stockholders nor the directors could bring about a sale or cause a transfer of any portion of the property, essential for the transaction of its customary business, of a solvent, prosperous corporation, which was justifying the reason for its corporate existence, against the will of a minority however small."); *In re* Clark's Will, 178 N.E. 766, 768 (N.Y. 1931) ("At common law, the assets of a corporation could not be sold without the consent of all stockholders."); Abbot v. American Hard Rubber Co., 33 Barb. 578 (N.Y. App. Div. 1861); Craddock-Terry Co. v. Powell, 25 S.E.2d 363, 368-69 (Va. 1943) ("In the absence of an enabling statute, the common law rule, as pronounced by the majority of the courts, was that a sale of all the assets of a corporation for cash or securities could not be made without the unanimous consent of the stockholders.").

There was, however, authority to the contrary. *See* Beidenkopf v. Des Moines Life Ins. Co., 142 N.W. 434 (Iowa 1913); Treadwell v. Salisbury Mfg. Co., 73 Mass. (7 Gray) 393, 404 (1856) ("At common law, the right of corporations, acting by a majority of their stockholders, to sell their property is absolute, and is not limited as to objects, circumstances or quantity."); Bowditch v. Jackson Co., 82 A. 1014 (N.H. 1912); Edward H. Warren, *Voluntary Transfers of Corporate Undertakings*, 30 HARV. L. REV. 335 (1917).

Relevant to this matter were cases involving the question whether a railroad corporation could enter into a long-term lease of its properties. In *Pennsylvania Railroad Co. v. St. Louis, Alton & Terre Haute Railroad Co.*, 118 U.S. 290 (1886), the Court, after reviewing a number of decisions, said the following:

> We think it may be stated, as the just result of these cases and on sound principle, that unless specially authorized by its charter, or aided by some other legislative action, a railroad company cannot, by lease or any other contract, turn over to another company, for a long period of time, its road and all its appurtenances, the use of its franchises, and the exercise of its powers, nor can any other railroad company without similar authority make a contract to receive and operate such road, franchises, and property of the first corporation, and that such a contract is not among the ordinary powers of a railroad company, and is not to be presumed from the usual grant of powers in a railroad charter.

Id. at 309. And in *Oregon Railway & Navigation Co. v. Oregonian Railway Co.*, 130 U.S. 1 (1889), the Court concluded that a corporation, even though authorized by its charter (filed under a general corporation statute) to buy or sell or lease railroads, could not enter into a 96-year lease of railroad properties—either as lessor or as lessee—in the absence of express statutory authorization to do so. *See id.* at 30-36.

shareholders that the corporate assets were to be employed for the life of the corporation in pursuance of the purposes stated in its charter.[12]

C. *Purchase/Sale of Controlling Stock Interest*

Absent authorization in its charter or in a statute,[13] a corporation could not, at common law, acquire stock of another corporation.[14] This was especially true when the stock purchase amounted to the

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12. Probably the best-known statement of this rationale is that contained in *Geddes v. Anaconda Copper Mining Co.*, 254 U.S. 590 (1921), the Court saying:

> It is, of course, a general rule of law that, in the absence of special authority so to do, the owners of a majority of the stock of a corporation have not the power to authorize the directors to sell all of the property of the company and thereby abandon the enterprise for which it was organized....
>
> The rule that owners of a majority of the stock may not authorize the sale of all of the property of a going and not unprofitable company, rests upon the principle that exercise of such power would defeat the implied contract among the stockholders to pursue the purpose for which it was chartered.

Id. at 595-96.

To the same effect is the following from *Fontaine v. Brown County Motors Co.*, 29 N.W.2d 744 (Wis. 1947):

> At the common law a business corporation other than a real estate corporation was not permitted to dispose of its entire property except by unanimous consent of the stockholders, if the corporation were a solvent going concern.... The basis for the limitation of authority was that such a conveyance was a substantial abandonment of the business enterprise and contrary to the implied agreement of the stockholders that the corporate property would be devoted to the prosecution of corporate purposes.

Id. at 746-47; *see also* Elliott, *supra* note 10, at 958 ("At common law, the sale of all the assets of a prosperous, going concern required unanimous shareholder consent. This doctrine was based on a theory of an implied contract between the shareholders to pursue the business for which the corporation was chartered.").

13. In *Meares v. Monroe Land & Improvement Co.*, 126 N.C. 662, 36 S.E. 130 (1900), it was stated to be the general rule that, absent an "express provision in [the corporation's] charter authorizing it to take stock in another corporation, it could not, in law, do so, if it had attempted to do so." *Id.* at 664, 36 S.E. at 131 (note that slight punctuation differences exist between the version of this quotation published in the North Carolina Reporter and the version published in the South Eastern Reporter; this version is taken from the South Eastern Reporter).

Similarly, in *State v. Atlantic City & Shore Railroad Co.*, 72 A. 111 (N.J. 1909), it was stated:

> [I]t is undoubtedly the general rule in this country that one corporation may not become a stockholder in another unless authority is clearly granted by statute; and this is but a corollary of the principle that corporations possess only such powers as are specifically granted by the state, and such incidental powers as are necessary for carrying these into effect.

Id. at 117.

14. See *Central Railroad Co. v. Collins*, 40 Ga. 582, 624-28 (1869), and *People v. Chicago Gas Trust Co.*, 22 N.E. 798, 800 (Ill. 1889), and the authorities cited therein.

acquisition of control,[15] and particularly if that control was to be exercised for the purpose of eliminating competition.[16] There were numerous reasons for this common-law rule, but chief among them was the limitation arising from the ultra vires doctrine.[17]

Free transferability of interests is, of course, one of the attributes of a corporation that distinguish it from a partnership. Thus, absent some self-imposed restriction on transfer (as in the case of a close corporation), shareholders are generally free to dispose of their stock at times and on terms of their own choosing. The corporation itself is involved only if one takes the view that control constitutes a corporate asset.[18]

D. Charter Authorization

If a corporation's original certificate of incorporation granted it the power to effect a merger or a sale of assets (upon the favorable vote of holders of some specified majority of the corporation's shares) or to acquire and vote the stock of another corporation (by director action without any shareholder vote), this would be tantamount to governmental authorization of such a transaction. Accordingly, the power could be validly exercised in accordance with the provisions of the original charter notwithstanding the absence of enabling legislation of general applicability. It has been so held as to a sale of assets[19] and as to a long-term lease of a railroad's road,[20] and

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15. In *De la Vergne Refrigerating Machine Co. v. German Savings Institute*, 175 U.S. 40 (1899), the Court said:

> But as the powers of corporations, created by legislative act, are limited to such as the act expressly confers, and the enumeration of these implies the exclusion of all others, it follows that, unless express permission be given to do so, it is not within the general powers of a corporation to purchase the stock of other corporations for the purpose of controlling their management.

Id. at 54-55; *see also* WALTER CHADWICK NOYES, INTERCORPORATE RELATIONS § 298, at 545-46 (2d ed. 1909) (stating that a corporation must have express authority before purchasing shares in another corporation to gain control).

16. *See* Elkins v. Camden & Atl. R.R. Co., 36 N.J. Eq. 5, 13-14 (Ch. 1882).

17. *See* Hill v. Nisbet, 100 Ind. 341, 349 (1884); Note, *Power of a Corporation to Acquire Stock of Another Corporation*, 31 COLUM. L. REV. 281, 284-86 (1931).

18. This concept is tangential to the subject now being addressed and will not be dealt with further. However, for a discussion of this subject, see Thomas L. Hazen, *Transfers of Corporate Control and Duties of Controlling Shareholders—Common Law, Tender Offers, Investment Companies—and a Proposal for Reform*, 125 U. PA. L. REV. 1023, 1024-41 (1977), and the authorities cited in note 1 of that article.

19. In *Butler v. New Keystone Copper Co.*, 93 A. 380 (Del. Ch. 1915), the court said:

> Stated succinctly, I hold . . . in this case that a corporation created to carry on the general business of mining, with general charter powers to buy, sell and deal in mines, and own shares of stock of other corporations, and with a special

there were dicta in support of this proposition with respect to both corporate mergers[21] and corporate acquisitions of stock of other corporations.[22]

On the other hand, it is doubtful that a charter amendment, adopted by less than all of a corporation's shareholders, could provide a sufficient basis for the consummation of such a transaction.[23] It has been held, for example, that in the absence of a statute authorizing a sale of assets for stock, a charter amendment adopted by less than all of the shareholders could not validly provide

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> charter power vested in the directors to sell, or otherwise dispose of, all or substantially all its property and assets of the corporation with the assent of the holders of three-fourths of all the stock, may with such assent sell substantially all its property and assets to another corporation and take in payment therefor shares of the purchasing corporation, even though some of the stockholders dissent, and the directors will not be enjoined from submitting to the stockholders the proposed sale.

Id. at 385; *accord* Traer v. Lucas Prospecting Co., 99 N.W. 290, 293-94 (Iowa 1904).

20. The North Carolina Rail Road Company was chartered by Act of Jan. 27, 1849, ch. 82, 1848-49 N.C. Sess. Laws 138. Section 19 of that special-act charter provided that "the said company may, when they see fit, farm out their right of transportation over said rail road." *Id.* § 19, 1848-49 N.C. Sess. Laws at 146. In *State v. Richmond & Danville Railroad Co.*, 72 N.C. 634 (1875), it was held that this charter provision was sufficient to validate a 30-year lease of the company's road to another corporation. *See id.* at 636-37.

21. *See* Jones v. Missouri-Edison Elec. Co., 135 F. 153, 156 (C.C.E.D. Mo. 1905) ("It is fundamental law that the right to exercise such a vital power of a corporation as contemplates [consolidation into another corporation] must be found in some positive plenary legislative grant either in the articles of association of the corporations consolidating or in the general law of the land."), *rev'd on other grounds*, 144 F. 765 (8th Cir. 1906); Market St. Ry. Co. v. Hellman, 42 P. 225, 229 (Cal. 1895) ("Corporations cannot, without the consent of all their stockholders, consolidate with others, except where the power so to do is given by their charters, or by a general statute . . . ."); Spencer v. Seaboard Air Line Ry. Co., 137 N.C. 107, 119, 49 S.E. 96, 101 (1904) ("It is settled that the power to consolidate may be conferred either in the charter, or by a general enabling act.") (note that this is the case name as it appears in the South Eastern Reporter; it is entitled *Spencer v. Railroad* in the North Carolina Reporter; also note that slight punctuation differences exist between the version of this quotation published in the North Carolina Reporter and the version published in the South Eastern Reporter; this version is taken from the South Eastern Reporter).

22. *See* Meares v. Monroe Land & Improvement Co., 126 N.C. 662, 36 S.E. 130 (1900) (quoted *supra* in note 13). For an example of a New Jersey corporation whose charter authorized it to acquire and vote the stock of an Illinois corporation, see *Ellerman v. Chicago Junction Railways & Union Stock-Yards Co.*, 23 A. 287 (N.J. Ch. 1891).

23. When a corporate charter prohibited the corporation from consolidating with another without majority approval of the shareholders but also authorized amendments to the charter by action of the directors alone, and thereafter the charter was amended by the directors to authorize a consolidation without majority approval by the shareholders, it was held that non-assenting shareholders were not bound to go along with a consolidation authorized only by a directors' resolution adopted pursuant to the charter amendment as approved by those directors. *See* Blatchford v. Ross, 54 Barb. 42, 47 (N.Y. App. Div. 1869).

authorization for such a sale.[24]

II. Coming of Change Through Enabling Legislation

A. Need for Enabling Statutes

With the quickening pace of the Industrial Revolution in the second half of the nineteenth century, the common-law rules restricting corporate combinations were inevitably displaced. Given the needs of a burgeoning economy, it came to be perceived that a requirement of unanimity—under which a single shareholder could forestall a presumably desirable corporate combination—was intolerable.[25] The desire, not only to facilitate corporate combinations in the public interest, but also to inhibit extortion by minority shareholders,[26] made apparent the need for legislation

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24. *See* American Seating Co. v. Bullard, 290 F. 896, 900-01 (6th Cir. 1923) (involving a New Jersey corporation).

25. In *Louisville & Nashville Railroad Co. v. Jarvis*, 87 S.W. 759 (Ky. 1905), the court said:

> It requires but little observation to know that the trend of railroad development has been constantly from isolated fragments of railway lines towards consolidation into grand trunk lines, and that in proportion as this has been successfully accomplished has the great usefulness of this branch of the common carriers of traffic and passengers of this country been increased. It therefore would seem to follow, as a natural and logical conclusion, that it is much to the interest of small and fragmentary lines that they should be enabled with the utmost facility, consistent with the preservation of the rights of the owners, to enter into contracts of consolidation or sale with other railroads, whereby they may become parts of great systems of interstate traffic, rather than remain small, isolated lines. To require the unanimous vote of all the stock of a railroad to unite with another railroad, or to sell its franchises out to another railroad, if that be desirable, is to render this method of developing the interest of the corporation impracticable, as it simply provides an opportunity for a small number of the stockholders to entirely block the interest of the great majority of the stock for their own selfish purposes.

Id. at 762; *accord* Armstrong v. Marathon Oil Co., 513 N.E.2d 776, 782 (Ohio 1987).

Weiss states that "[s]tate legislatures came to recognize that requiring unanimous consent for fundamental changes in a corporation's organization and barring take outs of dissenting shareholders created the potential for tyranny by the minority, thus impeding economic progress by blocking desirable commercial transactions." Weiss, *supra* note 4, at 629.

26. *See* Voeller v. Neilston Warehouse Co., 311 U.S. 531, 535 n.6 (1941) ("At common law, unanimous shareholder consent was a prerequisite to fundamental changes in the corporation. This made it possible for an arbitrary minority to establish a nuisance value for its shares by refusal to cooperate."); *In re* Timmis, 93 N.E. 522, 523 (N.Y. 1910) ("An incidental evil [of the requirement of unanimity for shareholder approval of a sale-of-assets transaction] was the power of a dissenting stockholder to compel the majority to buy him out on his own terms in order to secure unanimous consent with no one left to question the transaction.").

altering the common-law rules.

B. *Overcoming the Barrier to Utilization of Post-Incorporation Enabling Legislation*

While the common-law restrictions on corporate combinations could, of course, be changed by enabling statutes, there was a potential barrier to the utilization of such legislation by a pre-existing corporation.

1. Nature of the Barrier

With respect to corporations to be chartered subsequent to enactment of enabling legislation, the state legislatures enjoyed a free hand in authorizing (and prescribing both limitations on and liberalized procedures for) corporate combinations.[27] Statutory authorization of a corporate combination with only majority shareholder approval, if such authorization was contained in a special act chartering the corporation or in a general law under which the corporation was organized, would be a part of the charter contract and therefore be binding upon all the shareholders.[28]

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27. It was established in *Ogden v. Saunders*, 25 U.S. (12 Wheat.) 213, 369 (1827), that the Impairment Clause, U.S. CONST. art. 1, § 10, prohibited state legislation only to the extent that such legislation applied to pre-existing contracts. *See* BERNARD SCHWARTZ, A COMMENTARY ON THE CONSTITUTION OF THE UNITED STATES—PART II—THE RIGHTS OF PROPERTY 271-73 (1965).

The point was made as follows in *Edwards v. Kearzey*, 96 U.S. 595 (1877): "The States may legislate as to contracts thereafter made, as they may see fit. It is only those in existence when the hostile law is passed that are protected from its effect." *Id.* at 603.

In *Imperial Trust Co. v. Magazine Repeating Razor Co.*, 46 A.2d 449 (N.J. Ch. 1946), the court said:

> Endowed with the governmental power to legalize mergers, the legislature ex consequentia can prescribe the terms and conditions. Indeed, as Justice Swayze remarked, "The Legislature is under no compulsion to authorize a merger, and it may impose even fanciful conditions; it might, for instance, prescribe that the approval should be written in red ink."

Id. at 451 (quoting American Malt Corp. v. Board of Pub. Util. Comm'rs, 92 A. 362, 363 (N.J. 1914)).

28. In *Nugent v. Supervisors*, 86 U.S. (19 Wall.) 241 (1873), a county was held liable on bonds issued in payment of its subscription to stock of a railroad company, notwithstanding the consolidation of that company with another, because such consolidation was authorized by a pre-incorporation statute (as well as by a provision in the special-act charter of the company). *See id.* at 253. The Court said:

> In a multitude of cases decided in England and in this country it has been determined that a subscriber for the stock of a company is not released from his engagement to take it and pay for it by any alteration of the organization or purposes of the company which, at the time the subscription was made, were authorized either by the general law or by the special charter, and a clear

However, with respect to corporations already in existence, there was a problem concerning the utilization of enabling legislation that authorized a corporate combination upon the vote of holders of some specified majority (less than all) of the shares.[29] That problem arose from a concept deeply embedded in nineteenth-century

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> distinction is recognized between the effect of such alterations and the effect of those made under legislation subsequent to the contract of subscription.... The American authorities ... uniformly assert that the subscriber for stock is released from his subscription by a subsequent alteration of the organization or purposes of the company, only when such alteration is both fundamental *and not provided for or contemplated by either the charter itself or the general laws of the State.*

Id. at 250-51.

In *Dickinson v. Consolidated Traction Co.*, 114 F. 232 (C.C.D.N.J. 1902), *aff'd*, 119 F. 871 (3d Cir. 1903), when the executors of a deceased shareholder of a corporation sought rescission of a 999-year lease of the corporation's property and franchises that had been made to another corporation with the favorable vote of holders of a majority of the lessor's shares, the court denied such relief, noting that both corporations had been formed under the same 1893 act and that such act not only authorized such leases but also provided a right of appraisal to dissenting shareholders. *See id.* at 253-55.

In *Mayfield v. Alton Railway, Gas & Electric Co.*, 65 N.E. 100 (Ill. 1902), when a merger was effected pursuant to pre-incorporation legislation upon a two-thirds vote of shareholders and a dissenting shareholder sought payment in cash for his shares (even though the statute made no provision for a right of appraisal), the court denied relief, saying:

> Of course, statutes authorizing consolidation after subscriptions have been made cannot be held to compel a dissenting stockholder to transfer his subscription to the consolidated company, because to do so would impair the obligation of his contract. But if a statute already in existence to that effect enters into and becomes a part of his contract, then manifestly there is no impairment of his contract by requiring him to submit to the required majority vote for the consolidation....

Id. at 102; *accord* Allied Chem. & Dye Corp. v. Steel & Tube Co., 120 A. 486, 490 (Del. Ch. 1923); Norton v. Union Traction Co., 110 N.E. 113, 118-19 (Ind. 1915); Sparrow v. Evansville & Crawfordsville R.R. Co., 7 Ind. 369, 372-74 (1856); New Jersey & Hudson River Ry. & Ferry Co. v. American Elec. Works, 81 A. 989, 991 (N.J. 1911).

29. In *Fry's Executor v. Lexington & Big Sandy Railroad Co.*, 59 Ky. (2 Met.) 314 (1859), in commenting on post-incorporation legislation whereby the charter of a railroad corporation was amended to authorize it to consolidate with other railroad companies or to subscribe to the stock of other such companies, the court said:

> Each shareholder in an incorporated company has a right to insist on the prosecution of the particular objects of the charter. He can not be deprived of his rights or privileges without his assent. Such alterations of the charter as are necessary to carry into effect its main design, may be made without his consent. But an alteration which materially and fundamentally changes the responsibilities and duties of the company, or which superadds an entirely new enterprise to that which was originally contemplated, may be resisted by the stockholders, unless such alterations are provided for in the charter itself, or in the general laws of the State in force at the time the act of incorporation was passed.

Id. at 321.

corporate law—the concept that a corporate charter constituted a contract, one of whose central features was a limitation on the corporation's powers and purposes.[30] Part of that contractual arrangement was the understanding that the directors or majority shareholders could take action—notwithstanding opposition by minority shareholders—if such action was within the ambit of the powers and purposes stated in the corporate charter.[31] But there was

30. In *Hartford & New Haven Railroad Co. v. Croswell*, 16 N.Y. Com. Law Rep. (5 Hill) 383 (Sup. Ct. 1843), the court said:

> Indeed, [corporations] can exercise no powers over the corporators beyond those conferred by the charter to which they have subscribed, except on the condition of their agreement or consent. This is so in the case of private associations, where the articles entered into and subscribed by the members are regarded as the fundamental law or constitution of the society, which can only be changed by the unanimous voice of the stockholders. So here, the original charter is the fundamental law of the association—the Constitution which prescribes limits to the directors, officers and agents of the Company not only, but to the action of the corporate body itself—and no radical change or alteration can be made or allowed, by which new and additional objects are to be accomplished, or responsibilities incurred by the Company, so as to bind the individuals composing it, without their assent.

Id. at 386 (citation omitted).

31. *See* Clearwater v. Meredith, 68 U.S. (1 Wall.) 25, 40 (1863) ("When any person takes stock in a railroad corporation, he has entered into a contract with the company, that his interests shall be subject to the direction and control of the proper authorities of the corporation to accomplish the object for which the company was organized."). In *Durfee v. Old Colony & Fall River Railroad Co.*, 87 Mass. (5 Allen) 230 (1862), the point was made as follows:

> We suppose it may be stated as an indisputable proposition, that every person who becomes a member of a corporation aggregate by purchasing and holding shares agrees by necessary implication that he will be bound by all acts and proceedings, within the scope of the powers and authority conferred by the charter, which shall be adopted or sanctioned by a vote of the majority of the corporation, duly taken and ascertained according to law. This is the unavoidable result of the fundamental principle that the majority of the stockholders can regulate and control the lawful exercise of the powers conferred on a corporation by its charter. A holder of shares in an incorporated body, so far as his individual rights and interests may be involved in the doings of the corporation, acting within the legitimate sphere of its corporate power, has no other legal control over them than that which he can exercise by his single vote in the meetings of the company.... It cannot, therefore, be justly said that the contract, express or implied, between the corporation and the stockholders is infringed or impaired by any act or proceeding of the former which is authorized by a majority, and which comes within the terms of the original statute creating and establishing their franchise, and conferring on them capacity to exercise control over the rights and property of their members. On the contrary, the fair and reasonable implication resulting from the legal relation of the stockholder and the corporation is, that the majority may do any act either coming within the scope of the corporate authority, or which is consistent with the terms and conditions of the original charter, without and even against the consent of an individual member.

also the understanding that, if the directors or majority shareholders proposed to effect a significant change in the nature or operation of the corporate business as specified in the charter, a minority shareholder could successfully sue to enjoin or (as the question often arose) defend against an action by the corporation to collect on his unpaid stock subscription.[32]

Id. at 242-43.

32. In *Wiswall v. Greenville & Raleigh Plank-Road Co.*, 56 N.C. (3 Jones Eq.) 183 (1857), when minority shareholders of a corporation, organized to build and operate a plank road between two specified points, brought suit to enjoin the management from proceeding—pursuant to a majority vote of shareholders—to purchase a line of stages and to procure a contract for carrying mail, the court ruled in favor of the shareholder-plaintiffs. *See id.* at 185-86. In *Central Railroad Co. v. Collins*, 40 Ga. 582 (1869), in holding that a railroad corporation could be enjoined from purchasing a large block of stock in another railroad corporation, the court said:

> By becoming a stockholder he has contracted that a majority of the stockholders shall manage the affairs of the company within its proper sphere as a corporation, but no further; and any attempt to use the funds, or pledge the credit of the company not within the legitimate scope of the charter, is a violation of the contract which the stockholders have made with each other, and of the rights—the contract rights—of any stockholder who chooses to say, "I am not willing."

Id. at 618; *see also* Johnson v. Tribune-Herald Co., 116 S.E. 810, 811 (Ga. 1923) (enjoining an application for amendments to a corporate charter and stating that "[i]t is now well settled in this state that, when proposed amendments to a charter are fundamental, radical, or vital, the unanimous consent of all the stockholders to their acceptance is essential"); Faunce v. Boost Co., 83 A.2d 649, 652 (N.J. Super. Ct. Ch. Div. 1951) (holding that complaining minority shareholders could enjoin consummation of a charter amendment, proposed by the board and approved by vote of more than two-thirds of the outstanding shares, that would have effected a stock reclassification whereby the complainants would have been deprived of their voting rights); Elkins v. Camden & Atl. R.R. Co., 36 N.J. Eq. 5, 7-8, 13-16 (Ch. 1882) (holding that a shareholder could enjoin, on ultra vires grounds, a proposed acquisition by his railroad corporation of stock, bonds, and rolling equipment of another railroad corporation operating a parallel line on a narrower gauge, even though the transaction was to be consummated only if approved by a majority vote of shareholders of the acquiring corporation).

In *New Orleans, Jackson & Great Northern Railroad Co. v. Harris*, 27 Miss. 517 (1854), when suit was brought to collect on an unpaid stock subscription following a fundamental corporate change effected by a majority vote of shareholders pursuant to post-incorporation enabling legislation, the court denied relief, saying:

> [W]hen a person becomes a member of an incorporated company by his subscription to the stock, he agrees to be bound by the terms of his contract, as defined in the charter of incorporation; he agrees to be bound by the acts of the corporation and its officers, performed within the scope of the charter powers; but upon no principle can it be held that he impliedly consents to any alteration which would work a radical change in the structure of the association [in this case, a transaction amounting to a merger of the shareholder's corporation into another], which might be voted or accepted by even a majority of the whole of the corporators, and thereby be subjected to burdens and obligations wholly foreign to the purposes and objects of the original charter.

Id. at 540.

The problem was compounded by the provision in Article I, Section 10 of the U.S. Constitution that "[n]o State shall . . . pass any . . . Law impairing the Obligation of Contracts"[33] and by the decision in *Trustees of Dartmouth College v. Woodward*[34] that a corporate charter constituted a contract within the purview of that constitutional provision.[35] Moreover, after the Supreme Court's decision in the *Dartmouth College* case, it came to be accepted doctrine that a corporate charter, in addition to being a contract between the state and the corporation,[36] was also a contract between the corporation and its shareholders as well as a contract among the body of shareholders,[37] with the latter two of these contracts—as well

33. U.S. CONST. art. I, § 10. For a brief history of the Constitution's Impairment Clause, see Douglas W. Kmiec & John O. McGinnis, *The Contract Clause: A Return to the Original Understanding*, 14 HASTINGS CONST. L.Q. 525 (1987).

34. 17 U.S. (4 Wheat.) 518 (1819).

35. *See id.* at 650. Thus, in *Jefferson Branch Bank v. Skelly*, 66 U.S. (1 Black) 436 (1861), it was held that, when a bank's act of incorporation provided for a tax at the rate of 6% of its profit in lieu of all other taxes, a post-incorporation statute imposing an additional tax could not be applied to the bank because the charter provision constituted a contract protected by the Impairment Clause. *See id.* at 448-50. Similarly, in *The Binghamton Bridge*, 70 U.S. (3 Wall.) 51 (1865), when a corporation had been chartered by special act to build a toll bridge across a river, with the stipulation that no other party could build any bridge within two miles on either side of the authorized bridge, it was held that a subsequent act of the legislature, chartering another corporation to build another bridge within the two-mile limit, constituted a violation of the contract embodied in the earlier charter and was therefore void because of the Impairment Clause. *See id.* at 81-82; *see also* Louisiana State Lottery Co. v. Fitzpatrick, 15 F. Cas. 970, 984 (C.C.D. La. 1879) (No. 8541) (holding that, when a corporation was chartered by special act in 1868 to operate lotteries for a term of 25 years and no power was reserved to the legislature to amend or repeal the charter, a federal court could properly enjoin—as violative of the Impairment Clause—the implementation of a state statute enacted in 1879 purporting to terminate the corporation's existence and to make it unlawful to operate lotteries).

36. The holding that a corporate charter constituted a contract between the state and the corporation occasioned substantial criticism. *See, e.g.*, Barnett v. D.O. Martin Co., 11 S.E.2d 210, 213 (Ga. 1940). Nevertheless, it continues to be accepted doctrine. In *Stone v. Mississippi*, 101 U.S. 814 (1879), the Court said:

> It is now too late to contend that any contract which a State actually enters into when granting a charter to a private corporation is not within the protection of the clause in the Constitution of the United States that prohibits States from passing laws impairing the obligation of contracts. The doctrines of *Trustees of Dartmouth College v. Woodward*, announced by this court more than sixty years ago, have become so imbedded in the jurisprudence of the United States as to make them to all intents and purposes a part of the Constitution itself.

Id. at 816 (citations omitted).

37. *See* Hartford Accident & Indem. Co. v. W.S. Dickey Clay Mfg. Co., 24 A.2d 315, 322 (Del. 1942) ("Regarding the charter as a contract, it has such status as between the State and the corporation, as between the corporation and its shareholders, and, in some respects, as between the shareholders among themselves."); Morris v. American Pub.

as the first—being subject to the Impairment Clause.[38] Further, it was generally held that, if a corporation was formed not by special act but under a general law, the provisions of that law, as in effect at the time of incorporation, became part of the charter contract.[39] Finally,

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Utils. Co., 122 A. 696, 700 (Del. Ch. 1923); Bowman v. Armour & Co., 160 N.E.2d 753, 755 (Ill. 1959) ("The charter or articles of incorporation ... is a contract of a three-fold nature. It is operative as between the corporation and the State and it creates rights and duties as between the corporation and its shareholders, as well as between the shareholders themselves."); Western Foundry Co. v. Wicker, 85 N.E.2d 722, 726 (Ill. 1949) ("Spoken of as a contract having a threefold nature, [a corporate charter] operates to create rights and duties between the State and the corporation, between the corporation and its shareholders, and among the shareholders themselves."); Somerville v. St. Louis Mining & Milling Co., 127 P. 464, 465 (Mont. 1912) ("The charter granted by a state to corporation ... operates in a threefold relationship, viz.: (a) Between the state and the corporation; (b) between the corporation and its stockholders; and (c) between the stockholders inter sese."); *In re* Collins-Doan Co., 70 A.2d 159, 163 (N.J. 1949); Faunce v. Boost Co., 83 A.2d 649, 651 (N.J. Super. Ct. Ch. Div. 1951); Moore v. Conover, 195 A. 833, 841 (N.J. Ch. 1937); Dentel v. Fidelity Sav. & Loan Ass'n, 539 P.2d 649, 651 (Or. 1975) ("The articles of incorporation constitute 'a contract between the corporation and the state, between the corporation and its owners, and between the owners themselves.' " (quoting NORMAN D. LATTIN, THE LAW OF CORPORATIONS § 156, at 570 (2d. ed. 1971))); Winfree v. Riverside Cotton Mills Co., 75 S.E. 309, 311 (Va. 1912).

38. In *Calvert v. Capital Southwest Corp.*, 441 S.W.2d 247 (Tex. Civ. App. 1969), the court said: "It is also well settled law that the charter of a corporation creates contractual relations between the corporation and its shareholders, between the shareholders themselves, and that the rights growing out of this relationship are constitutionally protected." *Id.* at 255. In *Schramm v. Done*, 293 P. 931 (Or. 1930), the court said:

> Although there is some conflict in the decisions, the prevailing rules are as follows: Where the state has not reserved the power to alter, amend, or repeal the charter of a corporation, the provision of the Constitution of the United States (article 1, § 10) against laws impairing the obligation of contracts protects the contract between the corporators or members, and between them and the corporation, as well as the contract between the state and the corporators or corporation (Dartmouth College v. Woodward), and therefore any material or fundamental amendment of the charter by or under legislative authority, or by a constitutional amendment, in order that it may be binding, must have the unanimous assent of all the stockholders or members, and the Legislature cannot authorize acceptance of or assent to such an amendment by a majority of the stockholders or members so as to bind the minority.

Id. at 934 (citation omitted); *see also* Avondale Land Co. v. Shook, 54 So. 268, 269 (Ala. 1911) ("The charter is under the protection of [the impairment] clause of the federal Constitution in all three of its aspects as a contract.").

In *New Orleans, Jackson & Great Northern Railroad Co. v. Harris*, 27 Miss. 517 (1854), the court said:

> A charter is a contract, within the meaning of the constitution of the United States, between the State granting the charter and the corporation itself, the obligation of which it is not within the power of the legislature to impair. The contract subsisting between the members of a corporate body and the corporation is equally within the protection of the constitution.

Id. at 536.

39. *See* Federal United Corp. v. Havender, 11 A.2d 331, 338 (Del. 1940) ("It is

it was a basic tenet of contract law that, absent some contrary provision, a contract could not be amended without the assent of all the parties thereto.

From all of this, it followed that, if a state legislature passed a law authorizing some specified shareholder majority of an existing corporation to effect a fundamental change that previously would have required unanimous assent of the shareholders, any effort to utilize such a law—without some basis upon which to sustain such a change in the charter contract—would constitute an impairment of the obligation of that contract and therefore be unconstitutional.[40] In *Clearwater v. Meredith*,[41] when a railroad company was chartered under an Indiana statute that provided for the incorporation of such companies but made no provision for their merger or consolidation, and thereafter (without having previously reserved a power of alteration or amendment) the Indiana legislature adopted a statute

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elementary that these provisions [of Delaware's general corporation statute] are written into every corporate charter."); Bowman v. Armour & Co., 160 N.E.2d 753, 755 (Ill. 1959) ("The express nature of the [three-fold] contract is not limited to the specific language found in the articles of incorporation but the contract in its entirety includes the statutory provisions in force when the charter is granted as though those statutory provisions were literally recited in the contract."); *In re* Collins-Doan Co., 70 A.2d 159, 163 (N.J. 1949) ("A corporate charter granted under a general enabling act [here the 1896 New Jersey general corporation statute] embodies all the provisions of the constitution and the statute under which it is issued and all other applicable general laws . . . ."); Faunce v. Boost Co., 83 A.2d 649, 651 (N.J. Super. Ct. Ch. Div. 1951) ("Defendants argue that the statutory law in effect at the date of the formation of the corporation becomes a part of its charter, whether specifically referred to therein or not, and hence a part of said contract. This must be conceded."); State *ex rel.* Starkey v. Alaska Airlines, Inc., 413 P.2d 352, 358 (Wash. 1966) (en banc) ("It is axiomatic that the provisions of the statute under which a corporate charter is granted is an integral part of the charter and binds all parties to the contract, the state, the corporation, and the shareholders."). In *State v. Jefferson Lake Sulphur Co.*, 178 A.2d 329 (N.J. 1962), the court said:

> A charter granted under the General Corporation Act includes, as if written therein, the provisions of the statute under which it was issued and all applicable general laws. . . . Moreover, the state of the law is not only a continuing constituent part of the contract between the sovereign and the corporation, but stockholders purchase their stock subject to it, and it becomes an integral part of their contract with the corporation and with each other.

Id. at 335.

40. In *Mowrey v. Indianapolis & Cincinnati Railroad Co.*, 17 F. Cas. 930 (C.C.D. Ind. 1866) (No. 9891), the court said:

> These [cited] cases proceed on the just view that the relation between a stockholder and the corporation is one of contract; and that every fundamental change in its charter, made against his consent though on the authority of a subsequent act of the legislature, is a violation of that contract, and is forbidden by the national constitution.

Id. at 932.

41. 68 U.S. (1 Wall.) 25 (1863).

authorizing railroad companies to merge or consolidate, it was held by the Supreme Court that a merger or consolidation of the preexisting railroad corporation could not have been effected over the objection of a single shareholder.[42] Similarly, in *New Orleans, Jackson & Great Northern Railroad Co. v. Harris*,[43] when suit was brought to collect on an unpaid stock subscription, following a fundamental corporate change (amounting to a merger of the shareholder's corporation into another company) effected by a majority vote of shareholders pursuant to post-incorporation legislation, the court held for the shareholder-defendant on the ground that action taken pursuant to the enabling legislation impaired the obligation of the shareholder's contract with the corporation.[44] The same result was reached in many other cases—sometimes with, and sometimes without, express reference to the Impairment Clause of the Constitution.[45]

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42. The Court said:

> The power of the legislature to confer such authority [i.e., authority to merge or consolidate] cannot be questioned, and without the authority, railroad corporations organized separately, could not merge and consolidate their interests. But in conferring the authority, the legislature never intended to compel a dissenting stockholder to transfer his interest, because a majority of the stockholders consented to the consolidation. Even if the legislature had manifested an obvious purpose to do so, the act would have been illegal, for it would have impaired the obligation of a contract. There was no reservation of power in the act under which the [railroad company] was organized, which gave authority to make material changes in the purposes for which the corporation was created, and without such a reservation, in no event could a dissenting stockholder be bound.

Id. at 39.

43. 27 Miss. 517 (1854).

44. The court said:

> According to the doctrine that the legislature had the right to confer upon any number of the stockholders, who might own more than one half of the stock subscribed, the authority to accept of amendments to the charter, it is evident that the charter might be altered in its most essential stipulations, not only without the approbation but against the consent of the great body of the corporators, thereby subjecting them to duties and responsibilities not imposed by their contract with the company. This, we think, cannot be done without a clear violation of the constitution. Hence, we conclude that the act in question did not invest the stockholders representing a majority of the stock subscribed with authority to accept the amendment proposed to the charter.

Id. at 536.

45. These cases fall into five categories. The first category consists of cases involving a significant change in the nature of a corporation's business. In *Hartford & New Haven Railroad Co. v. Croswell*, 16 N.Y. Com. Law Rep. (5 Hill) 383 (Sup. Ct. 1843), a suit to collect on a subscription for stock in a Connecticut corporation chartered in 1833 to build and operate a railroad between Hartford and New Haven, the majority shareholders having voted to ratify the board's acceptance of an amendment passed by the Connecticut

legislature in 1839 authorizing the corporation to increase its capital by $200,000 for the procurement of steamboats to be used in connection with the railroad, it was held that such an extensive change in the powers and purposes of the corporation precluded a recovery on the defendant's subscription. *See id.* at 388. In *Stevens v. Rutland & Burlington Railroad Co.*, 29 Vt. 545 (Ch. 1851), a non-assenting shareholder succeeded in obtaining an injunction restraining his corporation from expending its funds to extend its line for a distance of 30 miles pursuant to post-incorporation legislation, even though such enabling legislation had been accepted by a majority vote of shareholders. *See id.* at 565; *see also* Winter v. Muscogee R.R. Co., 11 Ga. 438, 452-53 (1852) (holding that a subscriber to stock in a railroad company was not liable on his subscription when the route of the railroad had been changed pursuant to subsequent enabling legislation without the subscriber's consent); Hester v. Memphis & Charleston R.R. Co., 32 Miss. 378, 380-81 (1856) (same); First Nat'l Bank v. City of Charlotte, 85 N.C. 433, 438-40 (1881) (holding that a subscribing city was relieved of liability on its stock subscription when it had not, as had the majority shareholders, assented to a post-incorporation legislative amendment to the charter that effected a significant change in the nature of the corporate enterprise—the corporation having been organized before the state's first adoption of a reserved power). *But see* Banet v. Alton & Sangamon R.R. Co., 13 Ill. 504, 513 (1851) ("The alteration [of the railroad's route by post-incorporation legislation] is not of such a radical character as to exonerate the stockholders from the payment of their subscriptions.").

The second category of cases consists of those involving a corporate merger or consolidation. In *Lauman v. Lebanon Valley Railroad Co.*, 30 Pa. 42 (1858), when the Pennsylvania legislature, by special act, authorized the merger of two existing railroads but made no provision for dissenters' rights, it was held, in a suit for an injunction, that a dissenting shareholder of the disappearing corporation could not be compelled to accept stock of the surviving corporation and that the merger—even though approved by a majority vote of shareholders—could not go forward unless security was given for payment to the dissenting shareholder of the value of his stock. *See id.* at 49. In *McCray v. Junction Railroad Co.*, 9 Ind. 358 (1856), *aff'd on reconsideration*, 9 Ind. 359 (1857), the court held that a consolidation of one railroad company with another, pursuant to post-incorporation enabling legislation, released a non-assenting shareholder from the obligation of his subscription. *See id.* at 358. In so holding, the court said:

> As the state consented to the consolidation, the act of the companies in making it, is not void; but that act constituted so great a change in the companies committing it—bound them to so wide a departure from the original purpose of either company, that it furnished a cause for the discharge of stockholders not consenting to it.

Id. On reconsideration of *McCray*, the court said:

> The relation between a railroad company and a stockholder is one of contract; and any legislative enactment which, without his assent, authorizes a material change in the powers or purposes of the corporation, not in aid of the original object, if acted upon by the corporation, is not binding upon him.

McCray v. Junction R.R. Co., 9 Ind. 359, 359 (1857). On the other hand, in *Sparrow v. Evansville & Crawfordsville Railroad Co.*, 7 Ind. 369 (1856), and in *Bish v. Johnson*, 21 Ind. 299 (1863), it was held that a subscriber to stock was not relieved of his obligation by a consolidation occurring after his subscription if, at the time of his subscription, legislation existed that authorized such a consolidation. *See Sparrow*, 7 Ind. at 373-74; *Bish*, 21 Ind. at 299-300.

The third category consists of cases involving a corporation's sale or lease of its assets. In *Mayor of Knoxville v. Knoxville & Ohio Railroad Co.*, 22 F. 758 (C.C.E.D. Tenn. 1884), the court rescinded a corporation's sale of its assets, made upon the favorable vote of its majority shareholders, even though such a sale had been authorized

How, then, could a state legislature—confronted with the Impairment Clause—remove the common-law restrictions on corporate combinations with respect to corporations already in existence?

2. Solutions to the Problem

a. Emergence of Possible Solutions

The problem was one of finding a justifiable basis upon which a corporation, by vote of less than all of its shareholders, could avail itself of post-incorporation enabling legislation notwithstanding the Impairment Clause of the Constitution. Possible solutions began to emerge in the nineteenth century.

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by post-incorporation enabling legislation. *See id.* at 763. The court stated:

> [I]t was not competent for the legislature to do more in this respect than to waive the public rights. It could not divest or impair the rights of the shareholders, as between themselves, as guarantied by the company's charter, without their consent.... The charter invests the owners of a majority of the capital stock with the right to control the corporate business within the scope of its provisions. Within this limit the power of a majority, when acting in good faith, is supreme. But [the corporation's] charter does not, by any reasonable intendment, clothe the majority with authority to sell the company's franchise and property....

Id. at 763; *see also* South Western R.R. Co. v. Benton, 58 S.E.2d 905, 918 (Ga. 1950) (holding that a railroad corporation, organized (in 1845) before the state first adopted a reserved power (in 1863), could not avail itself of post-incorporation legislation (enacted in 1933) authorizing the company to sell all of its assets to another railroad corporation upon a majority vote of shareholders, because such a transaction would contravene the charter rights of minority shareholders); Small v. Minneapolis Electro Matrix Co., 47 N.W. 797, 798 (Minn. 1891) (enjoining, at the behest of a minority shareholder, a 25-year lease of all of the corporation's assets that was to be effected only upon an approving vote of the shareholders).

The fourth category consists of cases involving a corporation's purchase of stock in another corporation. *See* Central R.R. Co. v. Collins, 40 Ga. 583, 632 (1869) (stating that a railroad corporation could not, without the consent of every shareholder, avail itself of post-incorporation legislation to justify its purchase of a large block of stock in another railroad corporation).

The fifth category consists of cases involving a change in shareholder voting. *See* Tucker v. Russell, 82 F. 263, 268-69 (C.C.E.D.N.C. 1897) (holding, with respect to a North Carolina railroad corporation chartered by special act in 1852 (16 years before North Carolina adopted its first reserved power), that a provision of the charter specifying scaled voting could not be changed by legislation enacted in 1897 because this would constitute an impairment of the charter contract); State *ex rel.* Haeussler v. Green, 78 Mo. 188, 194 (1883) (holding that, when a corporation's 1853 special-act charter mandated straight voting in the election of directors and provided that the state's 1845 reserved power should not extend to this corporation, an 1875 constitutional provision mandating cumulative voting could not be applied to the corporation without violating the Impairment Clause).

First, following the lead suggested by Justice Story's dicta in the *Dartmouth College* case,[46] states began to include in their corporation statutes (whether special acts or general laws[47]) a reserved power—the power reserved to the legislature to amend or repeal such statutes.[48] New Jersey adopted a reserved power of general

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46. Justice Story stated:

> When a private eleemosynary corporation is thus created by the charter of the crown, it is subject to no other control on the part of the crown, than what is expressly or implicitly reserved by the charter itself. Unless a power be reserved for this purpose, the crown cannot, in virtue of its prerogative, without the consent of the corporation, alter or amend the charter, or devest the corporation of any of its franchises, or add to them, or add to, or diminish, the number of the trustees, or remove any of the members, or change, or control the administration of the charity, or compel the corporation to receive a new charter. This is the uniform language of the authorities, and forms one of the most stubborn, and well settled doctrines of the common law.

Trustees of Dartmouth College v. Woodward, 17 U.S. (4 Wheat.) 518, 675 (1819). Justice Story further stated:

> In my judgment it is perfectly clear, that any act of a legislature which takes away any powers or franchises vested by its charter in a private corporation or its corporate officers, or which restrains or controls the legitimate exercise of them, or transfers them to other persons, without its assent, is a violation of the obligations of that charter. If the legislature mean to claim such an authority, it must be reserved in the grant. The charter of Dartmouth College contains no such reservation; and I am, therefore, bound to declare, that the acts of the legislature of New Hampshire, now in question, do impair the obligations of that charter, and are, consequently, unconstitutional and void.

Id. at 712.

The concept of legislative reservation of a power to amend or repeal did not originate with Justice Story. It had been articulated as early as 1806 in *Wales v. Stetson*, 2 Mass. (2 Tyng) 143 (1806): "We are also satisfied that the rights legally vested in this, or in any corporation, cannot be controlled or destroyed by any subsequent statute, unless a power for that purpose be reserved to the legislature in the act of incorporation." *Id.* at 146. This case was cited with approval by Justice Story in his opinion in *Dartmouth College*, 17 U.S. (4 Wheat.) at 708.

Moreover, there were instances of reservation of a power of amendment in special-act charters of educational institutions granted before the *Dartmouth College* case was decided. *See* Houston v. Jefferson College, 63 Pa. 428, 437-38 (1869) (charter granted in 1802); Commonwealth v. Bonsall, 3 Whart. 559, 566-67 (Pa. 1838) (charter granted in 1784).

47. *See* Polk v. Mutual Reserve Fund Life Ass'n, 207 U.S. 310, 326 (1907) ("[I]t is immaterial whether the power to alter the charter is reserved in the original act of incorporation, or in the articles of association under a general law, or in a constitution in force when the incorporation under a general law is made ...."); People v. O'Brien, 18 N.E. 692, 703 (N.Y. 1888) ("Whatever may be the effect of such reservations [of power to alter or amend], it is immaterial whether they are embraced in the act of incorporation or in general statutes or provisions of the constitution.").

48. For brief statements of the history of this development, see *Spring Valley Water Works v. Schottler*, 110 U.S. 347, 369-73 (1884) (Field, J., dissenting), *Greenwood v. Freight Co.*, 105 U.S. 13, 19-21 (1881), *Noble State Bank v. Haskell*, 97 P. 590, 595-601 (Okla. 1908), and *Legislative Control over Railroad Charters*, 1 AM. L. REV. 451, 451-54

applicability in an 1846 statute[49] and later in its Constitution of 1875;[50]

(1867).

It appears that New York was the first state to adopt a reserved power of general applicability. *See Legislative Control over Railroad Charters*, *supra*, at 452. The reserved power was incorporated into New York's constitution in 1826. *See* Miller v. State, 82 U.S. (15 Wall.) 478, 478 (1872). Such a power was contained also in section 8 of title III of chapter XVIII of the First Part of the Revised Statutes of New York as adopted by Act of Dec. 4, 1827, ch. IX, §§ 1-2, 1827 (2d Mtg.) Laws of N.Y. 11, 11-13 (effective Jan. 1, 1828), which provided as follows: "The charter of every corporation, that shall hereafter be granted by the legislature, shall be subject to alteration, suspension and repeal, in the discretion of the legislature." *Id.* § 8, 1827 (2d Mtg.) Laws of N.Y. at 449.

But this does not mean that the reserved power was not included in special-act charters in New York prior to 1826. As early as 1822, the special act chartering the Farmers' Fire Insurance and Loan Company contained the following:

> *Provided always*, That the legislature may, at their pleasure, after the expiration of five years from and after the passing of this act, alter and modify all or any part thereof, or expunge any or every section of the same, as they may deem it proper. *Provided also*, That any such alteration and modification shall not annul or invalidate any of the engagements or contracts entered into by or with the said coporation [sic].

Act of Feb. 28, 1822, ch. 50, § I, 1822 N.Y. Laws 47, 48.

49. On frequent occasions during the first half of the nineteenth century, the New Jersey legislature made corporate charters (granted by special act) subject to alteration or repeal. *See* JOHN W. CADMAN, JR., THE CORPORATION IN NEW JERSEY 379-83 (1949). Pertinent cases include *New Jersey v. Yard*, 95 U.S. 104, 104-05 (1877) (involving an 1835 special act chartering a New Jersey railroad), and *McLaren v. Pennington*, 1 Paige Ch. 102, 103 (N.Y. Ch. 1828) (involving an 1824 special act chartering a New Jersey bank).

Then, in 1846, the New Jersey legislature enacted its first reserved power of general applicability—in language almost identical to that enacted by New York in 1827, *see supra* note 48 (second paragraph). Section 6 of the 1846 act provided as follows: "*And be it enacted*, That the charter of every corporation which shall hereafter be granted by the legislature, shall be subject to alteration, suspension, and repeal, in the discretion of the legislature." Act of Feb. 14, 1846, [no chapter number], § 6, 1846 N.J. Laws 16, 17.

Corporate charters granted by special act after 1846 were subject to the 1846 statute, reserving the power of amendment or repeal, even though such special-act charters themselves contained no such reservation. *See* State, Morris & Essex R.R. Co. v. Commissioner of R.R. Taxation, 37 N.J.L. 228, 237 (Sup. Ct. 1874); State, Warren R.R. Co. v. Person, 32 N.J.L. 134, 135-36 (Sup. Ct. 1866).

When New Jersey enacted its 1875 general corporation law, pursuant to a constitutional amendment adopted that year, *see infra* note 50 (first paragraph), that statute contained the following sections:

> 6. The charter of every corporation which shall hereafter be granted by or created under any of the acts of the legislature, shall be subject to alteration, suspension and repeal, in the discretion of the legislature.
>
> ....
>
> 35. The provisions contained in this act may be amended or repealed, at the pleasure of the legislature, and every company created by this act shall be bound by such amendment; but such amendment or repeal shall not take away or impair any remedy against any such corporation or its officers for any liability which shall have been previously incurred.

An Act Concerning Corporations (Act of Apr. 7, 1875), *published in* REVISED STATUTES OF NEW JERSEY 3, at 5, 14 (1875).

North Carolina's reserved power appeared first in its Constitution of 1868[51] and later in its 1901 corporation statute;[52] Delaware included a

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The 1896 corporation statute of New Jersey contained the following sections:

> 4. The charter of every corporation, or any supplement thereto or amendment thereof shall be subject to alteration, suspension and repeal, in the discretion of the legislature, and the legislature may at pleasure dissolve any corporation.
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> 5. This act may be amended or repealed, at the pleasure of the legislature, and every corporation created under this act shall be bound by such amendment; but such amendment or repeal shall not take away or impair any remedy against any such corporation or its officers for any liability which shall have been previously incurred; this act and all amendments thereof shall be a part of the charter of every corporation heretofore or hereafter formed hereunder, except so far as the same are inapplicable and inappropriate to the objects of such corporation.

Act of Apr. 21, 1896, ch. 185, §§ 4-5, 1896 N.J. Laws 277, 278-79; *see infra* text accompanying notes 206-08 (discussing the origins of the 1896 New Jersey corporation law).

50. At a constitutional convention in 1844, a proposal was made, but defeated, that the New Jersey Constitution include a provision that laws with respect to private corporations "may be altered, modified, or repealed by the legislature, whenever, in their opinion, the public good may require it." CADMAN, *supra* note 49, at 93-96. However, in 1875, the New Jersey Constitution was amended to include the following sentence: "The legislature shall pass no special act conferring corporate powers, but they shall pass general laws under which corporations may be organized and corporate powers of every nature obtained, subject, nevertheless, to repeal or alteration at the will of the legislature." N.J. CONST. of 1844, art. IV, § 7, ¶ 11 (1875); *see* A.P. Smith Mfg. Co. v. Barlow, 98 A.2d 581, 587 (N.J. 1953) (referring to the 1875 change in the New Jersey Constitution).

The absence of a constitutional reservation of the power of amendment or repeal prior to 1875 did not negate the effectiveness of an earlier statutory reservation of such power. *See* Moore v. Conover, 195 A. 833, 841 (N.J. Ch. 1937).

51. North Carolina's initial reserved power was contained in the second sentence of the following constitutional provision:

> Corporations may be formed under general laws, but shall not be created by special act, except for municipal purposes, and in cases where, in the judgment of the Legislature, the object of the corporations cannot be attained under general laws. All general laws and special acts passed, pursuant to this section, may be altered from time to time or repealed.

N.C. CONST. of 1868, art. VIII, § 1.

52. The first general corporation law enacted in North Carolina following ratification of that state's 1868 constitution authorized the formation of a corporation by any three or more persons "for the purpose of carrying on any manufacturing, mining, mechanical or chemical business" or for other stated purposes, Act of Apr. 12, 1869, ch. 280, § 1, 1868-69 N.C. Sess. Laws 669, 669-70, and it provided that "[t]he Legislature may at any time alter, amend or repeal this act, or may annul or repeal any incorporation formed under it," *id.* § 24, 1868-69 N.C. Sess. Laws at 677. However, a general law enacted three years later, in 1872, authorizing any three or more persons to form a corporation "for any purpose not unlawful," contained no reservation of the power to amend but only a provision "[t]hat every corporation may for just cause, and without prejudice to private rights, be suspended, dissolved, or nullified according to any general public law now existing or which may be hereafter enacted by the general assembly." Act of Feb. 12, 1872, ch. 199,

reserved power in its corporation statute as early as 1875,[53] but its constitution has focused on legislative revocation.[54] As will be seen

§§ 1, 10, 1871-72 N.C. Sess. Laws 347, 347, 350.

The 1901 corporation statute of North Carolina, borrowing heavily from New Jersey's 1896 statute, *see supra* note 49 (fifth paragraph), contained the following provisions:

> Sec. 6. The charter of every corporation, or any supplement thereto, or amendment thereof, shall be subject to alteration, modification, amendment or repeal, in the discretion of the Legislature, and the Legislature may, at pleasure, dissolve any corporation.
>
> Sec. 7. This act may be amended or repealed at the pleasure of the Legislature, and every corporation shall be bound by such amendment; but such amendment or repeal, shall not take away or impair any remedy against any such corporation, or its officers, for any liability which shall have been previously incurred; this act and all amendments thereof shall be a part of the charter of every corporation heretofore formed, or hereafter formed hereunder, except so far as the same are inapplicable and inappropriate to the objects of such corporation.

Act of Mar. 11, 1901, ch. 2, §§ 6-7, 1901 N.C. Sess. Laws 13, 14-15 (effective Apr. 1, 1901); *see infra* text accompanying notes 225-27 (discussing the origins of the 1901 North Carolina corporation law).

53. The Delaware corporation statute enacted in 1875, in implementation of the constitutional amendment ratified earlier that year, *see infra* note 54 (first paragraph), provided "[t]hat any charter of incorporation granted or made under the provisions of this act, shall be subject to revocation by the Legislature, and power to amend, revoke or annul all such charters, or any amendments, alterations or additions thereto, is hereby reserved to the Legislature." Act of Mar. 26, 1875, ch. 119, § 5, 15 Del. Laws 181, 183. The Delaware corporation statute of 1883, which repealed and replaced the 1875 statute, contained the following provision, borrowed almost verbatim from section 35 of New Jersey's 1875 statute, *see supra* note 49 (fourth paragraph):

> The provisions contained in this act may be amended or repealed at the pleasure of the Legislature, and every company created by this act shall be bound by such amendment; but such amendment or repeal shall not take away or impair any remedy against any such corporation or its officers for any liability which shall have been previously incurred.

Act of Mar. 14, 1883, ch. 147, § 21, 17 Del. Laws 212, 224.

When Delaware's 1899 general corporation statute was enacted, its reserved power provision, borrowing heavily from section 5 of New Jersey's 1896 statute, *see supra* note 49 (fifth paragraph), read as follows:

> This Act may be amended or repealed, at the pleasure of the Legislature, but such amendment or repeal shall not take away or impair any remedy against any corporation created under this Act, or its officers for any liability which shall have been previously incurred; this Act and all amendments thereof shall be a part of the charter of every such corporation except so far as the same are inapplicable and inappropriate to the objects of such corporation.

Act of Mar. 10, 1899, ch. 273, § 5, 21 Del. Laws 445, 446-47; *see infra* text accompanying notes 214-18 (discussing the origins of the 1899 Delaware corporation law).

In 1901, this provision was repealed as section 5 and reenacted as section 140 of the Delaware corporation statute, with no change except the insertion of a comma after the phrase "or its officers." *See* Act of Mar. 7, 1901, ch. 166, §§ 1, 40, 22 Del. Laws 255, 255, 283-84; Act of Mar. 7, 1901, ch. 167, § 140, 22 Del. Laws 286, 353.

54. A section of the Delaware Constitution of 1831 provided that "[n]o act of

below, a split developed between the courts of various states as to whether the reserved power provided an adequate solution to the problem concerning a corporation's utilization of post-incorporation enabling legislation.

Second, it came to be recognized that, notwithstanding the Impairment Clause, a state could alter or repeal a corporate charter—even in the absence of a reserved power—if such action was taken in the exercise of either of two sovereign powers of the state.[55]

One of those powers was the police power—the power of the state to protect the public health, safety, and morals—which could be

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incorporation, except for the renewal of existing corporations, shall be hereafter enacted without the concurrence of two-thirds of each branch of the legislature, and with a reserved power of revocation by the legislature." DEL. CONST. of 1831, art. II, § 17. In 1875, a new sentence was added to that section providing that "[t]he Legislature shall have power to enact a general incorporation act to provide incorporation for [specified purposes, including manufacturing]; and no attempt shall be made, in such act or otherwise, to limit or qualify the power of revocation reserved to the Legislature in this section." Act of Jan. 28, 1875, ch. 1, 15 Del. Laws 3, 3-4.

In *Wilmington City Railway Co. v. Wilmington & Brandywine Springs Railway Co.*, 46 A. 12 (Del. Ch. 1900), the court said, with respect to the above-quoted provision of the 1831 constitution:

> This long review of the authorities shows that there is no decision of any sort in opposition to the plain, logical interpretation of the phrase, "reserved power of revocation by the legislature," as meaning the power to revoke, at the pleasure of the legislature, any or all of the franchises granted to a corporation, the power to recall all the rights, privileges, or franchises granted to a corporation, or any number less than all, or any single right, privilege, or franchise; that it cannot mean less than this, and that it cannot mean more, and that it differs from the reserved power "to alter, amend, or repeal the charter" in not including the power to regulate or control corporations in the manner illustrated by the cases I have cited.

Id. at 18.

The Delaware Constitution of 1897 provides as follows:

> No corporation shall hereafter be created, amended, renewed or revived by special act, but only by or under general law, nor shall any existing corporate charter be amended, renewed or revived by special act, but only by or under general law; but the foregoing provisions shall not apply to municipal corporations, banks or corporations for charitable, penal, reformatory, or educational purposes, sustained in whole or in part by the State. The General Assembly shall, by general law, provide for the revocation or forfeiture of the charters of all corporations for the abuse, misuse, or non-user of their corporate powers, privileges or franchises.

DEL. CONST. art. IX, § 1.

55. The subject is discussed in the following: *In re Mechanics Trust Co.*, 181 A. 423, 427-30 (N.J. Ch. 1935); Leo Clarke, *The Contract Clause: A Basis for Limited Judicial Review of State Economic Regulation*, 39 U. MIAMI L. REV. 183, 190-94 (1985); and Robert L. Hale, *The Supreme Court and the Contract Clause* (pt. 2), 57 HARV. L. REV. 621, 636-63 (1944).

exercised notwithstanding the Impairment Clause.[56] In *Beer Co. v. Massachusetts*,[57] when a Massachusetts corporation, chartered in 1828 to manufacture and sell malt liquors, brought suit challenging the seizure of its product under a state prohibition law passed in 1869, the Court held that the 1869 law—being a valid exercise of the state's police power—did not unconstitutionally impair the obligation of the corporation's charter contract.[58] Similarly, in *Stone v. Mississippi*,[59]

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56. In *New York & New England Railroad Co. v. Bristol*, 151 U.S. 556 (1894), the Court said:

> It is ... thoroughly established in this court that the inhibitions of the Constitution of the United States upon the impairment of the obligation of contracts, or the deprivation of property without due process or of the equal protection of the laws, by the States, are not violated by the legitimate exercise of legislative power in securing the public safety, health, and morals.

Id. at 567. Further, in *Manigualt v. Springs*, 199 U.S. 473 (1905), the Court said:

> It is the settled law of this court that the [constitutional] interdiction of statutes impairing the obligation of contracts does not prevent the State from exercising such powers as are vested in it for the promotion of the common weal, or are necessary for the general good of the public, though contracts previously entered into between individuals may thereby be affected. This power, which in its various ramifications is known as the police power, is an exercise of the sovereign right of the Government to protect the lives, health, morals, comfort and general welfare of the people, and is paramount to any rights under contracts between individuals.

Id. at 480. And, in *Atlantic Coast Line Railroad Co. v. City of Goldsboro*, 232 U.S. 548 (1914), the Court said:

> For it is settled that neither the "contract" clause nor the "due process" clause has the effect of overriding the power of the State to establish all regulations that are reasonably necessary to secure the health, safety, good order, comfort, or general welfare of the community; that this power can neither be abdicated nor bargained away, and is inalienable even by express grant; and that all contract and property rights are held subject to its fair exercise.

Id. at 558.

57. 97 U.S. 25 (1877).

58. The Court said:

> If the public safety or the public morals require the discontinuance of any manufacture or traffic, the hand of the legislature cannot be stayed from providing for its discontinuance, by any incidental inconvenience which individuals or corporations may suffer. All rights are held subject to the police power of the State.
>
> ....
>
> Whatever differences of opinion may exist as to the extent and boundaries of the police power, and however difficult it may be to render a satisfactory definition of it, there seems to be no doubt that it does extend to the protection of the lives, health, and property of the citizens, and to the preservation of good order and the public morals. The legislature cannot, by any contract, divest itself of the power to provide for these objects.

Id. at 32-33; *accord* Fertilizing Co. v. Hyde Park, 97 U.S. 659, 669-70 (1878); Platte & Denver Canal & Milling Co. v. Dowell, 30 P. 68, 70-71 (Colo. 1892); Thorpe v. Rutland & Burlington R.R. Co., 27 Vt. 140, 149-51, 155-56 (1854).

when a Mississippi corporation was chartered in 1867 with authority to conduct lotteries for a period of twenty-five years, and a Mississippi statute enacted in 1870 (implementing a provision of that state's constitution of 1868) prohibited all kinds of lotteries, it was held that the ouster of the corporation from the franchise theretofore granted constituted a valid exercise of the state's police power and did not, therefore, entail a violation of the Impairment Clause.[60] However, if a post-incorporation statute (enacted without benefit of a reserved power) impinged upon corporate powers in such a way as to constitute an impairment of the charter contract, the statute could not survive a challenge to its constitutionality on the ground that it was enacted in what the legislature perceived to be the public interest; the statute could survive such a challenge only if it came within the narrower confines of a bona fide exercise of the state's police power.[61] And it was difficult to argue that legislation

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59. 101 U.S. 814 (1879).

60. *See id.* at 819-20. Moreover, in *Delaware & Hudson Co. v. Boston Railroad Holding Co.*, 81 N.E.2d 553 (Mass. 1948), the court said:

> It is manifest that the necessary and proper exercise of this [police] power will frequently limit and restrict the freedom of action which particular persons and corporations would otherwise enjoy in the management and control of their property, and that such limitation and restriction do not constitute a taking of property for which compensation must be allowed.

Id. at 558.

61. The North Carolina Rail Road Company was chartered by Act of Jan. 27, 1849, ch. 82, 1848-49 N.C. Sess. Laws 138. Its special-act charter contained no reserved power to alter or repeal, and there was no reserved power of general applicability in North Carolina until adoption of that state's constitution of 1868. The charter contained no requirement concerning the gauge of the company's rail line, and the line was built to a gauge of 4 feet 8 1/2 inches. In 1871, the corporation granted a 30-year lease of its line to a Virginia railroad corporation, and the lease agreement authorized the lessee to change the line's gauge. The validity of this lease arrangement was upheld by the North Carolina Supreme Court in its January term in 1875. *See* State v. Richmond & Danville R.R. Co., 72 N.C. 634, 637, 640 (1875). Having mandated a gauge of 4 feet 8 1/2 inches for other North Carolina railroads, the legislature enacted a statute making it a crime to change the gauge of any railroad in North Carolina that had been built to that gauge. *See* Act of Mar. 15, 1875, ch. 159, 1874-75 N.C. Sess. Laws 185. Thereafter, the lessee and two of its officers were indicted for violating the statute by a widening of the leased railroad's gauge to 5 feet. The question, then, was whether the criminal statute constituted an unconstitutional impairment of the charter contract (which the court construed as permitting any gauge for the railroad line) or whether the statute—in its effort to regulate the gauge of all railroads in the state—constituted an exercise of the state's police power, thereby making the Impairment Clause inapplicable. In *State v. Richmond & Danville Railroad Co.*, 73 N.C. 527 (1875), it was held that the criminal statute did not constitute a valid exercise of the state's police power and, therefore, amounted to an invalid impairment of the charter contract, the court saying:

> This police power, however extensive, must have reasonable limits. In some places it is said to extend to everything "necessary for the welfare and

authorizing corporate combinations had anything to do with the public health, safety, or morals.

The other sovereign power was that of eminent domain—the power of the state to take (or to authorize the taking of) private property, for public use, upon payment of just compensation—which, like the police power, could be exercised notwithstanding the Impairment Clause.[62] In *West River Bridge Co. v. Dix*,[63] when a Vermont corporation was chartered in 1795 with the exclusive privilege of building and operating a toll bridge over the West River for a hundred years, and in 1843, pursuant to an enabling statute enacted in 1839, the bridge was taken (with compensation) for a free public highway across the bridge, it was held that the exercise of the power of eminent domain did not entail a violation of the Impairment Clause.[64] When the granting of appraisal rights came to

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> prosperity of the State." But that would be to remove all limits.... A State cannot violate its contract under a pretended exercise of its police power. The act must be *bona fide* intended to relieve some evil within the reach of that power and strictly applicable to that end....
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> The Act ... does not appear to us to present the features of a police regulation.... It may be a wise and convenient policy to require an uniformity of gauge on all the railroads in the State, and it may be convenient to the roads connecting with the North Carolina road that its lessees should be prevented from changing its gauge from one uniform with theirs to a different one. But if the lessees of the North Carolina road had a right to change its gauge according to their ideas of their own interests (as in view of the decision of this Court at the last term, must be admitted), no newly adopted policy of uniformity or regard for the interests of other roads will authorize the State to deprive the lessees of this right, *except by virtue of its power of eminent domain, and upon compensation.*

Id. at 533-34.

62. In *Cincinnati v. Louisville & Nashville Railroad Co.*, 223 U.S. 390 (1912), the Court said:

> The constitutional inhibition upon any state law impairing the obligation of contracts is not a limitation upon the power of eminent domain. The obligation of a contract is not impaired when it is appropriated to a public use and compensation made therefor. Such an exertion of power neither challenges its validity nor impairs its obligation. Both are recognized, for it is appropriated as an existing enforceable contract. It is a taking, not an impairment of its obligation. If compensation be made, no constitutional right is violated. All of this has been so long settled as to need only the citation of some of the many cases.

Id. at 400.

63. 47 U.S. (6 How.) 507 (1848).

64. *See id.* at 536. The Court said:

> This power, denominated the *eminent domain* of the State, is, as its name imports, paramount to all private rights vested under the government, and these last are, by necessary implication, held in subordination to this power, and must yield in every instance to its proper exercise.

be perceived as an exercise of the power of eminent domain, this provided—as will be seen below—a fruitful solution to the problem of a corporation's utilization of post-incorporation enabling legislation.

b. Reserved Power Solution

The matter that first involved the courts—on the question whether, notwithstanding the Impairment Clause, a corporation could avail itself of post-incorporation enabling legislation—was an examination of the scope and reach of the reserved power. Such an examination had to take into account the fact that there was more than one aspect to a charter contract—not only the public aspect (the one involving only the state and the corporation) but also the private aspects (those involving the corporation and its shareholders).

There was little doubt that, pursuant to a reserved power, the public aspect of a charter contract could be altered by post-incorporation legislation without violating the Impairment Clause.[65]

> ... A correct view of this matter must demonstrate, moreover, that the right of eminent domain in government in no wise interferes with the inviolability of contracts; that the most sanctimonious regard for the one is perfectly consistent with the possession and exercise of the other.
>
> ... This right [of eminent domain] does not operate to impair the contract effected [sic] by it, but recognizes its obligation in the fullest extent, claiming only the fulfilment of an essential and inseparable condition.

Id. at 532-33. Similarly, in *Richmond, Fredericksburg & Potomac Railroad Co. v. Louisa Railroad Co.*, 54 U.S. (13 How.) 71 (1851), the Court said:

> The grant of a franchise is of no higher order, and confers no more sacred title, than a grant of land to an individual; and, when the public necessities require it, the one, as well as the other, may be taken for public purposes on making suitable compensation; nor does such an exercise of the right of eminent domain interfere with the inviolability of contracts.

Id. at 83; *see also* Long Island Water Supply Co. v. Brooklyn, 166 U.S. 685, 691 (1897) ("The true view is that the condemnation proceedings do not impair the contract, do not break its obligations, but appropriate it ... to public uses."); Central Bridge Corp. v. City of Lowell, 70 Mass. (4 Gray) 474, 480-82 (1855) (holding that a bridge built and owned by a corporation could be taken for public use, through exercise of the power of eminent domain, without violating the Impairment Clause); Boston Water Power Co. v. Boston & Worcester R.R. Corp., 40 Mass. (23 Pick.) 360, 394 (1839) ("Nor, in the opinion of the Court, is this exercise of power [of eminent domain] by the legislature [impinging upon a corporation's franchise], a law impairing the obligation of contracts, within the meaning of the constitution of the United States.").

65. *See* Citizens' Sav. Bank v. Owensboro, 173 U.S. 636, 644 (1899); Hamilton Gas Light & Coke Co. v. Hamilton City, 146 U.S. 258, 270 (1892); Spring Valley Water Works v. Schottler, 110 U.S. 347, 355-56 (1884); Shields v. Ohio, 95 U.S. 319, 324 (1877); Tomlinson v. Jessup, 82 U.S. (15 Wall.) 454, 459 (1872); State v. Miller, 30 N.J.L. 368, 370 (Sup. Ct. 1863), *aff'd per curiam*, 31 N.J.L. 521, 530 (1864); Mayor of New York v. Twenty-Third St. Ry. Co., 21 N.E. 60, 61-62 (N.Y. 1889); State v. Brown & Sharpe Mfg.

Indeed, this was the intended purpose of the reserved power—to overcome the holding in *Dartmouth College* so that a state legislature, acting in the public interest, could alter the state's contract with a corporation without violating the constitutional prohibition against impairing the obligation of contracts.[66]

Moreover, there were decisions by the Supreme Court that, under a reserved power, a state legislature could constitutionally alter the private aspects of a charter contract when, for a purpose deemed to be in the public interest, the legislature *compelled* an alteration of existing contractual arrangements between a corporation and its shareholders or among its shareholders. Thus, in *Sherman v. Smith*,[67] it was held that personal liability for subsequent debts of banking corporations could be imposed on their shareholders by post-

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Co., 25 A. 246, 250 (R.I. 1892); Charlotte, Columbia & Augusta R.R. Co. v. Gibbes, 4 S.E. 49, 51-52 (S.C. 1887). *See generally Legislative Control over Railway Charters*, *supra* note 48, at 455-69 (discussing a number of the early cases).

However, in the absence of a reserved power, the charter contract between the state and the corporation could not be altered to the corporation's detriment by post-incorporation legislation, because to do so would run afoul of the Impairment Clause. *See* Wilmington R.R. v. Reid, 80 U.S. (13 Wall.) 264, 267-68 (1871); Piqua Branch of the State Bank v. Knoop, 57 U.S. (16 How.) 369, 392 (1853); Planters' Bank v. Sharp, 47 U.S. (6 How.) 301, 318, 329-30 (1848). And the same result followed when, by terms of the corporate charter, the reserved power was made inapplicable. *See* Louisville Gas Co. v. Citizens' Gas Co., 115 U.S. 683, 696-97 (1885).

A state court case, reaching a result different from that reached in the cases cited in the first paragraph of this footnote, is to be found in *Sage v. Dillard*, 54 Ky. (15 B. Mon.) 340 (1854). This case involved the Western Baptist Theological Institute, incorporated in Kentucky in 1840 by a special-act charter that provided for a self-perpetuating board of trustees but provided also that the charter could be altered, amended, or repealed. *See id.* at 354-55. When legislation, enacted in 1848, amended the charter to increase the number of trustees to 16 above the number then in office and named the persons who were to be the 16 new members, the court held the act of the legislature to be an unconstitutional impairment of the obligation of the contract embodied in the corporate charter, notwithstanding the reserved power of amendment contained in the charter. *See id.* at 362-63.

66. *See* Zabriskie v. Hackensack & N.Y. R.R., 18 N.J. Eq. 178 (Ch. 1867), *overruled by* Brundage v. New Jersey Zinc Co., 226 A.2d 585, 594-95 (N.J. 1967); *infra* text accompanying notes 94-95 (quoting *Zabriskie*). In *Tomlinson v. Jessup*, 82 U.S. (15 Wall.) 454 (1872), the Court said:

> The object of the reservation ... is to prevent a grant of corporate rights and privileges in a form which will preclude legislative interference with their exercise if the public interest should at any time require such interference. It is a provision intended to preserve to the State control over its contract with the corporators, which without that provision would be irrepealable and protected from any measures affecting its obligation.

Id. at 458.

67. 66 U.S. (1 Black) 587, 590-91, 593-94 (1861); *accord* Bissell v. Heath, 57 N.W. 585, 587 (Mich. 1894).

incorporation legislation enacted pursuant to a reserved power. Similarly, in *Looker v. Maynard*,[68] it was held that a state, by way of post-incorporation legislation enacted pursuant to a reserved power, could compel corporations to accord to their shareholders the right of cumulative voting.[69]

The question that remained—the one of greatest difficulty—was whether a corporation could avail itself of post-incorporation legislation enacted pursuant to a reserved power, when such legislation, instead of compelling some change in the arrangements between a corporation and its shareholders (or among the shareholders) for a reason deemed to be in the public interest, simply permitted the holders of some specified majority of the shares to approve a particular kind of corporate action that could not have been taken over the objection of a single shareholder under the law as it had existed (and had become embodied in the charter contract) at the time of incorporation.[70]

The background for consideration of this question was the principle involved in the 1824 English case of *Natusch v. Irving*,[71] which was often cited by American courts.[72] The holding in that case was to the effect that, when a joint stock company had been formed to engage in the fire and life insurance business, a single shareholder could enjoin the majority from embarking the enterprise upon the business of marine insurance pursuant to enabling legislation enacted by Parliament subsequent to formation of the company. If an extension of the business of a joint stock company into a new line of endeavor required the unanimous assent of the company's shareholders notwithstanding enactment by Parliament of legislation authorizing such an extension, could less than all of the shareholders

68. 179 U.S. 46, 54 (1900); *accord* Gregg v. Granby Mining & Smelting Co., 65 S.W. 312, 314 (Mo. 1901); Cross v. West Virginia Cent. & Pittsburgh Ry. Co., 12 S.E. 1071, 1072 (W. Va. 1891).

69. For another example of a state (acting pursuant to a reserved power) mandating a change affecting shareholder rights, see *Miller v. State*, 82 U.S. (15 Wall.) 478, 498-99 (1872).

70. The matter is discussed in the following: E. Merrick Dodd, Jr., *Dissenting Stockholders and Amendments to Corporate Charters* (pt. 2), 75 U. PA. L. REV. 723, 723-38 (1927); Horace Stern, *The Limitations of the Power of a State Under a Reserved Right to Amend or Repeal Charters of Incorporation* (pt. 2), 53 AM. L. REG. (U. PA.) 73 (1905).

71. 47 Eng. Rep. 1196 (1824).

72. *See, e.g.*, New Orleans, Jackson & Great N. R.R. Co. v. Harris, 27 Miss. 517, 538 (1854); Zabriskie v. Hackensack & N.Y. R.R., 18 N.J. Eq. 178, 184 (Ch. 1867), *overruled by* Brundage v. New Jersey Zinc Co., 226 A.2d 585, 594-95 (N.J. 1967); Kean v. Johnson, 9 N.J. Eq. 401, 408 (Ch. 1853); Stevens v. Rutland & Burlington R.R. Co., 29 Vt. 545, 548 (Ch. 1851).

of an American corporation embark their company upon a significantly altered course permitted (but not required) by post-incorporation legislation enacted pursuant to a reserved power?

Decisions on this question, in the state courts, led to two clearly delineated schools of thought on the matter. Some courts adopted an expansive reading of the reserved power, while others adopted a restrictive reading.

The expansive reading was that, because the reserved power itself became part of the charter of any corporation formed after reservation of the power, there could be no impairment of minority shareholders' contractual rights by corporate action taken pursuant to post-incorporation legislation upon a vote of the majority of shares specified in the enabling legislation. A leading case espousing this view was the 1862 Massachusetts case of *Durfee v. Old Colony & Fall River Railroad Co.*,[73] in which a minority shareholder sought unsuccessfully to enjoin his railroad corporation from extending its line and uniting with another corporation pursuant to post-incorporation enabling legislation enacted under a reserved power, the court saying:

> The real contract into which the stockholder enters with the corporation is, that he agrees to become a member of an artificial body which is created and has its existence by virtue of a contract with the legislature, which may be amended or changed with the consent of the company, ascertained and declared in the mode pointed out by law [i.e., by majority shareholder vote]. Having, by virtue of the relation which subsists between himself and the corporation as a holder of shares, assented to the terms of the original act of incorporation, he cannot be heard to say that he will not be bound by a vote of the majority of the stockholders accepting an amendment or alterations of the charter made in pursuance of an express authority reserved to the legislature, and which by such acceptance has become binding on the corporation. Such we understand to be the result of the adjudicated cases.[74]

This view of the matter had been espoused by lower courts of New York in 1851[75] and 1853[76] and embraced by that state's highest court

73. 87 Mass. (5 Allen) 230 (1862).

74. *Id.* at 245-46; *accord* Hale v. Cheshire R.R. Co., 37 N.E. 307, 307 (Mass. 1894).

75. In *Northern Railroad Co. v. Miller*, 10 Barb. 260 (N.Y. App. Div. 1851), in holding a shareholder liable on his stock subscription notwithstanding changes made pursuant to post-incorporation legislation enacted under a reserved power, the court said:

> The defendant, when he subscribed for stock, yielded his assent to any alteration

in 1854.[77] This view was adopted also by the highest court of Missouri in 1853,[78] of Rhode Island in 1869,[79] and of California in 1895.[80] The

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> which the legislature might make. He can not, therefore, with truth say ... "*non haec in foedera veni.*" The alteration in question must be presumed to have been within his contemplation when he signed, and a part execution of the contract into which he entered.

Id. at 283.

76. In *White v. Syracuse & Utica Railroad Co.*, 14 Barb. 559 (N.Y. App. Div. 1853), the court denied injunctive relief to a minority shareholder of a New York railroad corporation (chartered in 1846) that sought to avail itself of post-incorporation legislation (enacted in 1851) authorizing railroad corporations of New York—with the consent of persons owning two-thirds of the stock of such a corporation—to subscribe to the stock of a Canadian railroad company provided that the eastern terminus of the Canadian company's road was at some point on the Niagara River. The court's decision was based in part on the ground that the change to be effected pursuant to the post-incorporation legislation, instead of altering the objects and business of the corporation, would promote the objects for which it was chartered; but it was based primarily on the ground that the "charter of the defendant, in express terms, reserves the right to the legislature to alter, modify or repeal the act [of incorporation]." *Id.* at 560.

77. In *Schenectady & Saratoga Plank Road Co. v. Thatcher*, 11 N.Y. 102 (1854), when the defendant sought to avoid liability for his unpaid subscription to stock of a plank road corporation chartered in 1848 (under a general corporation law enacted in 1847) on the ground that the corporation had proceeded without his assent to build a branch road pursuant to a post-incorporation statute (enacted in 1849) authorizing plank road corporations to build branch lines with the written consent of persons owning two-thirds of the stock, the court held the defendant liable on his subscription on the ground that the general law under which the corporation was formed contained a reserved power and that the defendant "subscribed to stock under the original act [of 1847], subject to the contingency that additional powers might be conferred or other changes made by an amendment of the law." *Id.* at 109. The opinion of Judge A.S. Johnson contained the following:

> The persons who contract to take shares in a company under such an act, contract subject to the same reservation of power. The courts are bound to read their agreement with the legislative condition. They agree to take and pay for the shares for which they subscribe, subject to the power of the legislature to alter or repeal the charter of the company, and it does not lie in their mouths to complain that the power has been exercised.

Id. at 114-15. This holding was followed in *Buffalo & New York City Railroad Co. v. Dudley*, 14 N.Y. 336 (1856), when the defendant was held liable on his stock subscription notwithstanding an extension of the corporation's railroad line pursuant to post-incorporation enabling legislation enacted under a reserved power. After citing *Thatcher*, Judge T.A. Johnson said: "The right to alter was reserved in the charter, and the subscription must be taken to have been made subject to having such additional powers conferred as the legislature might deem essential and expedient." *Id.* at 348.

78. In *Pacific Railroad v. Renshaw*, 18 Mo. 210 (1853), a subscriber to stock in a railroad corporation was held liable on his subscription notwithstanding material changes made in the charter by post-incorporation legislation enacted under a reserved power and accepted by a majority in interest of the shareholders. The court said:

> Into such a corporation, subject to such [reserved] powers of legislative control, the defendant entered when he subscribed for stock in the company, and he cannot now be allowed to complain that the power has been exercised, nor is he, by the exercise of such power, discharged from his obligation to pay for the

highest court of Maine appears to have been ambivalent.[81]

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stock.

Id. at 215.

79. In *Gardner v. Hope Insurance Co.*, 9 R.I. 194 (1869), the court said:

> The legislature have reserved the power, at any time to alter or repeal the charter, or any of its provisions. The corporators accepted it upon this condition, and agreed that its provisions might be changed, and every purchaser of stock in this company has assented to these terms, and has agreed to hold his shares subject to this liability to change.

Id. at 199-200.

80. In *Market Street Railway Co. v. Hellman*, 42 P. 225 (Cal. 1895), the court said:

> The objection that the proceedings under which the [corporate] consolidation was had were violative of the constitutional rights of nonconsenting stockholders, does not call for extended comment.... When an individual becomes a stockholder in a corporation, it is with the implied assent, on his part, to the right of the legislature to alter and amend the law within the scope of the constitutional [reserved power] provision, and is as binding upon him as a contract to like effect of his own making would be.... Corporations cannot, without the consent of all their stockholders, consolidate with others, except where the power so to do is given by their charters, or by a general statute, existing at the date of incorporation, or in those cases where the right is reserved by constitutional or statutory provision to the legislature to alter or amend the charter. There is some conflict of authority as to the power of the legislature to so amend the statute as to authorize corporations, without the consent of all the stockholders, to consolidate, but the weight of authority is, as we think, clearly in favor of the position that it may do so, and that the legislature, corporation, and majority are not subject to the will of dissenting stockholders.... The contract of the stockholders was made in view of the existence of our constitutional [reserved power] provision, which entered into and formed a part of the charter as effectually as did the statutes under which the corporations were organized.

Id. at 229 (citations omitted).

81. Conflicting pronouncements were made in 1849 and 1855 by Maine's highest court in two cases involving efforts to collect on unpaid stock subscriptions. In *South Bay Meadow Dam Co. v. Gray*, 30 Me. 547 (1849), one of the subscriber's defenses was that post-incorporation legislation had increased the liability of shareholders, but the court rejected this defense, saying:

> The act of incorporation was accepted, and the subscription was made, with a provision in the act, that it should be subject to all the duties and liabilities imposed upon corporations by the seventy-sixth chapter of the Revised Statutes. The twenty-third section of that chapter provides, that all acts of incorporation thereafter granted, shall at all times be liable to be amended, altered or repealed at the pleasure of the Legislature. The defendant cannot therefore correctly allege, that his liability has been increased without his consent. He consented to such action of the Legislature by becoming a member of the corporation.

Id. at 551-52. Six years later, in *Oldtown & Lincoln Railroad Co. v. Veazie*, 39 Me. 571 (1855), the same court decided in favor of a subscriber by distinguishing the *Gray* case and saying:

> It is the charter only and the rights and liabilities of the corporation and of its corporators, as such in consequence thereof, that can be varied by [a post-incorporation] Act of the Legislature; and not the private contracts made

While the expansive reading of the reserved power had a superficial appeal, its conclusion did not follow from its premise. It was true that the reserved power became part of a subsequent corporate charter,[82] and one could even assert that shareholders were thereby put on notice that the charter of their corporation could be altered or repealed by legislative action.[83] But given the fact that the impetus for adoption of a reserved power came from the decision in the *Dartmouth College* case, it was far more plausible to believe that the power was reserved by a state simply for the purpose of enabling its legislature to mandate changes in the state's contracts with its corporations, for reasons deemed to be in the public interest,[84] than to suppose that the power was reserved also for the purpose of enabling the legislature to authorize changes in the private aspects of existing corporate charters so that majority shareholders could

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between the corporation as one party and of its corporators as the other.
Id. at 580-81.

82. *See* Citizens' Sav. Bank v. Owensboro, 173 U.S. 636, 644 (1899) ("[A] general statute reserving the power to repeal, alter or amend is by implication read into a subsequent charter and prevents it from becoming irrevocable."); Hamilton Gas Light & Coke Co. v. Hamilton City, 146 U.S. 258, 270 (1892) ("This [1851] reservation [in the state constitution] of power to alter or revoke a grant of special privileges necessarily became a part of the charter of every corporation formed under the [1852] general statute providing for the formation of corporations."); Tomlinson v. Jessup, 82 U.S. (15 Wall.) 454, 457 (1872) ("The provisions of that law [a pre-incorporation reserved power statute] ... were as operative and as much a part of the charter and [an] amendment [thereof], as if incorporated into them."); Wilmington City Ry. Co. v. Wilmington & Brandywine Springs Ry. Co., 46 A. 12, 15-16 (Del. Ch. 1900); Pacific R.R. v. Renshaw, 18 Mo. 210, 215-16 (1853); *In re* Collins-Doan Co., 70 A.2d 159, 163-64 (N.J. 1949); State, Morris & Essex R.R. Co. v. Commissioner of R.R. Taxation, 37 N.J.L. 228, 237 (Sup. Ct. 1874), *quoted with approval in* Moore v. Conover, 195 A. 833, 842 (N.J. Ch. 1937); Elizabeth City Water & Power Co. v. Elizabeth City, 188 N.C. 278, 287, 124 S.E. 611, 615 (1924); State v. Cantwell, 142 N.C. 604, 606-07, 55 S.E. 820, 821 (1906); State v. Morris, 77 N.C. 512, 517 (1877).

83. *See* Tomlinson v. Jessup, 82 U.S. (15 Wall.) 454, 458 (1872) ("The original corporators, or subsequent stockholders, took their interests with knowledge of the existence of this [reserved] power, and of the possibility of its exercise at any time in the discretion of the legislature."); *see also* quotations *supra* in notes 79 and 80.

84. *See* Spring Valley Water Works v. Schottler, 110 U.S. 347, 352, 355 (1884); Greenwood v. Freight Co., 105 U.S. 13, 20 (1881); *Tomlinson*, 82 U.S. (15 Wall.) at 458 ("The object of the reservation, and of similar reservations in other charters, is to prevent a grant of corporate rights and privileges in a form which will preclude legislative interference with their exercise if the public interest should at any time require such interference."); *In re* Opinion of the Justices, 33 A. 1076, 1080-84 (N.H. 1891); Lord v. Equitable Life Assurance Soc'y, 87 N.E. 443, 446-47 (N.Y. 1909); Cross v. Peach Bottom Ry. Co., 90 Pa. 392, 395 (1879) ("The legislative reservation is in the nature of a police power designed for the protection of the public welfare, and where such protection becomes necessary, the law-making power may act without consulting either the interests or will of the company .... The reservation ... was only intended to enable the legislature to act without the consent and against the will of the corporation.").

thereafter take actions previously requiring unanimous shareholder assent. It was one thing to say that a state could preserve its right to protect the public interest through the reservation of a unilateral power to alter terms agreed to by the state at the time of its becoming party to a contract through the granting of a corporate charter. It was quite another thing to say that a state could adopt a reserved power whose effect would be that the private aspects of all charter contracts entered into after such reservation would themselves be subject to subsequent alteration in whatever manner and to whatever extent the legislature might authorize.[85] This could be regarded as tantamount to an unacceptable reservation of power to violate the Constitution's Impairment Clause. It is not surprising, then, that some state courts adopted a different reading of the reserved power.

The restrictive reading of the reserved power was that such power had no purpose or effect other than to overcome the result in the *Dartmouth College* case; that, accordingly, the power related solely to the public aspect of the charter contract (i.e., the contract between the corporation and the state); and, therefore, that post-incorporation enabling legislation—even though enacted pursuant to a reserved power—could not validly empower majority shareholders to take an action, over the objection of a minority, if such action would effect a change in the nature or operation of the corporation's business of such significance as to constitute a breach of the original charter contract between the corporation and its shareholders or the contract among the shareholders. An early case espousing this view was the 1863 case of *Kenosha, Rockford & Rock Island Railroad Co. v. Marsh*,[86] in which a subscriber to corporate stock successfully defended against a suit brought on his subscription after his railroad

85. A case holding that this could not be done was *Bank of the Old Dominion v. McVeigh*, 61 Va. (20 Gratt.) 457 (1871), although the case did not involve rights of shareholders. The court said:

> It is undoubtedly true that it is in the power of the Legislature, under its reserved rights, to alter or amend the charters of banking institutions, or to take them away altogether. But it does not follow that in doing this it may interfere with and abrogate contracts lawfully made under such charters, or disturb rights already legally vested under them in the course of its legitimate business.
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> The Legislature did reserve the right to modify and amend the charter of the Bank of the Old Dominion; but it did not and could not reserve the right to alter contracts made under the old charter. All contracts made in pursuance of its charter are to be construed with reference to the charter in force at the time they were made. The charter may be changed, but the contracts made under that charter cannot be altered by the Legislature.

Id. at 466-67.

86. 17 Wis. 13 (1863).

corporation had changed its line and consolidated with another company pursuant to post-incorporation enabling legislation enacted under a reserved power, the court saying:

> The occasion of reserving such a power either in the constitution or in charters themselves is well understood. It grew out of the decisions of the supreme court of the United States, that charters were contracts within the meaning of the constitutional provision that the states should pass no laws impairing the obligation of contracts. This was supposed to deprive the states of that power of control over corporations which was deemed essential to the safety and protection of the public. Hence the practice, which has extensively prevailed since those decisions, of reserving the power of amending or repealing charters. But this power was never reserved upon any idea that the legislature could alter a contract between a corporation and its stock subscribers, nor for the purpose of enabling it to make such alteration. It was solely to avoid the effect of the decision that the charter itself was a contract between the state and the corporation, so as to enable the state to impose such salutary restraint upon these bodies as experience might prove to be necessary....
>
> ... The power of amendment was never reserved with reference to any question between the corporation and its stock subscribers, but solely with reference to questions between the corporation and the state, when the latter desired to make compulsory amendments against the wish of the former.[87]

This view of the matter was adopted by the highest court of Kentucky in 1873 and 1888.[88] It was adopted also by the highest court of New

87. *Id.* at 16-18.

88. In *Weir v. Railey*, 7 Ky. Op. 379 (1873), when a corporation had been organized to insure against loss of livestock, it was held, notwithstanding a pre-incorporation reserved power, that a non-consenting shareholder was not bound by a post-incorporation amendment of the charter authorizing the company to insure against losses by fire or other destruction of property. *See id.* at 381-82. The court said:

> The right reserved by the law-making power to amend or repeal the charter, is for the protection of the interests of the state, enabling the legislature to place such restrictions upon the company as to prevent an injury to the public, and if necessary to repeal the act itself; but when new franchises are created by an amendment, and additional and increased obligations created, it is a virtual dissolution of the original contract, so far as it affects those who are not consenting and who have never ratified it.

Id. at 382.

In *Botts v. Simpsonville & Buck Creek Turnpike Co.*, 10 S.W. 134 (Ky. 1888), it was

Hampshire in 1887[89] and that of Georgia in 1889.[90]

Notwithstanding a bizarre pronouncement by a lower Delaware court in 1855[91] and references to the reserved power in North

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held that dissenting shareholders could enjoin a consolidation of their turnpike corporation with another such company pursuant to post-incorporation legislation authorizing such a consolidation upon a majority vote of shareholders. *See id.* at 135. The court said:

> Whether a consolidation could be authorized, under a general power reserved by the legislature to alter or annul the charter, is not necessary to be decided. It is certain that it cannot be done when it affects the rights of the stockholders by increasing their liability as such, or diminishing the value of their stock, and with such a radical change the burden would be placed on the consolidated company to show that no harm could be done the stockholder entering his protest. Whether the appellants would be injured by this change does not appear in this record, and, if it did, this court would be reluctant to hold, in the absence of authority in the charter, where one has become a stockholder in a turnpike road of a certain description, and for a certain purpose, that the legislature could unite him as a stockholder in another corporation, and for other or additional objects in view than are to be found in his original contract. In so doing his contract is destroyed, and another made for him, against his consent.
>
> In our opinion, the act of consolidation in this case is void, unless made by the unanimous consent of the stockholders.

Id. at 135.

89. In *Dow v. Northern Railroad*, 36 A. 510 (N.H. 1887), a minority shareholder succeeded in his suit to enjoin a 99-year lease of his corporation's railroad line and property, entered into upon a two-thirds shareholder vote pursuant to post-incorporation enabling legislation, even though the corporation's charter included a reserved power. *See id.* at 511 n.1; *see also Lease of Railroad by Majority of Stockholders with Assent of Legislature* (pts. 1 & 2), 8 HARV. L. REV. 295, 396 (1895) (setting forth notes made by the judge who authored the opinion in *Dow*).

90. In *Snook v. Georgia Improvement Co.*, 9 S.E. 1104 (Ga. 1889), the court held that a subscriber to stock in a railroad corporation (whose charter was obtained under a general law that authorized changes to be made in the routes of railroads but made no provision for any change in their termini) was released from his subscription when, pursuant to legislation enacted under a reserved power after his subscription, the corporation was permitted to change one terminus of its railroad. *See id.* at 1105-06. The court said:

> The doctrine is now well settled that if the charter of a corporation is materially, fundamentally, or radically changed by the legislature after a person has subscribed for stock therein, without his consent, he is released from such subscription.... It is also held that the charter of a corporation is a contract of a dual character,—*First*, a contract between the state which grants the charter and the corporation; and, *secondly*, a contract between the corporation and its members; and while the state, if it reserves the power to do so, can alter and amend the charter, and the corporation itself cannot object to the alteration or amendment, yet the state has no power to make any material or essential alteration in the contract between the members themselves and the corporation.

Id. at 1105.

91. In *Delaware Railroad Co. v. Tharp*, 6 Del. (1 Houst.) 149 (Super. Ct. 1855), the defendant was held liable on his subscription to stock in a corporation chartered in 1849 (at which time there appears to have been no reserved power in Delaware) even though

Carolina decisions in 1879 and 1892,[92] it appears that there was no authoritative adoption of either the expansive or the restrictive reading of the reserved power in either of those two states during the nineteenth century. However, matters were different in New Jersey. Notwithstanding a brief flirtation with the expansive reading in an 1863 decision,[93] the chancery court of New Jersey came down

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the terminus of the corporation's railroad was changed pursuant to subsequent legislation. *See id.* at 175. The judge's charge to the jury included the following:

> The grant of acts of incorporation by the State is professedly for the public good generally; and there is an inherent right in the Legislature to amend, change, or alter the charter of any incorporated company with its consent. Those who become corporators do so with that contingency, and their engagements are therefore subject to it. If a subscriber to stock enters into the corporation generally without specific stipulations, he is bound and concluded by the action of a majority of the corporation; and if the Legislature change or amend the charter on the application of the company, and with its assent and approval, without thereby impairing the contract of the corporators, in the mode we have stated, they will not be thereby discharged from their liability as subscribers to stock.

Id. at 174-75.

92. The reserved power was referred to in *Western North Carolina Railroad Co. v. Rollins*, 82 N.C. 524, 527-29 (1880). In *Bass v. Roanoke Navigation & Waterpower Co.*, 111 N.C. 439, 16 S.E. 402 (1892), the court said:

> Unless the power is specially reserved when the charter is granted, or under the constitution or general laws, the legislature cannot, as a general rule, modify the charter so as to take away any power which would inure to the profit of, or prove a protection to, a company from loss; but there is no restriction upon the right of the sovereign to enlarge its powers or extend its privileges, except that in so doing it must not infringe upon the vested rights of another.

Id. at 452-53, 16 S.E. at 406 (note that slight capitalization and punctuation differences exist between the version of this quotation published in the North Carolina Reporter and the version published in the South Eastern Reporter; this version is taken from the South Eastern Reporter).

93. In *Story v. Jersey City & Bergen Point Plank Road Co.*, 16 N.J. Eq. 13 (Ch. 1863), relief was denied to a shareholder who sought to enjoin his corporation from applying to the legislature for authority to abandon part of its road, to change its objects, and to alter its structure. *See id.* at 22-23. The court said:

> The complainant's bill is framed upon the theory that the charter of an incorporated company cannot be altered in any essential particular, even with the consent of the corporation, without the consent, express or implied, of every stockholder; and that such alteration would be unconstitutional, as impairing the obligation of the contract entered into between the state and such stockholder. If this doctrine should be admitted in its fullest extent, it is not perceived that it can affect the result of the present application.
>
> When the charter of the [corporation], of which the complainant claims to be a stockholder, was granted, it was provided by a general law of the state that the charter of every corporation granted by the legislature should be subject to alteration, suspension and repeal, in the discretion of the legislature. The legislature, therefore, in granting the charter to the plank road company, must be deemed to have reserved to themselves the right of altering, suspending, or repealing the charter, whenever, in their discretion, the public good might

squarely on the side of the restrictive reading in the 1867 decision of *Zabriskie v. Hackensack & New York Railroad Co.*,[94] in which the court said:

> The object and purpose of [the reserved power] are so plain, and so plainly expressed in the words, that it seems strange that any doubt could be raised concerning it. It was a reservation to the state, for the benefit of the public, to be exercised by the state only. The state was making what had been decided to be a contract, and it reserved the power of change, by altering, modifying, or repealing the contract. Neither the words nor the circumstances, nor apparent objects for which this provision was made, can, by any fair construction, extend it to giving a power to one part of the corporators as against the other, which they did not have before.
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> It was to avoid the rule in the Dartmouth College case, not that in *Natusch v. Irving*, that the change was made. The words limit the power to that object.
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> ....

> require it, as fully as if the reservation were inserted in the charter. And all the contracts, express or implied, resulting from the act of incorporation and its acceptance by the stockholders, must be deemed to have been entered into by both parties, subject to that reservation. Whatever limitation may exist to the reserved right of the legislature to alter or repeal the contract, I am clear that the reservation is in itself valid, and that this court ought not, upon a motion for a preliminary injunction, to pronounce any alteration, suspension, or repeal of the charter to be unconstitutional or illegal. Much less should this court make such declaration in advance of any actual legislation.

Id. at 21-22.

The decision in this case is difficult to follow because of the statement in the facts that the company was incorporated on March 8, 1840. *See id.* at 14. Had this been an accurate statement, it would have been nonsense for the court to proceed on the premise that the incorporation occurred after the 1846 adoption of New Jersey's reserved power, *see supra* note 49 (second paragraph). In fact, the company was incorporated by Act of Mar. 6, 1850, [no chapter number], 1850 N.J. Laws 255.

Interestingly, this case was not even cited in the *Zabriskie* decision. *See infra* notes 94-95 and accompanying text.

94. 18 N.J. Eq. 178 (Ch. 1867), *overruled by* Brundage v. New Jersey Zinc Co., 226 A.2d 585, 594-95 (N.J. 1967). In *Zabriskie*, the corporation had been chartered in 1856—10 years after New Jersey's adoption of its first reserved power of general applicability, *see supra* note 49 (second paragraph)—to build a railroad five miles long. *See Zabriskie*, 18 N.J. Eq. at 180. In 1861, the legislature amended its charter to authorize a 12-mile extension, and the corporation was about to extend its line pursuant to this authorization. *See id.* at 180-81. A minority shareholder brought suit to enjoin the extension, and he prevailed. *See id.* at 193-94.

The validity of the *Brundage* decision, in which *Zabriskie* was disavowed, is questioned *infra* in text accompanying notes 1099-1114.

> There is no other alternative to the proposition, that while the power reserved authorizes the legislature, within certain limits, to make such alterations as they choose to impose, it gives no authority, when the legislature does not impose them, for the majority to adopt such alterations or enter upon such enterprises as are allowed by the legislature.[95]

However, adoption of this restrictive reading of the reserved power left matters in an undesirable state. It meant that the reserved power provided an insufficient basis for the utilization by a pre-existing corporation of enabling legislation designed to eliminate the common-law restrictions on corporate combinations. Some other basis was needed to sustain a corporation's utilization of such post-incorporation enabling legislation.

c. Eminent Domain Solution

New Jersey's highest court found such a basis when the post-incorporation legislation provided a right of appraisal for dissenting shareholders. *Black v. Delaware & Raritan Canal Co.*[96] involved a proposed 999-year lease, whereby the properties of three New Jersey transportation corporations (called the United Companies) would be leased to the Pennsylvania Railroad Company pursuant to enabling legislation enacted by the New Jersey legislature in 1870. The reserved power was not involved in this case, because the charters of the three corporations proposing to make the lease contained no reserved power and they were all chartered (in 1830-32) prior to the 1846 enactment of New Jersey's first general reservation of power to amend or repeal charters subsequently granted.[97] After first concluding, on ultra vires grounds, that the corporations could not enter into such a lease without legislative authorization,[98] the court

95. *Zabriskie*, 18 N.J. Eq. at 185-86, 192.

96. 24 N.J. Eq. 455 (1873).

97. *See* Black v. Delaware & Raritan Canal Co., 22 N.J. Eq. 130, 141, 393 (Ch. 1871), *rev'd*, 24 N.J. Eq. 455 (1873). For New Jersey's 1846 reserved power statute, see *supra* note 49 (second paragraph).

98. The appellate court said:

> Was it within the power of the defendants, without the sanction of express legislation, to make such lease?
>
> There is an implied contract as well between the United Companies and their stockholders as between the companies and the state, that their corporate franchises, powers and property shall not be appropriated to uses or purposes not contemplated or authorized by their charters. As corporations, any action outside of the limits marked out for them in the legislative grant, is *ultra vires*.

Black, 24 N.J. Eq. at 463.

next considered whether the corporations could avail themselves of the post-incorporation enabling legislation in effecting the lease with the consent of two-thirds in interest of their shareholders, and its conclusion on this question also was in the negative.[99] However, the court then proceeded to hold that legislative provision of a right of appraisal—at least with respect to stock of a transportation corporation—constituted a valid exercise of the state's power of eminent domain. The court said:

> In the exercise of the right of eminent domain, the legislature may authorize shares in corporations, and corporate franchises, to be taken for public uses upon just compensation. The title to this species of property is no more secure against invasion when the public uses require it, than is the ownership of real estate. Under this paramount right in the public, subject to which all private property is held, the franchises of one corporation have been, and may be taken and bestowed upon another.
>
> . . . .
>
> There can be no doubt that a railroad company may be empowered to extend their road beyond the point to which it was built under the original grant, if proper compensation is provided for stockholders who may resist it, and I can see no difference in principle, whether the original company, in order to secure a through route under one management, is authorized to take the lands of individuals, or to take the property which individuals have in the stock of an existing road. In the first case, for the purpose of establishing the through route, one kind of private property, to wit, the lands of individuals, is taken by the corporation; in the second case, another kind of property, to wit, the shares of stock of individuals in an existing company, is authorized to be condemned. In the latter instance, the use is as clearly a public use as in the former, and when the legislature declares that it may be done it is no more necessary to

99. The court said:

> The proposition now considered is, whether, after shareholders have entered into a contract among themselves under legislative sanction, and expended their money in the execution of the plan mutually agreed upon, the scheme can be radically changed by the majority, by virtue of legislative enactment, and a dissentient stockholder compelled to engage in a new and totally different undertaking, without impairing the obligation of his contract with his associates and with the state. That this cannot be done, is as well supported by every consideration of justice and right, as it is firmly embedded in judicial decision.

Id. at 468.

> declare in the grant that public necessity requires it, than it is essential, in order to validate a railroad charter, that there should be an express announcement by the legislature that it is in aid of public uses. The same rule applies to both cases, unless property in stock can claim a superior right to protection. This, with all other private property, is held under the dominant right of eminent domain.[100]

Moreover, by treating the statutory right of appraisal as an exercise of the state's power of eminent domain, the matter of dissenting shareholders' contractual rights was removed from the prohibition of the Impairment Clause.[101] In *West River Bridge Co. v. Dix*,[102] the Supreme Court said that "the right of eminent domain in government in no wise interferes with the inviolability of contracts"[103] and that the right "does not operate to impair the contract effected [sic] by it, but recognizes its obligation in the fullest extent."[104] Similarly, in *Richmond, Fredericksburg & Potomac Railroad Co. v. Louisa Railroad Co.*,[105] that Court said: "[W]hen the public necessities require it, the one [a franchise], as well as the other [land], may be taken for public purposes on making suitable compensation; nor does such an exercise of the right of eminent domain interfere with the inviolability of contracts."[106]

Furthermore, by resting the matter on the exercise of a state's power of eminent domain, the existence of a reserved power became irrelevant. In *Spencer v. Seaboard Air Line Railway Co.*,[107] when a railroad company was chartered by North Carolina (in 1835) prior to that state's 1868 adoption of its first reserved power,[108] and thereafter

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100. *Id.* at 468-69, 470.

101. Noyes commented on this matter as follows:

> The legislature has power to authorize the consolidation of railroad and other *quasi*-public corporations, without the unanimous consent of their stockholders, when it makes provision for appraising and paying for the stock of dissenting stockholders. This power is entirely unaffected by the constitutional prohibition against impairing the obligations of contracts and is based upon the sovereign power of eminent domain. Corporate shares, as well as all other property, are subject to the paramount necessities of the State for the promotion of public interests.

NOYES, *supra* note 15, § 51, at 98.

102. 47 U.S. (6 How.) 507 (1848).

103. *Id.* at 532; *see supra* note 64 (quoting *Dix*).

104. *Dix*, 47 U.S. (6 How.) at 533; *see supra* note 64 (quoting *Dix*).

105. 54 U.S. (13 How.) 71 (1851).

106. *Id.* at 83.

107. 137 N.C. 107, 49 S.E. 96 (1904).

108. *See supra* note 51 and accompanying text.

the company entered into a merger pursuant to post-incorporation legislation (enacted in 1901) authorizing the merger with approval of a majority vote of shareholders but according a right of appraisal to dissenters, it was held that utilization of the enabling legislation did not violate the Impairment Clause because the grant of appraisal rights constituted a valid exercise of the state's power of eminent domain.[109] Similarly, in *In re Paterson & Hudson River Railroad Co.*,[110] which involved a New Jersey railroad corporation chartered by special act in 1831 (fifteen years before New Jersey adopted its first reserved power of general applicability), it was held that a sale of the corporation's assets to its parent corporation could be validly effected pursuant to post-incorporation enabling legislation that provided a right of appraisal for dissenting shareholders, because, even if the application of the post-incorporation legislation impaired the obligation of the contract embodied in the subsidiary's charter, the provision for appraisal constituted a valid exercise of the state's

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109. *See Spencer*, 137 N.C. at 125-26, 49 S.E. at 103. The court said:

> The plaintiff [shareholder] next contends that, assuming that the [enabling] statute confers the power upon the [plaintiff's] Railroad to consolidate, such power can be exercised only by the unanimous consent of the stockholders; that a dissenting stockholder cannot be compelled to surrender his stock in the corporation, and accept in lieu thereof stock in another company; that unless such power is conferred upon the majority of the stockholders in the charter, or by amendment thereto made before the subscription of the dissenting stockholder, an act of the Legislature conferring such power would be invalid, as impairing the obligation of the contract between the stockholders. This proposition is amply sustained upon principle and authority.... The defendant, conceding this to be the law, says that the statute conferring the power upon the several railroad companies consolidating expressly provides for paying the dissenting stockholder the full value of his stock at the time of the consolidation. This provision can only be sustained by invoking the right of eminent domain, and condemning the stock for a public use by making compensation therefor.... The Legislature, in the exercise of its power, confers upon the majority of the stockholders the power to consolidate with the other constituent companies, and accept in consideration therefor such number of shares in the new or consolidated corporation as may be agreed upon. This can be done only with the consent of the Legislature. The Legislature, having decided that such consolidation was promotive of the public welfare, recognized that it had no power to compel a dissenting stockholder to accept stock in the new corporation. Therefore, in the exercise of the right of eminent domain, it empowers the corporation to condemn the stock of such dissenting stockholder when it cannot otherwise be acquired. This power is entirely distinct from the [reserved] power to amend the charter.

Id. at 119-21, 49 S.E. at 101 (note that slight punctuation differences exist between the version of this quotation published in the North Carolina Reporter and the version published in the South Eastern Reporter; this version is taken from the South Eastern Reporter).

110. 94 A.2d 657 (N.J. 1953).

power of eminent domain.

There was criticism of this doctrine by which the constitutional barrier to a corporation's utilization of post-incorporation enabling legislation was said to be overcome, not on the basis of an exercise of the reserved power, but on the basis of an exercise of the state's power of eminent domain.[111] However, New Jersey and North Carolina were not the only states in which it was held to be a valid exercise of the power of eminent domain when the legislature made provision for removing the obstacle of minority shareholders dissenting from a corporate combination by according to such dissenters a right of appraisal.[112] And this view was supported by nineteenth-century commentary.[113]

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111. *See* Leonard M. Daggett, *Taking Corporate Shares by Right of Eminent Domain*, 5 YALE L.J. 205, 209-12 (1896); Note, *Consolidation of Railroads and Condemnation of Shares of Dissenting Stockholders*, 3 MICH. L. REV. 309, 309-10 (1905).

112. *Gregg v. Northern Railroad*, 41 A. 271 (N.H. 1893), involved the valuation of shares of a dissenting shareholder under a New Hampshire statute, Act of July 24, 1889, ch. 5, § 1, 1889 N.H. Laws 35, 35-37, that authorized a railroad corporation to institute valuation proceedings with respect to stock of shareholders who dissented from a lease or union with another railroad corporation. *See Gregg*, 41 A. at 271. The court said:

> The question of fact to be tried was the market value of Northern Railroad stock on the 1st day of January, 1890, the day when Gregg's stock was taken by an exercise of the right of eminent domain. This power of purchase was exercised for the purpose of obviating Gregg's objection to a lease of the road to the Boston & Maine Railroad for 99 years from that date.

Id. (citations omitted).

113. One commentator stated:

> The property and privileges belonging to individual members of a corporation are subject to the power of eminent domain, to the same extent as the property and privileges belonging to the corporation collectively; and in the exercise of this power a State may enable any portion of the shareholders in a corporation to dissolve their association and consolidate with another company, or to engage in an entirely new enterprise, upon making just compensation to such shareholders as are not willing to accept the change.

VICTOR MORAWETZ, PRIVATE CORPORATIONS 1050 (1886). Another commentator stated:

> It is not within the power of courts of law or equity to decree that the stock of shareholders dissenting from a plan of consolidation shall be condemned, appraised and sold, for the purpose of quieting factious opposition. But the legislature may, by virtue of the State's sovereign power of eminent domain, which extends not only to real, but also to personal property, provide, in the statute authorizing consolidation, lease, or sale, that dissenting shareholders' stock shall be appraised and condemned.

CHARLES F. BEACH, JR., LAW OF RAILWAYS 662 (1890).

3. Statutory Right of Appraisal

a. Origin of the Right

It has been said that, when state statutes were enacted to authorize mergers and sale-of-assets transactions, the right of appraisal was accorded to dissenting shareholders as the quid pro quo for loss of the right that existed at common law to veto such transactions.[114] However, there has been a divergence of views as to both the origins of, and the reasons for, the statutory right of appraisal.

Manning states that "the first appraisal statute" was enacted by the Pennsylvania legislature in 1861 in response to the 1858 decision in *Lauman v. Lebanon Valley Railroad Co.*[115] However, Eisenberg takes issue with Manning, stating that "Ohio had enacted rudimentary appraisal statutes even before 1858."[116] Commentators also have disagreed as to whether the right derived from a desire to accord fair treatment to dissenting shareholders or from a concern over the constitutionality of applying combination statutes to pre-

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114. *See* ROBERT C. CLARK, CORPORATE LAW 443-44 (1986) ("Historically, appraisal rights seem to have been given to shareholders as the quid pro quo for abandonment of the old nineteenth century rule that major corporate changes like mergers require the unanimous consent of all the shareholders."); Vorenberg, *supra* note 4, at 1194 ("The appraisal remedy has been described as having been the *quid pro quo* for statutes giving the majority the right to override the veto which previously the holder of even one share could exercise against mergers, sales of all assets, and other basic corporate changes.").

Probably the most frequently cited statement of the proposition is that in *Chicago Corp. v. Munds*, 172 A. 452 (Del. Ch. 1934), the court saying:

> What is the purpose of provisions of statutes which provide for the appraisement of the stock of a person who objects to the merger of his corporation with another? At common law it was in the power of any single stockholder to prevent a merger. When the idea became generally accepted that, in the interest of adjusting corporate mechanisms to the requirements of business and commercial growth, mergers should be permitted in spite of the opposition of minorities, statutes were enacted in state after state which took from the individual stockholder the right theretofore existing to defeat the welding of his corporation with another. In compensation for the lost right a provision was written into the modern statutes giving the dissenting stockholder the option completely to retire from the enterprise and receive the value of his stock in money.

Id. at 455; *accord* Meade v. Pacific Gamble Robinson Co., 51 A.2d 313, 316 (Del. Ch. 1947), *aff'd*, 58 A.2d 415 (Del. 1948); Stanton v. Republic Bank, 559 N.E.2d 1064, 1066 (Ill. App. Ct. 1990); Anderson v. International Minerals & Chem. Corp., 67 N.E.2d 573, 576-77 (N.Y. 1946); Armstrong v. Marathon Oil Co., 513 N.E.2d 776, 782 (Ohio 1987); Johnson v. Baldwin, 69 S.E.2d 585, 591 (S.C. 1952).

115. 30 Pa. 42 (1858); *see* Bayless Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L.J. 223, 246 n.38 (1962).

116. MELVIN ARON EISENBERG, THE STRUCTURE OF THE CORPORATION 75 (1976).

existing corporations in the absence of a provision for appraisal.[117] It is instructive, therefore, to examine the question of when and why the statutory right of appraisal first appeared.

Eisenberg makes reference to Ohio statutes enacted in 1851 and 1852.[118] These, however, were not true appraisal statutes; they gave to dissenters only the right to be paid at least par value for their shares.[119] Moreover, these Ohio statutes were not the first of their kind. As early as 1831, a statute of New Jersey, authorizing the consolidation of a canal company and a railroad company upon a seven-eighths shareholder approval, provided "that if any stockholders shall disagree to the provisions of this act, ... it shall be the duty of the company, to pay such person or persons dissenting, the sum paid for his, her or their stock, with interest, on transferring the same to the Company."[120]

True appraisal statutes—in the sense of awarding to dissenters the value of their shares at the time of the transactions to which they objected, as distinguished from giving them a return of their (or their predecessors') initial investments—came in New Jersey and New York in the early 1850s. In both states, enactment of such statutes was accompanied by intimations that the reserved power alone was considered insufficient to remove the constitutional impediment to the utilization of permissive enabling legislation by pre-existing corporations.

In 1847, the year following enactment of New Jersey's first reserved power of general applicability,[121] that state's legislature

117. *See id.*; *see also* Ernest L. Folk, III, *De Facto Mergers in Delaware:* Hariton v. Arco Electronics, Inc., 49 VA. L. REV. 1261, 1264-65 (1963) (discussing the derivation of the appraisal right).

118. *See* EISENBERG, *supra* note 116, at 75 n.17.

119. The 1851 Ohio statute authorized the consolidation of two or more railroad companies whose lines were such as to permit continuous passage; and (in addition to requiring approval by a two-thirds vote of shareholders) it required the agreement of consolidation to prescribe "the manner of compensating stockholders in each of said two or more corporations who refuse to convert their stock into the stock of such new corporation" and provided that "all stockholders in either of such corporations who shall refuse to convert their stock into the stock of such new corporation shall be paid at least par value for each of the shares so held by them, if they shall so require, previous to said consolidation being consummated." Act of Mar. 3, 1851, [no chapter number], § 1.I, 49 Ohio Laws 94, 94-95.

Similar provisions were contained in the 1852 Ohio statute with respect to the consolidation of railroad companies, turnpike and plank road companies, and telegraph companies. *See* Act of May 1, 1852, [no chapter number], §§ 21.I, 43, 48, 50 Ohio Laws 274, 279-80, 287, 288.

120. Act of Feb. 15, 1831, [no chapter number], 1831 N.J. Laws 124, 124.

121. *See supra* note 49 (second paragraph).

chartered the Somerville and Easton Railroad Company[122] and two years later, in 1849, authorized that corporation to purchase (for shares of its stock) the railroad line of another New Jersey corporation with the consent of the latter's shareholders.[123] In 1853, in *Kean v. Johnson*,[124] it was held that such consent required the concurrence of all of the shareholders of the acquired corporation, not simply the holders of a majority of its stock;[125] thus it was considered unnecessary "to enter upon the interesting question ... whether the act would not be unconstitutional because impairing the obligation of contracts, unless it provided for the consent of all the stockholders."[126] The following year, in 1854, the New Jersey legislature enacted a supplement to the act chartering the Somerville and Easton Railroad Company (by then the Central Railroad Company of New Jersey) whereby that corporation was authorized "to purchase or lease, or operate any railroad which may connect with or intersect their road, ... or to consolidate the stock of such company with their own"[127] but only with the assent of three-quarters in interest of the shareholders and with a right of appraisal accorded to dissenters.[128] This sequence of events clearly implied that the right

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122. *See* Act of Feb. 26, 1847, [no chapter number], 1847 N.J. Laws 128.

123. *See* Act of Feb. 22, 1849, [no chapter number], 1849 N.J. Laws 90.

124. 9 N.J. Eq. 401 (Ch. 1853).

125. *See id.* at 408 ("Nothing is more certainly settled than that any fundamental alteration of a charter, or material deviation from or extension of a road, in the case of road companies, interferes with the rights of the corporators, and that no majority, however large, can compel any individual stockholders to submit.").

126. *Id.* at 420-21.

127. Act of Mar. 17, 1854, ch. 216, § 3, 1854 N.J. Laws 524, 525.

128. The right of appraisal, as stated in the 1854 Act, was as follows:

> [I]f any stockholder or stockholders shall refuse his or their assent, ... application may be made by such stockholder or stockholders within three months from the time that the purchase or consolidation shall take effect, to one of the justices of the supreme court of this state, for the appointment of three disinterested, impartial persons, well acquainted with the value of railroad property, as commissioners to appraise the value of the shares held by such stockholder or stockholders; *provided*, the appraisement shall in no case be less than the par value thereof, whereupon such proceedings shall be had as are provided in section seven of the act of incorporation for appraising and taking lands, so far as the same is applicable.

Id.

A somewhat different provision for appraisal was included in an 1857 statute of Pennsylvania. *See* Act of May 16, 1857, No. 579, § 3, 1857 Pa. Laws 519, 521. That statute provided for the public sale of the Main Line of Public Works (consisting of railroads and canals owned and operated by the state) and authorized the sale to be made to the Pennsylvania Railroad Company at a premium price coupled with tax concessions. *See* Mott v. Pennsylvania R.R. Co., 30 Pa. 9, 34 (1858). It contained the following provision:

> *And provided further*, That in case of the refusal of any stockholder or

of appraisal was included in the 1854 statute to avoid the constitutional difficulty alluded to in the 1853 decision in *Kean*, and the wording of the appraisal provision evidenced an intention on the part of the legislature to invoke the state's power of eminent domain.

An 1850 New York statute[129] authorized the directors of two existing railroad corporations to consolidate the two into a new corporation without shareholder approval, but it conditioned the holding of the first election of new directors upon an appraisal of the value of dissenters' stock if the holders of one-fourth of the stock of either of the consolidating corporations registered their dissent and the corporation failed to pay them the amount they claimed for their stock.[130] Then, in 1853, New York enacted a statute authorizing the

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> stockholders of said company to comply with the provisions of this act, after the same may have been accepted by a majority of the stockholders of the company, it shall be lawful for said company to pay the stockholder or stockholders so refusing the full market value of his, her or their share or shares of stock, and such share or shares shall enure to the benefit of the company to be disposed of by the directors for the benefit of the balance of the stockholders.

Act of May 16, 1857, No. 579, § 3, 1857 Pa. Laws 519, 521.

129. *See* Act of Apr. 9, 1850, ch. 239, 1850 N.Y. Laws 471.

130. Two sections of the 1850 statute provided as follows:

> § 2. The notice of the first election shall be published immediately after filing the said articles of association [of the new corporation resulting from consolidation of the two former corporations], and shall contain a notice to the stockholders of the two former companies respectively, that such companies have been united according to law, that unless they file with the secretary of the new company ... a dissent from becoming members of the new corporation, ... they will severally be deemed as assenting to the union of the two companies, and be members of the new corporation .... Any stockholder dissenting from the union of the two companies shall file his written dissent with the secretary, at least five days before the day designated for the said election, and shall state therein the amount claimed for his stock.
>
> § 3. If persons holding stock in either company to the amount of one-fourth of the whole stock therein shall duly dissent from such union and the corporation shall decline to pay the amount the amount [sic] claimed for the stock, so as to leave one-fourth still dissenting, the first election shall be postponed until the value of the stock shall be ascertained and paid as hereinafter provided. Whenever the corporation shall decline to pay any stockholders [sic], who has duly filed his dissent, the amount claimed for his stock, it shall immediately apply to a justice of the supreme court ... for the appointment of three persons to appraise the value of such stock. If the judge shall be satisfied that reasonable notice has been given, he shall thereupon appoint three competent persons to appraise the value of such stock, and shall designate ... the manner in which payment shall be made to such stockholders for the value of their stock. The appraisers ... or any two of them shall estimate and certify the value of such stock, and shall deliver one copy of their appraisal to the corporation ... and another copy to any stockholder who shall demand the same.... When the corporation shall have paid to any stockholder according to the order of the judge, the amount so appraised, or the amount agreed upon

consolidation of several railroad companies,[131] thereby providing the basis for creation of the New York Central Railroad Company.[132] This statute, in addition to requiring approval by shareholders of each consolidating company "by the vote of at least two-thirds in amount of the stockholders present at such meetings respectively,"[133] gave to dissenting shareholders a right of appraisal in terms that sound almost modern.[134] This 1853 statutory right of appraisal was the subject of a New York court's comment, in the year following its enactment, suggesting that the legislature entertained doubts that the reserved power alone (i.e., without the right of appraisal) would sustain the utilization by a pre-existing corporation of enabling legislation upon a vote of less than all of its shareholders.[135]

> without appraisal, such stockholder shall thereafter have no interest in the stock and the same may be disposed of by the corporation.

Act of Apr. 9, 1850, ch. 239, §§ 2-3, 1850 N.Y. Laws 471, 472-73.

131. *See* Act of Apr. 2, 1853, ch. 76, 1853 N.Y. Laws 110.

132. *See* FRANK W. STEVENS, THE BEGINNINGS OF THE NEW YORK CENTRAL RAILROAD 350-87 (1926).

133. Act of Apr. 2, 1853, ch. 76, § 1, 1853 N.Y. Laws 110, 110-11.

134. The appraisal section of the 1853 statute provided as follows:

> If any stockholder shall, at said meeting of stockholders, or within twenty days thereafter, object to said consolidation, and demand payment for his stock, such stockholder or said new company may, if said consolidation take effect at any time thereafter, apply to the supreme court . . . for the appointment of three persons to appraise the value of such stock. If the court shall be satisfied that reasonable notice has been given of such application, it shall thereupon appoint three persons to appraise the value of said stock, and shall designate the time and place of meeting of such appraisers, and give such directions in regard to the proceedings on said appraisement as shall be deemed proper, and shall also direct the manner in which payment for such stock shall be made to such stockholder. The court may fill any vacancy in the board of appraisers occurring by refusal or neglect to serve, or otherwise; the appraisers shall meet at the time and place designated, and they or any two of them, after being duly sworn honestly and faithfully to discharge their duties, shall estimate and certify the value of such stock at the time of such dissent as aforesaid, and deliver one copy of their appraisal to the said company, and another to the said stockholder, if demanded . . . . When the corporation shall have paid the amount of the appraisal as directed by the court, such stockholder shall cease to have any interest in the said stock, and in the corporate property of the said corporation, and the said stock may be held or disposed of by the said corporation.

Act of Apr. 2, 1853, ch. 76, § 6, 1853 N.Y. Laws 110, 113.

135. In *Troy & Rutland Railroad Co. v. Kerr*, 17 Barb. 581 (N.Y. App. Div. 1854), a subscriber to stock in a New York railroad corporation was held liable on his subscription notwithstanding actions taken by the company pursuant to post-incorporation enabling legislation whereby portions of the corporation's road and franchises were leased or conveyed to other corporations and the amount of its authorized capital stock was reduced accordingly. *See id.* at 602, 607. In the course of its opinion, the court said:

> One who had embarked his fortune in the construction of a railroad, perhaps to run past his own door, could hardly have supposed that, under the usual power

b. Importance of the Right

(1) *New Jersey Cases*

From the 1873 decision in *Black v. Delaware & Raritan Canal Co.*[136] until well into the twentieth century, the New Jersey law, concerning a corporation's utilization of permissive post-incorporation legislation, could be summarized as follows. Notwithstanding the reserved power, which had existed in New Jersey since 1846,[137] a corporation could not—over the opposition of a single shareholder—avail itself of post-incorporation legislation that permitted the taking of some significant action (not authorized by the corporation's charter or by the general law under which it had been incorporated) upon the approval of the holders of some specified majority of its shares, unless (i) there had been some earlier acceptance of the enabling statute by all of the corporation's shareholders or (ii) the enabling statute accorded a right of appraisal to dissenting shareholders.

While the first of these exceptions was implicit in New Jersey law following the 1867 decision in *Zabriskie v. Hackensack & New York Railroad Co.*,[138] it was made explicit around the turn of the century. In 1873, Justice Bradley, writing for the U.S. Supreme Court in *Railway Co. v. Allerton*,[139] had said: "[A] subsequent [enabling] act ... would not bind the stockholders without their acceptance of it, or assent to it in some form."[140] Later, in 1908, a New Jersey court, in *Einstein v. Raritan Woolen Mills*,[141] said: "I take it that, when Mr.

> of repeal and amendment reserved by the legislature, he could be forced to lend his money to, or become a member of, another railroad corporation chartered and doing business in a foreign country. We have one or two other similar enactments I believe, upon our statute books; but the legislature seems to have given a more restricted construction to its powers; and, in a recent act to authorize the consolidation of certain railroad corporations, inserted provisions enabling a dissenting stockholder to receive compensation for his stock, and withdraw.

Id. at 607 (citation omitted). In support of the last statement, the court cited the appraisal provision (quoted *supra* in note 134) of the 1853 New York statute discussed *supra* in text accompanying notes 131-34.

136. 24 N.J. Eq. 455 (1873); *see supra* notes 96-100 and accompanying text.

137. *See supra* note 49 (second paragraph).

138. 18 N.J. Eq. 178 (Ch. 1867), *overruled by* Brundage v. New Jersey Zinc Co., 226 A.2d 585, 594-95 (N.J. 1967); *see supra* text accompanying notes 94-95 (discussing and quoting *Zabriskie*).

139. 85 U.S. (18 Wall.) 233 (1873).

140. *Id.* at 235-36.

141. 70 A. 295 (N.J. Ch. 1908).

Justice Bradley speaks of the consent of the shareholders, he means the consent of every shareholder, and that a mere majority, however large, would not have the power to interfere with the rights and property of the minority."[142] In 1900, in the case of *Rankin v. Newark Library Ass'n*,[143] it had been held that shareholders were bound by the provisions of a post-incorporation statute, enacted pursuant to New Jersey's reserved power, because all of them (by action or acquiescence) had assented to its application.[144] On the other hand, in the 1908 decision in *Einstein*,[145] it was held that a corporation could not avail itself of post-incorporation enabling legislation, even though enacted pursuant to the reserved power, if all of the shareholders had not agreed.[146]

Absent the assent of all of the shareholders, the only basis upon which a New Jersey corporation could avail itself of permissive post-incorporation legislation, authorizing a significant change in the nature or operation of the corporation's business, was through legislative provision of a right of appraisal for dissenters. In 1886, in *Mills v. Central Railroad Co.*,[147] a 999-year lease of a corporation's railroad line to another company, although approved by a majority vote of shareholders, was annulled at the behest of a minority, because the post-incorporation enabling legislation, though enacted pursuant to a pre-incorporation reserved power, gave dissenting shareholders no right of appraisal.[148] In 1894, in *Loewenthal v.*

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142. *Id.* at 297.

143. 45 A. 622 (N.J. 1900).

144. The *Rankin* court said: "Thus, the [post-incorporation] statute, which on its enactment became perhaps only conditionally the law of this association,—the condition being the assent of all the stockholders,—became on fulfillment of that condition the absolute law of the corporation." *Id.* at 624.

145. *See supra* text accompanying notes 141-42.

146. The court said:

> I must hold that this [post-incorporation] act is merely the consent of the state that the stockholders may, if they all agree, do the things which are provided for in that act; but, if all the stockholders do not agree, the act cannot be held to be a portion of the charter of the corporation or an amendment thereto. This is specifically held in [cited New Jersey cases] and many other cases which have ingrafted this doctrine into our law so deeply as to be beyond disturbance.

Einstein, 70 A. at 297.

147. 2 A. 453 (N.J. Ch. 1886).

148. The court said:

> The provision in [an 1880 enabling statute], that it shall be lawful to lease or consolidate, is merely a legislative authorization—a concession on the part of the legislature of the power—to do that which could not lawfully be done without such authority. It is not an enactment that the directors may, without the consent of the stockholders of the company, lease, consolidate, or merge; nor is

Rubber Reclaiming Co.,[149] it was held that a corporation, whose corporate documents provided for cumulative voting and required a two-thirds vote of shareholders for an amendment, could not (over the objection of a minority) eliminate cumulative voting by availing itself of post-incorporation legislation authorizing corporate charters to be amended with the assent of a simple majority in interest of shareholders.[150] In the 1899 case of *German Mutual Fire Insurance*

> it in effect an enactment that they may, with the consent of the majority of the stockholders, do so. But the statute is merely an enabling act,—a law intended to give once for all a general legislative authority to lease, consolidate, or merge. The legislature did not intend to affect the rights of stockholders *inter sese*, and the act does not do so either expressly or by implication. It was settled law when the act was passed that, after shareholders had entered into a contract among themselves under legislative sanction, and expended their money in the execution of the plan mutually agreed upon, the plan could not, even by virtue of legislative enactment, be radically changed by the majority alone, and dissentient stockholders be compelled to engage in a new and totally different undertaking; because such action would impair the obligation of the dissenting stockholders' contract with their associates and the state. This was declared by the highest tribunal of the state to be the law, and to be as well supported by every consideration of justice and right as it was firmly imbedded in judicial decision. *Black v. Delaware & R. C. Co.*
>
> The rights of unwilling stockholders are not protected by the act of 1880, and, inasmuch as their interest cannot be taken or controlled *in invitum* except under the exercise of the right of eminent domain, it is a legal conclusion, from the absence of any provision in that respect, that the legislature did not intend to exercise the right of eminent domain at all, but simply to confer the right to do the act, or exercise the power given, on first obtaining the consent of those affected, or on payment of satisfactory compensation to such outside of legislative provisions....
>
> ....
>
> ... It is for the legislature to say whether the stock of dissenting stockholders shall be taken, as for a public use, under the exercise of the rights of eminent domain. It has not said that it may be so taken in this case.

Id. at 454-55, 460 (citation omitted); *see supra* text accompanying notes 96-100 (discussing and quoting *Black*).

149. 28 A. 454 (N.J. Ch. 1894).

150. The court said:

> The law, as contended for by complainants, is well settled. Mills v. Railroad Co. and cases cited. If the certificate of incorporation and the by-laws of a corporation form a contract between the stockholders, then the legislature has no power to authorize a mere majority to alter it, except in the manner provided by the contract itself....
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> ....
>
> It was urged by the counsel of defendants ... that the rule of the majority is the law of the corporation, and must govern, and that to hold this by-law unrepealable, except by a two-thirds vote of all the stockholders, is in derogation of this law. The authority relied upon for this position is Durfee v. Railroad Co. That case, as I read it, is in direct conflict with the line of cases in this state culminating in Mills v. Railroad Co., above cited. Its reasoning is expressly repudiated by Chancellor Zabriskie in Zabriskie v. Railroad Co.

Co. v. Schwarzwaelder,[151] the plaintiff, a policyholder in a mutual fire insurance corporation entitled to vote at its meetings, succeeded in enjoining the changing of her corporation from a mutual company to a joint stock company—whereby she would have lost her right to vote—when the only basis for making such a change was enabling legislation enacted after she had become a policyholder.[152]

(2) North Carolina Cases

In North Carolina, as in New Jersey,[153] there was nineteenth-century case law suggesting that post-incorporation legislation could be accepted by shareholders[154] and that such acceptance could take the form of acquiescence.[155] But there does not appear to have been any nineteenth-century decision in North Carolina on the question whether the provision of appraisal rights for dissenters was adequate (or necessary) to sustain the utilization by a corporation of permissible post-incorporation legislation.

Id. at 454, 456 (citations omitted); *see supra* text accompanying notes 73-74 (discussing and quoting *Durfee*), 94-95 (discussing and quoting *Zabriskie*), and 147-48 (discussing *Mills*).

151. 44 A. 769 (N.J. 1899).

152. The court said:

> The [enabling act], if enforced against the complainant, would impair the obligation of her contract by enabling the company to take from her a right derived from her contract with it, in a method not authorized by the contract. Such a law would be unconstitutional and void. Although the act under which the company was organized is subject to amendment, alteration, and repeal by the legislature, yet such amendment, alteration, or repeal can be effected only by the legislative power of that body, and its legislative power does not extend to the enactment of a law which impairs the obligation of a legal contract previously made.

Id. at 770.

153. *See supra* text accompanying notes 138-46.

154. It appears to have been assumed in North Carolina in the early part of the nineteenth century that a statutory amendment of a corporate charter became effective upon acceptance of the amendment by the shareholders. *See* Attorney-General v. President & Dirs. of the State Bank, 21 N.C. (1 Dev. & Bat. Eq.) 545, 547-48 (1837). And, in 1850, it was said that the creation of a corporation by the legislature entailed the making of a contract that "cannot be modified, changed or annulled without the consent of both parties." Columbus Mills v. Williams, 33 N.C. (11 Ired.) 558, 561 (1850).

155. In *Western North Carolina Railroad Co. v. Rollins*, 82 N.C. 524 (1880), the court said:

> While it is true that each corporator may object to the repeal or to any material modification of the provisions of a charter granted for other than municipal purposes, and constituting a legislative contract protected by the Constitution of the United States, yet, in the absence of complaint, acquiescence in the change may be inferred, and ultimately its acceptance by the corporators.

Id. at 531-32.

However, there was a significant North Carolina decision, in 1904, embracing the New Jersey doctrine that a corporation could avail itself of post-incorporation legislation, authorizing a corporate merger upon approval by less than all of the shareholders, when the enabling legislation accorded a right of appraisal to dissenters. In *Spencer v. Seaboard Air Line Railway Co.*,[156] it was held, with respect to a corporation chartered prior to the state's initial reservation of the power of alteration or amendment, that the corporation could utilize post-incorporation merger legislation, because the enabling statute's provision of appraisal rights for dissenters amounted to a valid exercise of the state's power of eminent domain.[157]

(3) Delaware Cases

It appears that there was no Delaware decision in the nineteenth century concerning the relevance of a right of appraisal to corporate utilization of post-incorporation enabling legislation.

C. *Early Enabling Statutes*

The early statutes authorizing corporate combinations tended to be special acts, but enabling statutes of general applicability began to appear before the end of the nineteenth century.

1. Merger

Most of the merger law in this country had its origin in the perceived need to make provision for combining the connecting lines of railroad or other transportation companies. Special acts authorizing railroad mergers were enacted in the nineteenth century both in North Carolina[158] and in Delaware.[159] Moreover, in 1872, the North Carolina legislature enacted a general statute providing for the formation of railroad corporations and authorizing any two or more of such companies to consolidate to form a continuous line.[160]

However, because of New Jersey's location—between the cities of New York and Philadelphia[161]—railroad merger statutes were far

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156. 137 N.C. 107, 49 S.E. 96 (1904).

157. *See supra* notes 107-09 and accompanying text.

158. *See, e.g.*, Act of Jan. 16, 1849, ch. 83, 1848-49 N.C. Sess. Laws 160.

159. *See, e.g.*, Act of Feb. 22, 1877, ch. 434, 15 Del. Laws 514; Act of Feb. 1, 1883, ch. 163, 17 Del. Laws 293.

160. *See* Act of Feb. 8, 1872, ch. 138, §§ 1, 58-62, 1871-72 N.C. Sess. Laws 186, 186, 215-18.

161. The preamble to an 1867 New Jersey statute began: "Whereas, it is desirable that the Railroad lines between New York and Philadelphia, forming by their connection

more numerous in that state during the nineteenth century, beginning with special acts.[162] Reference has been made previously to an 1831 statute authorizing two named corporations to consolidate (and allowing dissenters to receive a return of their investment)[163] and to an 1854 statute authorizing a named railroad corporation to consolidate with any railroad connecting with or intersecting its line (and according to dissenters a right of appraisal).[164] Other New Jersey statutes, authorizing named railroad corporations to consolidate with other companies and according appraisal rights to dissenters, were enacted in 1866,[165] 1867,[166] and 1870;[167] but an 1872 statute of that state,[168] while authorizing the consolidation of two named railroad corporations, inexplicably made no provision for appraisal rights. A more generalized approach to railroad mergers came in an 1873 New Jersey act,[169] as supplemented by statutes enacted in 1878[170] and 1881,[171] providing for the formation of railroad

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essentially one line, should be more closely united in interest and management, whereby great advantages would accrue to the public as well as to the stockholders . . . ." Act of Feb. 27, 1867, ch. 69, 1867 N.J. Laws 114, 114.

162. Cadman states:

> No general statutes were enacted in New Jersey during the period [prior to 1875] to regulate lease or consolidation agreements made between corporations. Laws authorizing particular railroad companies to enter lease or consolidation arrangements appeared, however, in considerable number after 1850. Between that date and 1875, twenty-six railroads were authorized by charter amendments and thirteen were allowed by the terms of their original charters to enter into some sort of lease or consolidation arrangement.

CADMAN, *supra* note 49, at 324-25.

163. *See supra* text accompanying note 120.

164. *See supra* text accompanying notes 127-28.

165. *See* Act of Feb. 6, 1866, ch. 10, §§ 1, 3, 1866 N.J. Laws 15, 15-16, 17.

166. *See* Act of Feb. 27, 1867, ch. 69, § 1, 1867 N.J. Laws 114, 114-15.

167. *See* Act of Mar. 17, 1870, ch. 389, §§ 1, 4, 1870 N.J. Laws 811, 811, 813; Act of Mar. 17, 1870, ch. 432, § 1, 1870 N.J. Laws 916, 916-17. The latter was the statute involved in the case of *Black v. Delaware & Raritan Canal Co.*, 24 N.J. Eq. 455 (1873). For discussion of *Black*, see *supra* text accompanying notes 96-100.

168. *See* Act of Apr. 2, 1872, ch. 450, 1872 N.J. Laws 1017.

169. *See* Act of Apr. 2, 1873, ch. 413, §§ 1, 17, 1873 N.J. Laws 88, 88-89, 98-99. This act provided as follows:

> [I]t shall be lawful for any corporation incorporated under this act at any time during the continuance of its charter to lease its road, or any part thereof, to any other corporation or corporations, of this or any other state, or to unite and consolidate as well as merge its stock, property, and franchises and road with those of any other company or companies, of this or any other state, or to do both; and such other company and companies are hereby authorized to take such lease, or to unite, consolidate as well as merge its stock, property, franchises and road with said company, or to do both . . . .

Id. § 17, 1873 N.J. Laws at 98-99.

170. *See* Act of Mar. 7, 1878, ch. 49, §§ 1, 2, 1878 N.J. Laws 58, 58-59.

corporations by the filing of articles of association (rather than by special act), authorizing such corporations to merge or consolidate, and giving a right of appraisal to dissenters. By statutes enacted in 1883[172] and 1888,[173] similar authorization to merge or consolidate was extended to corporations organized for specified purposes other than the construction and operation of railroads. Then, in 1893, New Jersey enacted its first merger statute of general applicability[174] titled "An Act to authorize corporations incorporated under the laws of this state to merge and consolidate their corporate franchises and other property."[175]

2. Purchase/Sale of Assets

A purchase by one corporation of the assets of another corporation did not require enabling legislation.[176] On the other hand, a sale by a prosperous corporation of all of its assets could not be effected, in the absence of enabling legislation, unless there was unanimous assent by the shareholders.[177] Surprisingly, statutes of general applicability, authorizing corporations to sell all of their assets upon the approval of some specified majority (less than all) of the voting shares, did not come in any of the three subject states until well into the twentieth century.[178]

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171. *See* Act of Mar. 25, 1881, ch. 178, §§ 1, 8, 1881 N.J. Laws 222, 222, 225.

172. *See* Act of Mar. 23, 1883, ch. 198, 1883 N.J. Laws 242.

173. *See* Act of Apr. 17, 1888, ch. 294, 1888 N.J. Laws 441.

174. *See* Brundage v. New Jersey Zinc Co., 226 A.2d 585, 593 (N.J. 1967); *infra* note 1106 (quoting *Brundage*).

175. Act of Mar. 8, 1893, ch. 67, 1893 N.J. Laws 121.

176. *See supra* text accompanying notes 8-9. Nonetheless, section 49 of New Jersey's 1896 corporation statute provided as follows:

> Any corporation formed under this act may purchase mines, manufactories or other property necessary for its business, or the stock of any company or companies owning, mining, manufacturing or producing materials, or other property necessary for its business, and issue stock to the amount of the value thereof in payment therefor....

Act of Apr. 21, 1896, ch. 185, § 49, 1896 N.J. Laws 277, 293-94; *see infra* text accompanying notes 206-08 (discussing the origin of New Jersey's 1896 corporation statute).

And section 55 of New Jersey's 1875 general corporation statute provided as follows: "The directors of any company incorporated under this act may purchase mines, manufactories, or other property necessary for their business, and issue stock to the amount of the value thereof in payment therefor...." An Act Concerning Corporations (Act of Apr. 7, 1875), *published in* REVISED STATUTES OF NEW JERSEY 3, 20 (1875).

177. *See supra* notes 10-12 and accompanying text.

178. For Delaware, see *infra* notes 810-11 and accompanying text. For North Carolina, see *infra* note 824 (first paragraph) and accompanying text. For New Jersey, see *infra* note 843 (first paragraph) and accompanying text.

Nevertheless, the perceived need to permit common management of connecting railroads led to the enactment in New Jersey of nineteenth-century special acts permitting one railroad corporation to lease its line to another such corporation.[179] A more generalized approach to the leasing of its line by one railroad corporation to another came in the same 1873 statute[180] that contained New Jersey's more generalized approach to railroad mergers.[181] Then, in 1899, New Jersey enacted a statute authorizing any corporation of that state (except railroad and canal companies) to lease its property and franchises with the assent of two-thirds in interest of its shareholders but without any statutory right of appraisal.[182]

3. Purchase/Sale of Controlling Stock Interest

There were numerous special acts, enacted in New Jersey in the second half of the nineteenth century,[183] authorizing one corporation to hold stock of another corporation.[184] For example, in 1857, New Jersey chartered a railroad company with a provision that any other railroad company incorporated by that state's legislature "may subscribe for and hold the stock . . . of this company."[185]

Said to be the first state in the nation to do so,[186] New Jersey

179. For example, a New Jersey statute, enacted in 1856, authorized an existing railroad corporation "with the consent of the stockholders representing two-thirds of its capital stock" to "lease out for a term of years the said road, with its powers and authorities." Act of Feb. 25, 1856, ch. 37, § 2, 1856 N.J. Laws 65, 66. Similarly, in 1857, New Jersey chartered a railroad corporation with a provision authorizing the road to be leased out for a term of years "with the consent of the stockholders representing two-thirds of its capital stock." Act of Mar. 20, 1857, ch. 111, § 18, 1857 N.J. Laws 313, 322. Neither of these statutes made any provision for a right of appraisal for dissenters.

180. *See* Act of Apr. 2, 1873, ch. 413, § 17, 1873 N.J. Laws 88, 98-99 (quoted *supra* in note 169).

181. *See supra* text accompanying note 169.

182. The statute provided as follows:

> Any corporation of this state, except railroad and canal corporations, may hereafter, with the assent of two-thirds in interest of its stockholders, . . . lease its property and franchises to any corporation, and every corporation of this state is hereby authorized to take the lease or any assignment thereof, for such terms and upon such conditions as may be agreed upon, and . . . any such lease or assignment, or both, heretofore made, are hereby validated . . . .

Act of Mar. 24, 1899, ch. 150, § 1, 1899 N.J. Laws 334, 334.

183. *See* CADMAN, *supra* note 49, at 230-31.

184. The same was true in other states as well. *See* William Randall Compton, *Early History of Stock Ownership by Corporations*, 9 GEO. WASH. L. REV. 125, 127-29 & nn.3-10 (1940).

185. Act of Mar. 20, 1857, ch. 111, § 18, 1857 N.J. Laws 313, 321.

186. *See* Louis K. Liggett Co. v. Lee, 288 U.S. 517, 556 n.32 (1933) (Brandeis, J.,

enacted, in 1888, a statute of general applicability concerning ownership by one corporation of stock of another corporation.[187] However, this statute appeared to limit New Jersey corporations to the ownership of stock of other New Jersey corporations. Then in 1893—the same year in which New Jersey adopted its first merger statute of general applicability[188]—a statute was enacted giving to New Jersey corporations virtually unlimited authorization to own and vote stock of other corporations both domestic and foreign.[189] This statute, and its successor in section 51 of the 1896 New Jersey general corporation statute,[190] played a significant role in New Jersey's becoming the home of many of the nation's industrial giants near the turn of the century.[191]

D. *Move from Special Acts to General Laws*

In the early decades of the nineteenth century, most American corporations were created by special acts of the state legislatures. However, the perception that such special acts entailed political favoritism led ultimately to the enactment of general laws pursuant to which some specified number of persons could avail themselves of the privilege of forming a corporation by filing the necessary certificate. Moreover, in time, many states made it a constitutional

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dissenting) ("New Jersey was the first state to confer the general power of intercorporate stockholding."); RUSSELL CARPENTER LARCOM, THE DELAWARE CORPORATION 60 (1937) ("New Jersey was the first state to authorize broad powers for intercorporate stockholdings by amendment to its general incorporation law in 1888 and 1889.").

187. That statute provided as follows:

> That it shall be lawful for any corporation of this state, or of any other state, doing business in this state and authorized by law to own and hold shares of stock and bonds of corporations of other states, to own and hold and dispose thereof in the same manner and with all the rights, powers and privileges of individual owners of shares of the capital stock and bonds or other evidences of indebtedness of corporations of this state.

Act of Apr. 4, 1888, ch. 269, § 1, 1888 N.J. Laws 385, 385-86.

188. *See supra* text accompanying notes 174-75.

189. That statute provided as follows:

> That it shall and may be lawful for any corporation or corporations created under the provisions of the act to which this is a further supplement to purchase, hold, sell, assign, transfer, mortgage, pledge or otherwise dispose of the shares of the capital stock of any other corporation or corporations created under the law of this or any other state, and to exercise while owners of such stock all the rights, powers and privileges, including the right to vote thereon, which natural persons, being the owners of such stock, might, could or would exercise.

Act of Mar. 14, 1893, ch. 171, § 1, 1893 N.J. Laws 301, 301.

190. *See infra* note 236 (first paragraph) and accompanying text.

191. *See* Edward Q. Keasbey, *New Jersey and the Great Corporations*, 13 HARV. L. REV. 198, 207-08 (1899).

requirement that incorporation of business enterprises be by way of general laws rather than special acts.[192]

1. New Jersey

It appears that New York was the first state to enact a general corporation statute,[193] having done so in 1811.[194] New Jersey followed in 1816,[195] patterning its statute on that of New York.[196] However, it seems that the New Jersey statute of 1816 was not used, and it was repealed in 1819.[197] More than a quarter of a century passed before New Jersey, in 1846, passed another general corporation law.[198] This statute,[199] authorizing five or more persons "to associate themselves into a company to carry on any branch or branches of lawful manufactures within this state" upon filing a written certificate,[200] was revised and replaced by an expanded statute in 1849.[201] Other general corporation statutes were enacted in New Jersey during the next several years.[202]

In 1875, the year when New Jersey's constitution was amended to require incorporation under general laws (rather than by special act),[203] that state's legislature enacted a general corporation law[204] that, according to one writer, gave New Jersey the title of "Mother of Corporations."[205] However, New Jersey's 1875 statute was replaced

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192. For the 1875 constitutional provision in New Jersey, see *supra* note 50 (first paragraph). For the 1868 constitutional provision in North Carolina, see *supra* note 51. For the 1897 constitutional provision in Delaware, see *supra* note 54 (third paragraph).

193. *See* LARCOM, *supra* note 186, at 1 ("The state of New York in 1811 passed the first general legislation providing for the formation and the regulation of certain types of business companies."); Adolf A. Berle, Jr., *Historical Inheritance of American Corporations*, 3 THE POWERS AND DUTIES OF CORPORATE MANAGEMENT, N.Y.U. SCH. L. 189, 198 (1950) ("The first 'general corporation law for business purposes' is commonly credited to the State of New York, in the year 1811.").

194. *See* An Act Relative to Incorporations for Manufacturing Purposes, ch. 67, 1811 N.Y. Laws 111.

195. *See* CADMAN, *supra* note 49, at 18-23.

196. *See id.* at 23 ("New Jersey's general law of 1816 was nothing more than a duplicate of the New York law of 1811 with some slight changes." (footnote omitted)).

197. *See id.* at 24-25.

198. *See id.* at 25, 112-15.

199. *See* Act of Feb. 25, 1846, [no chapter number], 1846 N.J. Laws 64.

200. *Id.* § 1, 1846 N.J. Laws at 64.

201. *See* Act of Mar. 2, 1849, [no chapter number], 1849 N.J. Laws 300.

202. *See* CADMAN, *supra* note 49, at 121-22.

203. *See supra* note 50 (first paragraph) and text accompanying note 192.

204. *See* An Act Concerning Corporations (Act of Apr. 7, 1875), *published in* REVISED STATUTES OF NEW JERSEY 3, 3-37 (1875).

205. *See* Berle, *supra* note 193, at 198 ("After a classic constitutional struggle, New

in 1896 by a new general corporation statute[206] that has been called "the first of the modern liberal corporation statutes."[207] This 1896 act, with its subsequent amendments and codifications, constituted the general corporation law of New Jersey until January 1, 1969.[208]

2. Delaware

In 1871, Delaware enacted a general corporation law authorizing the formation of corporations (by the filing of a certificate) for the purpose of canning, manufacturing, and preparing fruits and other products for sale;[209] however, this statute remained in force for only four years.[210] In 1875, pursuant to an amendment of Delaware's constitution authorizing the legislature "to enact a general incorporation act to provide incorporation" for specified purposes,[211] a statute was enacted authorizing the formation of a corporation (through a somewhat cumbersome procedure including judicial scrutiny of the charter prior to its being filed in the office of the secretary of state) for any of the stated purposes.[212] This 1875 statute was repealed and replaced in 1883 by a more elaborate general corporation law.[213]

Although the Delaware Constitution of 1897 required that corporations be created under general law (rather than by special act),[214] it was not until two years later[215] that the legislature—copying largely from New Jersey's 1896 statute[216]—enacted Delaware's general corporation law of 1899.[217] This 1899 statute, with its

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Jersey, thereby acquiring the title 'Mother of Corporations,' passed a general incorporation act in 1875 giving the widest powers to those who availed themselves of it, and took leadership as an incorporating state.").

206. *See* Act of Apr. 21, 1896, ch. 185, 1896 N.J. Laws 277.

207. William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663, 664 (1974).

208. *See infra* note 250.

209. *See* Act of Mar. 21, 1871, ch. 152, 14 Del. Laws 229.

210. *See* LARCOM, *supra* note 186, at 3.

211. *See supra* note 54 (first paragraph).

212. *See* Act of Mar. 26, 1875, ch. 119, 15 Del. Laws 181.

213. *See* Act of Mar. 14, 1883, ch. 147, 17 Del. Laws 212.

214. *See supra* note 54 (third paragraph) and text accompanying note 192.

215. For an account of the delay, see LARCOM, *supra* note 186, at 8-9.

216. *See* Chicago Corp. v. Munds, 172 A. 452, 454 (Del. Ch. 1934) ("[I]t is common knowledge that the general act of this state adopted in 1899 was modeled after the then existing New Jersey act . . . ."); Cary, *supra* note 207, at 664 ("Shortly afterwards, Delaware, seeking new sources of revenue, copied very largely from the New Jersey act to establish its own statute.").

217. *See* Act of Mar. 10, 1899, ch. 273, 21 Del. Laws 445.

subsequent amendments and codifications, constituted the general corporation law of Delaware until July 3, 1967.[218]

3. North Carolina

In 1837, the North Carolina legislature passed "An Act to encourage the culture and manufacture of silk and sugar in this State" authorizing "any six or more citizens of any congressional district in this State" to form a corporation for either or both of the stated purposes.[219] Later, in 1852, a statute was enacted making it lawful "for any number of persons not less than five, desirous to engage in the business of mining, or to establish any manufactory at any place within this State, and wishing to become incorporated for convenience in raising the necessary capital and in conducting the business, to become incorporated."[220]

In the year following ratification of North Carolina's Constitution of 1868, requiring incorporation under general laws (rather than by special act),[221] the legislature passed "An act to authorize the formation of corporations for manufacturing, mining, mechanical, chemical and other purposes" that authorized any three or more persons to form a corporation by filing a certificate.[222] Other general corporation statutes were enacted in North Carolina in 1872—one relating to the formation of railroad corporations[223] and the other authorizing corporations to be formed "for any purpose not unlawful."[224]

Soon after the turn of the century, North Carolina enacted its 1901 general corporation statute.[225] Just as Delaware had patterned its 1899 statute on that of New Jersey, North Carolina's 1901 statute "was almost identical to the famous New Jersey General Corporation Act of 1896."[226] This 1901 statute, with its subsequent amendments and codifications, constituted the general corporation law of North Carolina until July 1, 1957.[227]

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218. *See infra* note 251.
219. Act of Jan. 20, 1837, ch. 12, 1836-37 N.C. Sess. Laws 40.
220. Act of Dec. 22, 1852, ch. 81, § 1, 1852 N.C. Sess. Laws 147, 147.
221. *See supra* note 51 and text accompanying note 192.
222. Act of Apr. 12, 1869, ch. 280, § 1, 1868-69 N.C. Sess. Laws 669, 669-70.
223. *See* Act of Feb. 8, 1872, ch. 138, 1871-72 N.C. Sess. Laws 186.
224. Act of Feb. 12, 1872, ch. 199, § 1, 1871-72 N.C. Sess. Laws 347, 347.
225. *See* Act of Mar. 11, 1901, ch. 2, 1901 N.C. Sess. Laws 13 (effective Apr. 1, 1901).
226. RUSSELL M. ROBINSON, II, ROBINSON ON NORTH CAROLINA CORPORATION LAW 3 (5th ed. 1995).
227. *See infra* note 252.

III. COMBINATION LAW AT THE TURN OF THE CENTURY

A. New Jersey

Sections 104 through 109 of New Jersey's 1896 general corporation statute embodied almost verbatim the provisions of that state's 1893 merger statute.[228] The basic authorization to merge, set forth in section 104 of the 1896 statute, contained two limitations: first, it authorized mergers of domestic corporations only; second, it authorized mergers only between corporations organized to carry on the same or a similar kind of business.[229] The procedural requirements for a merger, set forth in sections 105 and 108 of the 1896 statute, were as follows: (i) a joint agreement entered into by the directors of the merging corporations,[230] (ii) the conversion of the capital stock of each constituent corporation into "stock or obligations" of the surviving corporation,[231] (iii) the approval by vote of "the holders of two-thirds of all the capital stock" of each of the constituent corporations with "each share of stock entitling the holder thereof to one vote,"[232] and (iv) a right of appraisal for the dissenting shareholders of any merging corporation having "the right to exercise any franchise, for public use."[233]

New Jersey's 1896 general corporation statute did not contain any authorization for a corporation to sell all or substantially all of its assets.[234] However, as previously noted, an 1899 New Jersey statute authorized any corporation of that state (except railroad and canal companies) to lease its property and franchises to another corporation.[235]

Section 51 of New Jersey's 1896 general corporation statute

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228. *See supra* text accompanying notes 174-75.

229. The statute provided as follows:

> Any two or more corporations organized or to be organized under any law or laws of this state for the purpose of carrying on any kind of business of the same or a similar nature may merge or consolidate into a single corporation, which may be either one of said merging or consolidating corporations, or a new corporation to be formed by means of such merger and consolidation....

Act of Apr. 21, 1896, ch. 185, § 104, 1896 N.J. Laws 277, 309.

230. *See id.* § 105.I, 1896 N.J. Laws at 310.

231. *Id.*

232. *Id.* § 105.II, 1896 N.J. Laws at 311.

233. *Id.* § 108, 1896 N.J. Laws at 312.

234. No such statutory authorization was enacted in New Jersey until 1931. *See infra* note 843 (first paragraph) and accompanying text.

235. *See* Act of Mar. 24, 1899, ch. 150, § 1, 1899 N.J. Laws 334, 334 (quoted *supra* in note 182).

contained broad authority for a corporation to own and vote shares of stock of any other corporation of that or any other state.[236] This section embodied the substance of the 1893 New Jersey statute on this subject referred to previously.[237]

B. Delaware

Sections 54 through 56 of Delaware's 1899 general corporation statute authorized corporate mergers on terms similar to those contained in New Jersey's 1896 statute.[238] Section 54 of the 1899 statute limited such mergers to domestic corporations formed to carry on business of the same or similar nature.[239] The procedural requirements for a merger, set forth in sections 54 and 56 of the 1899 statute, were as follows: (i) an agreement entered into by a majority of the directors of the merging corporations,[240] (ii) the conversion of "the shares of each of the old corporations into the new,"[241] (iii) the "written consent of the owners of at least two-thirds of the capital stock of each corporation,"[242] and (iv) a right of appraisal for dissenting shareholders of either of the merging corporations.[243]

Delaware's 1899 general corporation statute contained no

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236. The statute provided as follows:

> Any corporation may purchase, hold, sell, assign, transfer, mortgage, pledge or otherwise dispose of the shares of the capital stock of ... any other corporation or corporations of this or any other state, and while owner of such stock may exercise all the rights, powers and privileges of ownership, including the right to vote thereon.

Act of Apr. 21, 1896, ch. 185, § 51, 1896 N.J. Laws 277, 294-95.

Statements in the case of *Dittman v. Distilling Co. of America*, 54 A. 570 (N.J. Ch. 1903), suggested two limitations: (i) that where one corporation acquired stock of another corporation "the purchase and ownership must be for the purposes of the business" of the acquiring corporation, *id.* at 576, and (ii) that a New Jersey corporation could acquire stock of foreign corporations only if the latter were "organized in states whose laws authorize their own domestic corporations to hold stock in and control their own domestic companies," *id.*

237. *See supra* note 189 and accompanying text.

238. *See supra* text accompanying notes 229-33.

239. The statute provided as follows:

> Any two or more corporations organized under the provisions of this Act, or existing under the laws of this State, for the purpose of carrying on any kind of business of the same or similar nature, may consolidate into a single corporation which may be either one of said consolidating corporations, or a new corporation to be formed by means of such consolidation ....

Act of Mar. 10, 1899, ch. 273, § 54, 21 Del. Laws 445, 461.

240. *See id.*

241. *Id.*

242. *Id.* § 54, 21 Del. Laws at 462.

243. *See id.* § 56, 21 Del. Laws at 462-63.

authorization for a corporation to sell all or substantially all of its assets.[244] Nor did it contain authorization for a corporation to lease its properties and franchises.

Section 133 of the 1899 Delaware statute contained broad authority for one corporation to own and vote stock of another corporation.[245] This section was patterned after section 51 of the 1896 New Jersey statute.[246]

C. *North Carolina*

North Carolina's 1901 general corporation statute—while borrowing extensively from the 1896 New Jersey statute in other respects—contained no authorization for a corporate merger,[247] for a sale by a corporation of all of its assets,[248] or for the acquisition by one corporation of stock of another corporation.[249]

PART TWO: EVOLUTION OF COMBINATION LAW IN THE TWENTIETH CENTURY

The point of departure in considering the twentieth-century evolution of the statutes governing corporate combinations in the three subject states has to be New Jersey's general corporation statute of 1896,[250] Delaware's general corporation statute of 1899,[251]

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244. No such statutory authorization was enacted in Delaware until 1917. *See infra* notes 810-11 and accompanying text.

245. The statute provided as follows:

> Any corporation created under the provisions of this act may purchase, hold, sell, assign, transfer, mortgage, pledge or otherwise dispose of, the shares of the capital stock of ... any other corporation or corporations of this State or any other State, ... and while owner of said stock may exercise all the rights, powers and privileges of ownership including the right to vote thereon.

Act of Mar. 10, 1899, ch. 273, § 133, 21 Del. Laws 445, 500-01.

246. *See* LARCOM, *supra* note 186, at 61-62. For the New Jersey statute, see *supra* note 236 (first paragraph).

247. No general authorization of corporate mergers was enacted by North Carolina until 1925. *See infra* notes 255-56 and accompanying text.

248. It was not until 1925 that North Carolina enacted legislation authorizing a corporation to sell all or substantially all of its assets. *See infra* note 824 (first paragraph) and accompanying text.

249. Legislation authorizing one corporation to own and vote stock of another corporation was enacted by North Carolina in 1903. *See infra* note 912 and accompanying text.

250. *See* Act of Apr. 21, 1896, ch. 185, 1896 N.J. Laws 277. The provisions of this statute (as amended) became title 14 of the New Jersey Revised Statutes when that codification was adopted by Act of Dec. 20, 1937, ch. 188, 1937 N.J. Laws 832 (which appears in the front part of 1938 N.J. Laws). Sections of title 14 were designated section 14:1-1 et seq.

and North Carolina's general corporation statute of 1901.[252]

I. MERGER[253]

The statutory law governing mergers, as that law evolved after the turn of the century, entailed two aspects: (i) the authorization to merge and (ii) the requirements for effecting a merger. The first of these is of minor importance and can be covered quickly; the second is the principal subject of this part of this Article and will be covered

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Title 14 was rewritten as title 14A by Act of Nov. 21, 1968, ch. 350, 1968 N.J. Laws 1011 (effective Jan. 1, 1969). Sections of the new title 14A are designated section 14A:1-1 et seq.

251. *See* Act of Mar. 10, 1899, ch. 273, 21 Del. Laws 445. By Act of Mar. 7, 1901, ch. 166, 22 Del. Laws 255, the 1899 statute was modified by some revisions and changes in section numbers, and (as so modified) it was reenacted by Act of Mar. 7, 1901, ch. 167, 22 Del. Laws 286. The provisions of this statute (as amended) became the major part of chapter 65 of the 1915 Revised Code of Delaware when that codification was adopted on October 19, 1914, at a special session, and they continued as the major part of chapter 65 of the 1935 Revised Code of Delaware when that codification was adopted by Act of Mar. 8, 1935, ch. 74, 40 Del. Laws 293. From 1915 until 1953, provisions of the Delaware corporation statute bore two sets of section numbers: section numbers within chapter 65 (beginning with section 1) and section numbers within the Code (beginning with section 1915 in the 1915 Code and section 2033 in the 1935 Code). When the Delaware Code of 1953 was approved in February of that year, *see* 49 Del. Laws 7, the Delaware corporation statute (formerly contained in chapter 65 of the Delaware Codes of 1915 and 1935) became chapter 1 (titled "General Corporation Law") of title 8 (titled "Corporations") of the Delaware Code of 1953 with a single designation for each section (beginning with section 101).

The Delaware General Corporation Law was rewritten by Act of July 3, 1967, ch. 50, 56 Del. Laws 151. It continued as chapter 1 of title 8 of the Delaware Code (beginning with section 101).

252. *See* Act of Mar. 11, 1901, ch. 2, 1901 N.C. Sess. Laws 13 (effective Apr. 1, 1901). The provisions of this statute (as amended) became chapter 22 of the North Carolina Consolidated Statutes (with section numbers beginning with section 1113) when that codification was adopted by Act of Mar. 10, 1919, ch. 238, 1919 N.C. Sess. Laws 449. In 1943, the general statutes of North Carolina were re-codified as the North Carolina General Statutes by Act of Feb. 4, 1943, ch. 33, 1943 N.C. Sess. Laws 33, and the corporation statute became chapter 55 of the North Carolina General Statutes (with sections designated as section 55-1 et seq.).

The Business Corporation Act of North Carolina was rewritten by Act of May 26, 1955, ch. 1371, 1955 N.C. Sess. Laws 1432 (effective July 1, 1957). It continued as chapter 55 of the North Carolina General Statutes (beginning with section 55-1).

The North Carolina Business Corporation Act was rewritten again by Act of June 8, 1989, ch. 265, 1989 N.C. Sess. Laws 566 (effective July 1, 1990). It continues as chapter 55 of the North Carolina General Statutes (beginning with section 55-1-01).

253. For general discussions of mergers, see SECURITIES AND EXCHANGE COMMISSION, REPORT ON THE STUDY AND INVESTIGATION OF THE WORK, ACTIVITIES, PERSONNEL AND FUNCTIONS OF PROTECTIVE AND REORGANIZATION COMMITTEES—PART VII—MANAGEMENT PLANS WITHOUT AID OF COMMITTEES app. B, pt. II, at 526-56 (1938), and Comment, *Statutory Merger and Consolidation of Corporations*, 45 YALE L.J. 105 (1935).

in detail.

A. *Removal of Limitations on Authorization to Merge*

As previously noted,[254] the merger provisions of both the 1896 New Jersey corporation statute and the 1899 Delaware statute contained two limitations on the authorization to merge: (i) only domestic corporations were authorized to merge, and (ii) such corporations were allowed to merge only if they were organized to carry on business of the same or a similar nature. When the 1901 North Carolina corporation statute was amended in 1925 by the addition of that state's earliest general authorization of mergers,[255] it contained the first but not the second of these limitations.[256] Later, these limitations were eliminated from the statutes of all three states.

1. Intrastate Limitation

In 1918, New Jersey's merger statute was amended[257] to provide that a New Jersey corporation could merge with a corporation of another state, with two provisos: (i) that the survivor be a New Jersey corporation and (ii) that the merger be authorized by the laws of the other state.[258] Then, in 1929, the first proviso was revised[259] to

254. *See supra* note 229 and accompanying text, and note 239 and accompanying text.

255. *See* ROBINSON, *supra* note 226, at 486 n.5; Note, *Corporations*, 3 N.C. L. REV. 132, 132-33 (1925).

256. In 1925, a new article 13, containing sections 1224-a through 1224-f, was added to chapter 22 of the North Carolina Consolidated Statutes. The new section 1224-a began as follows:

> Any two or more corporations organized under the provisions of this chapter, or existing under the laws of this State, for the purpose of carrying on any kind of business, may consolidate into a single corporation which may be either one of said consolidated corporations or a new corporation to be formed by means of such consolidation....

Act of Feb. 27, 1925, ch. 77, § 1, 1925 N.C. Sess. Laws 81, 81.

257. *See* Act of Mar. 4, 1918, ch. 271, § 1, 1918 N.J. Laws 1013, 1013-14 (amending section 104 of the 1896 New Jersey corporation statute).

258. Section 104 of the 1896 New Jersey statute, as amended in 1918, provided as follows:

> Any two or more corporations organized or to be organized under any law or laws of this State, or any corporation organized under the laws of this State and any corporation organized under the laws of any other State for the purpose of carrying on any kind of business of the same or a similar nature, may merge or consolidate into a single corporation, which may be either one of said merging or consolidating corporations; *provided*, the same be a corporation originally organized under the laws of this State, or a new corporation under the laws of this State to be formed by means of such merger and consolidation; *and provided, further*, that a merger or consolidation of the corporation so proposed to be merged or consolidated with such New Jersey corporation is authorized by

permit the survivor in a merger to be either the New Jersey corporation or the corporation of the other state.[260]

In 1935, Delaware's merger statute was amended[261] by the addition of a provision allowing a Delaware corporation to merge with a corporation of another state provided only that the merger be permitted by the laws of the other state.[262] Under this new provision, the survivor could be either the Delaware corporation or the corporation of the other state.[263]

In 1939, North Carolina's merger statute was amended[264] to provide that a North Carolina corporation could merge with a corporation of another state if the laws of the other state permitted such a merger, but with the proviso that the survivor be a North Carolina corporation.[265] In 1943, the North Carolina merger statutes

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the laws of such other State....

Id. § 1, 1918 N.J. Laws at 1013-14.

259. *See* Act of May 4, 1929, ch. 261, § 1, 1929 N.J. Laws 478, 478-79.

260. The 1929 amendment changed the 1918 version of section 104 of the 1896 New Jersey statute, *see supra* note 258, by inserting in the first proviso, after the phrase "originally organized under the laws of this State," the phrase "or of the State where either of said corporations may have been originally organized." Act of May 4, 1929, ch. 261, § 1, 1929 N.J. Laws 478, 479.

261. *See* Act of Apr. 18, 1935, ch. 148, § 6, 40 Del. Laws 524, 534-37. By Act of Mar. 7, 1901, ch. 166, §§ 5-6, 22 Del. Laws 255, 274-75, the merger provisions (sections 54 through 59) of the 1899 Delaware corporation statute had been re-numbered as sections 59 through 64, and the change made in 1935 was a change in section 59 (formerly section 54).

262. The third paragraph of section 59, as amended in 1935, provided as follows:

> Any one or more corporations organized under the provisions of this Chapter, or existing under the laws of this State, may consolidate or merge with one or more other corporations organized under the laws of any other State or States ..., if the laws under which said other corporation or corporations are formed shall permit such consolidation or merger. The constituent corporations may merge into a single corporation, which may be any one of said constituent corporations, or they may consolidate to form a new corporation, which may be a corporation of the State of incorporation of any one of said constituent corporations as shall be specified in the agreement hereinafter required.

Act of Apr. 18, 1935, ch. 148, § 6, 40 Del. Laws 524, 535-36.

263. *See id.* It is interesting to note that, for a time, the Delaware corporation statute authorized a merger or consolidation of a Delaware corporation with a corporation of a foreign country only if the surviving or resulting corporation would be a Delaware corporation. *See* former DEL. CODE. ANN. tit. 8, §§ 252(a), 253(e) (1991). That requirement was eliminated by Act of July 1, 1993, ch. 61, §§ 4, 8, 69 Del. Laws 54, 54.

264. *See* Act of Feb. 1, 1939, ch. 5, § 1, 1939 N.C. Sess. Laws 27, 27-28 (amending section 1224-a of the North Carolina Consolidated Statutes).

265. As amended in 1939, section 1224-a provided as follows:

> Any two or more corporations organized or to be organized, or existing under the laws of this State, or any corporation organized under the laws of this State and any corporation organized under the laws of any other state for the purpose of carrying on any kind of business may merge or consolidate into a

were rewritten,[266] and a new paragraph was added covering mergers of North Carolina corporations with corporations of other states and allowing the survivor to be either the North Carolina corporation or the corporation of the other state.[267]

When the Model Business Corporation Act was first published in 1950,[268] section 70 authorized a merger between a domestic and a foreign corporation if allowed by the laws of the state under which the foreign corporation was organized, and it permitted either corporation to be the survivor.[269]

Today, the statutes of Delaware,[270] New Jersey,[271] and North Carolina,[272] and the provisions of the Model Business Corporation Act,[273] give broad authority for mergers between domestic and foreign corporations.

2. Similar Business Limitation

As noted above,[274] both the 1896 New Jersey corporation statute and the 1899 Delaware statute limited mergers to corporations organized for the purpose of carrying on any kind of business of the same or a similar nature.[275] The North Carolina merger statute, when

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> single corporation which may be either one of said merging or consolidating corporations or a new corporation under the laws of this State to be formed by means of such merger and consolidation, *provided*, the corporation resulting from said merger and consolidation shall be a corporation of the State of North Carolina....

Id. § 1, 1939 N.C. Sess. Laws at 27-28.

266. *See* Act of Feb. 26, 1943, ch. 270, § 1, 1943 N.C. Sess. Laws 257, 257-64.

267. The first two sentences of the third paragraph of section 1224-a, as amended in 1943, were identical (except for some differences in capitalization) to the provisions of the 1935 Delaware statute quoted *supra* in note 262. *Compare id.* § 1, 1943 N.C. Sess. Laws at 259, *with* Act of Apr. 18, 1935, ch. 148, § 6, 40 Del. Laws 524, 535-36.

268. Following circulation of a draft in 1946, the Model Business Corporation Act was first published in 1950, *see* MODEL BUS. CORP. ACT (1950), *in* 6 BUS. LAW. 1 (1950), and it was revised on numerous occasions thereafter. *See* Melvin Aron Eisenberg, *The Model Business Corporation Act and the Model Business Corporation Act Annotated*, 29 BUS. LAW. 1407 (1974). The first edition of the Model Business Corporation Act Annotated was published in 1960; a second edition was published in 1971, followed by Supplements in 1973 and 1977; and a third edition was published in 1984 and supplemented and amended thereafter.

269. *See* MODEL BUS. CORP. ACT § 70 (1950), *in* 6 BUS. LAW. at 57-58.

270. *See* DEL. CODE ANN. tit. 8, § 252 (1991 & Supp. 1996).

271. *See* N.J. STAT. ANN. § 14A:10-7 (West Supp. 1997).

272. *See* N.C. GEN. STAT. § 55-11-07 (1990).

273. *See* MODEL BUS. CORP. ACT ANN. § 11.07 (1996).

274. *See supra* text accompanying note 254.

275. *See supra* note 229 and accompanying text, and note 239 and accompanying text.

enacted in 1925, did not contain this limitation;[276] nor did the Model Business Corporation Act when first published in 1950.[277]

Delaware removed this limitation as early as 1901,[278] but New Jersey did not follow until many years later. It came to be established in New Jersey that the test of similarity depended upon the purposes stated in the charters of the corporations proposing to merge (rather than the businesses actually carried on by them) and that a lack of similarity in charter purposes constituted grounds for invalidating a merger.[279] In 1935, an addition to the New Jersey merger statute was enacted[280] to permit two New Jersey corporations, one holding 51% or more of the voting stock of the other, to merge even though not organized for the purpose of carrying on business of the same or a similar nature.[281] But it also came to be recognized that the similarity-of-business limitation could be avoided by the simple expedient of amending the charter of one or the other of the corporations wishing to merge so as to harmonize the two charters

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276. *See supra* note 256 and accompanying text.

277. The 1950 Model Business Corporation Act provided simply that "[a]ny two or more domestic corporations may merge into one of such corporations pursuant to a plan of merger approved in the manner provided in this Act." MODEL BUS. CORP. ACT § 64 (1950), *in* 6 BUS. LAW. 1, 52 (1950).

278. By Act of Mar. 7, 1901, ch. 166, §§ 5-6, 22 Del. Laws 255, 274-75, the merger provisions (sections 54 through 59) of the 1899 Delaware corporation statute were renumbered as sections 59 through 64, and the first of those sections, as quoted *supra* in note 239, was amended to eliminate the phrase "of the same or similar nature."

279. *See* Colgate v. United States Leather Co., 72 A. 126, 129-30 (N.J. 1909); Imperial Trust Co. v. Magazine Repeating Razor Co., 46 A.2d 449, 451-53 (N.J. Ch. 1946).

280. *See* Act of Mar. 26, 1935, ch. 141, § 1, 1935 N.J. Laws 354, 354-55 (codified at former N.J. STAT. ANN. § 14:12-9 (West 1939)). This provision provided in part as follows:

> Any corporation of this state, fifty-one per cent or more of the voting stock of which is held by any other corporation of this state, may merge into, consolidate with or merge into itself a corporation holding fifty-one per cent or more of its voting stock, notwithstanding that the said corporations may not have been organized for the purpose of carrying on business of the same or a similar nature.

Id. This provision was amended (in respects not important herein) by Act of Apr. 9, 1943, ch. 170, § 1, 1943 N.J. Laws 490, 490-91.

When title 14 was replaced by title 14A effective January 1, 1969, *see supra* note 250 (second paragraph), this provision was omitted. *See* N.J. STAT. ANN. tit. 14A (vol. 2) tbl., at 382 (West 1969).

While it was in effect, this provision did not affect the procedural requirements for effecting the merger of a parent and its 51%-owned subsidiary. Thus, appraisal rights were available to shareholders dissenting from a merger to which this provision applied. *See In re* Janssen Dairy Corp., 64 A.2d 652, 653 (N.J. Super. Ct. Law Div. 1949).

281. The similarity-of-business requirement was eliminated also in the 1952 New Jersey statute authorizing parent-subsidiary mergers. *See infra* note 383.

before steps were taken to effect the merger.[282] That being so, New Jersey eliminated the phrase "of the same or a similar nature" from its basic merger statute in 1967.[283]

B. Requirements for Merger Through 1950

Evolution of the statutory requirements for effecting a merger is best understood against the backdrop of a classical merger. There were four main ingredients to the classical merger—each entailing a significant safeguard of the interests of shareholders. First, there was the requirement that the directors of both of the merging corporations approve the plan of merger. This requirement visualized arm's length negotiation in which the management of each corporation would seek to strike the best possible bargain for shareholders of that corporation. Second, the classical merger required the approving vote of shareholders of both of the merging corporations. This meant that the shareholders of either corporation could veto the proposed merger if they perceived it to be contrary to their interests. Third, the classical merger assumed that the consideration flowing to shareholders of the disappearing corporation would consist of stock of the surviving corporation. This meant that shareholders of the disappearing corporation would have a continuing equity interest in the combined enterprise. Fourth, if the proposed merger was approved by vote of the prescribed majority of shares, dissenting shareholders were accorded a right of appraisal. This entitled a shareholder of either corporation to withdraw from the enterprise and receive payment in cash for the value of his shares.

Much of the current law relating to the requirements for effecting a merger is of relatively recent vintage. To highlight this fact, changes in the requirements are described herein in two time segments—those made through 1950, and those made thereafter. The year 1950 was chosen as the dividing line in part because that year marked the first publication of the Model Business Corporation Act.[284]

1. Long-Form Merger

As recently as 1950, the merger statutes of the three subject

282. *See* Brundage v. New Jersey Zinc Co., 226 A.2d 585, 596 (N.J. 1967).

283. *See* Act of May 25, 1967, ch. 70, § 1, 1967 N.J. Laws 313, 313-14 (amending former N.J. STAT. ANN. § 14:12-1 (West 1939)).

284. *See supra* note 268.

states permitted (with only one exception) nothing but long-form mergers. (The exception, discussed below, was the parent-subsidiary merger—allowed only in Delaware by 1950.) The statutory requirements for a long-form merger covered four basic matters: (i) director action, (ii) shareholder approval, (iii) permissible consideration, and (iv) the right of appraisal.

a. Director Action

(1) Statutory Provisions

The early merger statutes of the three subject states required that the directors of the merging corporations enter into a merger agreement.[285] This requirement of an agreement entered into by the directors continued to be a statutory requirement of the three states past 1950.[286]

On the other hand, the Model Business Corporation Act, as published in 1950, contained the more modern version of the requirement for director action. It required simply that the two boards, by resolution, approve a plan of merger.[287]

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285. The 1896 New Jersey corporation statute provided as follows: "The directors of the several corporations proposing to merge or consolidate may enter into a joint agreement . . . for the merger or consolidation of said corporations, and prescribing the terms and conditions thereof. . . ." Act of Apr. 21, 1896, ch. 185, § 105.I, 1896 N.J. Laws 277, 310.

The 1899 Delaware corporation statute provided as follows: "[T]he directors or a majority of them, of such corporations, as desire to consolidate, may enter into an agreement signed by them . . . prescribing the terms and conditions of consolidation . . . ." Act of Mar. 10, 1899, ch. 273, § 54, 21 Del. Laws 445, 461.

The 1925 North Carolina merger statute contained, in section 1224-a, the same provision as that of Delaware (except for differences in punctuation). *See* Act of Feb. 27, 1925, ch. 77, § 1, 1925 N.C. Sess. Laws 81, 81.

286. In 1950, the New Jersey statute provided as follows: "The directors of the several corporations proposing to merge or consolidate shall enter into a joint agreement . . . for their merger or consolidation . . . ." N.J. STAT. ANN. § 14:12-2 (West 1939).

In the same year, the Delaware statute provided as follows: "[T]he directors, or a majority of them, of such corporations as desire to consolidate or merge, may enter into an agreement signed by them . . . prescribing the terms and conditions of consolidation or merger . . . ." REV. CODE OF DEL. § 2091 (1935).

At that time, section 55-165 of the North Carolina General Statutes was identical (in this respect) to the Delaware statute. *See* former N.C. GEN. STAT. § 55-165 (1950).

287. The 1950 Model Business Corporation Act provided as follows: "The board of directors of each corporation shall, by resolution adopted by each such board, approve a plan of merger . . . ." MODEL BUS. CORP. ACT § 64 (1950), *in* 6 BUS. LAW. 1, 52 (1950).

(2) Cases and Commentary

The requirement of director action brought into play the fiduciary duty of directors[288] and the related duty owed by controlling shareholders.[289] This meant that directors could not confront

288. Perhaps the best-known statement in the first half of the twentieth century, concerning the fiduciary duty of directors, was that contained in *Guth v. Loft, Inc.*, 5 A.2d 503 (Del. 1939), the court saying:

> Corporate officers and directors are not permitted to use their position of trust and confidence to further their private interests. While technically not trustees, they stand in a fiduciary relation to the corporation and its stockholders. A public policy, existing through the years, and derived from a profound knowledge of human characteristics and motives, has established a rule that demands of a corporate officer or director, peremptorily and inexorably, the most scrupulous observance of his duty, not only affirmatively to protect the interests of the corporation committed to his charge, but also to refrain from doing anything that would work injury to the corporation .... The rule that requires an undivided and unselfish loyalty to the corporation demands that there shall be no conflict between duty and self-interest. The occasions for the determination of honesty, good faith and loyal conduct are many and varied, and no hard and fast rule can be formulated. The standard of loyalty is measured by no fixed scale.

Id. at 510.

New Jersey also recognized the fiduciary duty of directors. In *German Mutual Fire Insurance Co. v. Schwarzwaelder*, 44 A. 769 (N.J. 1899), the court said:

> [T]he complainant's case ... belongs to a class over which equitable cognizance is firmly established,—cases where the directors of a corporation have adopted or are about to adopt some measure which is beyond the scope of their corporate authority, or in violation of the fiduciary duty which they owe to the members of the corporation. In such a case a single member, on his own behalf merely, or on behalf of himself and all others similarly situated, may prosecute a suit in equity against the directors, making the corporation a co-defendant, to obtain appropriate relief, either by rescission or by prevention.

Id. at 769. Also, in *Whitfield v. Kern*, 192 A. 48 (N.J. 1937), the court said:

> At common law, and by the modern current of authority in this country and in England, the directors of a private corporation, while not regarded as trustees in the strict, technical sense (for title to the corporate property is in the corporation itself and not in its directors), are considered in equity as bearing a fiduciary relation to the corporation and its stockholders.

Id. at 53.

The fiduciary duty of directors was recognized also in North Carolina. *See* Teague v. Teague Furniture Co., 201 N.C. 803, 807, 161 S.E. 530, 532 (1931); Pender v. Speight, 159 N.C. 612, 615, 75 S.E. 851, 852 (1912).

289. In *Southern Pacific Co. v. Bogert*, 250 U.S. 483 (1919), the Court said: "The rule of corporation law and of equity invoked is well settled and has been often applied. The majority has the right to control; but when it does so, it occupies a fiduciary relation toward the minority, as much so as the corporation itself or its officers and directors." *Id.* at 487-88.

Another statement of the principle is that contained in *Allied Chemical & Dye Corp. v. Steel & Tube Co.*, 120 A. 486 (Del. Ch. 1923), the court saying:

> [I]t will be in order first to define the relations which equity will regard as subsisting between the controlling majority members of the corporation and the

shareholders with an unfair merger proposal even when there was a statutory right of appraisal for dissenters.[290] Moreover, in an interested-party merger (as when a majority-owned subsidiary was being merged into its parent), the burden was on the controlling shareholder to prove the fairness of the merger.[291]

> minority. That under certain circumstances these relations are of a fiduciary character is clear. No one, of course questions the fiduciary character of the relationship which the directors bear to the corporation. The same considerations of fundamental justice which impose a fiduciary character upon the relationship of the directors to the stockholders will also impose, in a proper case, a like character upon the relationship which the majority of the stockholders bear to the minority. When, in the conduct of the corporate business, a majority of the voting power in the corporation join hands in imposing its policy upon all, it is beyond all reason and contrary, it seems to me, to the plainest dictates of what is just and right, to take any view other than that they are to be regarded as having placed upon themselves the same sort of fiduciary character which the law impresses upon the directors in their relation to all the stockholders. Ordinarily the directors speak for and determine the policy of the corporation. When the majority of stockholders do this, they are, for the moment, the corporation. Unless the majority in such case are to be regarded as owing a duty to the minority such as is owed by the directors to all, then the minority are in a situation that exposes them to the grossest frauds and subjects them to most outrageous wrongs.

Id. at 491.

290. In *Colgate v. United States Leather Co.*, 67 A. 657 (N.J. Ch. 1907), *rev'd on other grounds*, 72 A. 126 (N.J. 1909), the court said:

> In reference to the effect on these suits for injunction of [New Jersey's appraisal statute], my conclusion is that the directors are bound under the consolidation act to propose an agreement which does not unfairly or inequitably impair the legal or equitable right of any preferred stockholder, and that such stockholder cannot be required to exercise any option of surrendering his stock on compensation until he has had an opportunity of joining in the consolidation "under terms and conditions" which, as to him, are legal and equitable. Any other construction or application of this act relating to proceedings for condemnation would leave it altogether in the power of the statutory majority of the stockholders to compel the sale of the stock of dissentient stockholders by the devise [sic] of imposing terms so illegal or inequitable that consent would be neither contemplated nor given.

Id. at 668.

Similarly, in *Bingham v. Savings Investment & Trust Co.*, 138 A. 659 (N.J. Ch. 1927), the court said:

> The objection that the merger is unfair and inequitable calls for careful judicial scrutiny of the plan, in view of the interests in the merger of interlocking directorates, and of interlocking interests of stockholders of the three concerns [two being merged into the third]. The plan must be free from unfairness before the complainants can be put to their election of joining their associates or taking compensation [by way of appraisal] in lieu.

Id. at 662.

291. In *Outwater v. Public Service Corp.*, 143 A. 729 (N.J. Ch. 1928), *aff'd per curiam*, 146 A. 916 (N.J. 1929), the court said:

> The merger agreement, procedurally, is in legal form, and the right to

b. Shareholder Approval

(1) Statutory Provisions

A key requirement for a merger under the statutes of the three subject states through 1950 was approval by the prescribed vote of shareholders. Moreover, the required approval extended to shareholders of the surviving corporation as well as to those of the disappearing corporation. The variant factor in the statutes of the three states related to the quantum of shareholder approval required.

The requirement in the 1896 New Jersey corporation statute was a vote of the holders of two-thirds of all the capital stock of each of the merging corporations with each share entitling the holder to one vote.[292] This requirement continued through 1950[293] and remained in effect until late in the 1960s.[294] However, in 1921, New Jersey amended its corporation statute to allow corporations (by charter provision) to specify, as the base for determining shareholder approval of a transaction, the shares "present and voting" rather than the shares outstanding.[295]

> merge is in entire harmony with the complainants' corporate contract; but, as the merger is, in reality, an apropriation [sic] of corporate property by a majority of stockholders, by force of numbers and the grace of the statute, and, while no valid legal objection can be interposed on that score (Colgate v. United States Leather Co.), the agreement calls for careful judicial scrutiny, and the burden is on the majority to show that the consideration is fair and equitable, and judgment, as to fairness, is not to be influenced by the heavy note [sic vote?] of approval, as it otherwise would be if the vote were independent....

Id. at 730 (citation omitted).

292. *See supra* text accompanying note 232.

293. In 1950, the New Jersey statute provided as follows:

> The agreement shall be submitted to the stockholders of each of the merging or consolidating corporations at separate meetings thereof.... At each of such stockholders' meetings a vote of the stockholders shall be taken ... for the adoption or rejection of such agreement, each share of stock entitling the holder to one vote.
>
> If the votes of the holders of two-thirds of all the capital stock of each of the merging or consolidating corporations shall be in favor of the adoption of the agreement, that [shall constitute approval thereof].

Former N.J. STAT. ANN. § 14:12-3 (West 1939).

294. See *Brundage v. New Jersey Zinc Co.*, 226 A.2d 585 (N.J. 1967), in which the court said: "It may be noted that the requirement of stockholders' approval for [charter] amendment is two-thirds in interest of each class whereas the requirement for merger is two-thirds of all of the corporate stock with each share of stock entitling the holder to one vote." *Id.* at 596 (citations omitted).

295. The statute, as amended, provided as follows:

> [E]very corporation ... may by its original or amended certificate of incorporation provide that any action which, at any meeting of stockholders,

The 1899 Delaware corporation statute, as amended in 1901, required a merger to be approved by vote of the holders of two-thirds of the capital stock of each of the merging corporations with each share entitling the holder to one vote.[296] With a minor change of statutory wording made in 1927,[297] this continued to be the shareholder voting requirement in Delaware through 1950.[298]

As enacted in 1925, North Carolina's first merger statute required the shareholders of each of the merging corporations to approve the merger by vote of "a majority of the outstanding shares of stock entitled to vote."[299] Notwithstanding a change of statutory

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> requires the vote, assent or consent of two-thirds in interest of all the stockholders, or of two-thirds in interest of each class of stockholders having voting powers, or which requires such assent or consent in writing to be filed, may be taken upon the assent of and the assent given and filed by two-thirds in interest of the stockholders present and voting at such meeting in person or by proxy; *provided*, that where assent by classes is required such assent shall be given by two-thirds in interest of each class so present and voting....

Act of Apr. 12, 1921, ch. 304, § 1, 1921 N.J. Laws 873, 873-74. This act amended Act of Apr. 21, 1896, ch. 185, § 17, 1896 N.J. Laws 277, 282-83, as that statute had been amended by Act of Mar. 22, 1901, ch. 119, § 1, 1901 N.J. Laws 260, 260. It was later embodied, with minor changes, in former section 14:10-9 of the New Jersey Statutes Annotated. *See* former N.J. STAT. ANN. § 14:10-9 (West 1939).

296. Section 54 of the 1899 Delaware corporation statute required, for approval of a merger, the written consent of the owners of at least two-thirds of the capital stock of each of the merging corporations. *See* Act of Mar. 10, 1899, ch. 273, § 54, 21 Del. Laws 445, 462 (quoted *supra* in text accompanying note 242). In 1901, the former section 54 was re-numbered section 59, and the shareholder approval requirement was changed to read as follows:

> [A]t said meeting [of the stockholders of each of the merging corporations held separately] said agreement shall be considered and a vote ... taken for the adoption or rejection of the same, each share entitling the holder thereof to one vote; and if the votes of stockholders of each corporation representing two-thirds in amount of its capital stock shall be for the adoption of the said agreement, then that [shall constitute approval thereof].

Act of Mar. 7, 1901, ch. 166, § 5, 22 Del. Laws 255, 274-75.

297. By Act of Mar. 2, 1927, ch. 85, § 18, 35 Del. Laws 220, 245-46, the provision quoted *supra* in note 296 was amended to read as set forth *infra* in note 298.

298. In 1950, the Delaware statute provided as follows:

> [A]t said meeting [of the stockholders of each of the merging corporations held separately] said agreement shall be considered and a vote ... taken for the adoption or rejection of the same, each share entitling the holder thereof to one vote; and if the votes of stockholders of each such corporation representing two-thirds of the total number of shares of its capital stock shall be for the adoption of the said agreement, then that [shall constitute approval thereof].

REV. CODE OF DEL. § 2091 (1935).

299. Section 1224-a of the 1925 North Carolina merger statute, as adopted by Act of Feb. 27, 1925, ch. 77, § 1, 1925 N.C. Sess. Laws 81, 81-82. This section also included the phrase "each share entitled to vote entitling the holder thereof to one vote." *Id.* § 1, 1925 N.C. Sess. Laws at 82.

wording made in 1943,[300] this continued to be the North Carolina voting requirement through 1950.[301] Thus, from 1925 through 1950, North Carolina differed from New Jersey and Delaware by requiring, for shareholder approval of a merger, only a simple majority of the voting shares rather than two-thirds of all the shares.

The Model Business Corporation Act, as published in 1950, required approval of a merger by the shareholders of each of the merging corporations; and, as in the case of the New Jersey and Delaware statutes, it required a two-thirds vote of all outstanding shares whether or not otherwise entitled to vote.[302] However, unlike the 1950 statutes of the three subject states, the 1950 Model Act provided for class voting on a merger if the plan of merger contained "any provision which, if contained in a proposed amendment to articles of incorporation, would entitle such class of shares to vote as a class."[303]

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300. By Act of Feb. 26, 1943, ch. 270, § 1, 1943 N.C. Sess. Laws 257, 258, the phrase quoted *supra* in the second sentence of note 299 was deleted from the merger statute.

301. In 1950, the North Carolina statute provided as follows:

> [A]t said meeting [of the stockholders of each of the merging corporations held separately] said agreement shall be considered and a vote ... taken for the adoption or rejection of the same; and if the votes of stockholders of each such corporation representing a majority of the outstanding shares of stock entitled to vote shall be for the adoption of the said agreement, then that [shall constitute approval thereof].

Former N.C. GEN. STAT. § 55-165 (1950).

302. The 1950 Model Business Corporation Act contained the following provision:

> At each such meeting, a vote of the shareholders shall be taken on the proposed plan of merger or consolidation. Each outstanding share of each such corporation shall be entitled to vote on the proposed plan of merger or consolidation, whether or not such share has voting rights under the provisions of the articles of incorporation of such corporation. The plan of merger or consolidation shall be approved upon receiving the affirmative vote of the holders of at least two-thirds of the outstanding shares of each such corporation, unless any class of shares of any such corporation is entitled to vote as a class thereon, in which event, as to such corporation, the plan of merger or consolidation shall be approved upon receiving the affirmative vote of the holders of at least two-thirds of the outstanding shares of each class of shares entitled to vote as a class thereon and of the total outstanding shares. Any class of shares of any such corporation shall be entitled to vote as a class if the plan of merger or consolidation, as the case may be, contains any provision which, if contained in a proposed amendment to articles of incorporation, would entitle such class of shares to vote as a class.

MODEL BUS. CORP. ACT § 66 (1950), *in* 6 BUS. LAW. 1, 53-54 (1950).

303. *Id.*, *in* 6 BUS. LAW. at 54. The occasions for class voting on charter amendments were set forth in section 55 of the 1950 Model Act. *See id.* § 55, *in* 6 BUS. LAW. at 43-44. They included such matters as changing the preferences or relative rights of a class of stock, limiting or denying preemptive rights, and canceling accrued dividends.

(2) Cases and Commentary

As recently as 1950, the statutes of the three subject states and the provisions of the Model Business Corporation Act required approval by shareholders of the surviving corporation, as well as those of the disappearing corporation, without regard to the scale of the merger. If the merger consideration consisted of shares of the surviving corporation's stock (which was not required in New Jersey during the first half of the twentieth century[304] but was required in Delaware until 1941[305] and in North Carolina until 1943[306]), approval by shareholders of the surviving corporation would be in order if it was necessary to authorize the issuance of additional shares for purposes of the merger. On the other hand, if the surviving corporation had ample shares of authorized but unissued stock, and if the transaction did not contemplate any change in the rights of the survivor's shareholders, there was little reason to require those shareholders to approve a merger of small consequence.

In 1950, the statutes of Delaware and New Jersey, as well as the provisions of the Model Business Corporation Act, required a two-thirds vote for approval of a merger, while the North Carolina statute required only a simple majority vote. The latter approach was clearly preferable.[307] If the base for calculating a shareholder vote was the number of shares voted, it might make sense to require a two-thirds vote in order to make allowance for the possibility of substantial abstentions. On the other hand, when the base is the number of shares outstanding, an abstention has the same effect as a negative vote, and a favorable vote of a simple majority of the outstanding shares represents the vote of a true majority in interest. To require a favorable vote of two-thirds of the outstanding shares is to run the risk of letting the issue be determined by vote of a minority in interest or even by a substantial number of abstentions.[308]

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304. *See infra* notes 314-15 and accompanying text.

305. *See infra* notes 316-18 and accompanying text.

306. *See infra* notes 319-23 and accompanying text.

307. The unfortunate consequences that can flow from a two-thirds voting requirement are illustrated by the case of *Aiple v. Twin City Barge & Towing Co.*, 143 N.W.2d 374 (Minn. 1966). A person who owned in excess of one-third of the corporation's outstanding stock, and who happened also to have an interest in a competing business, was able to thwart the corporation's expansion program. *See id.* at 379.

308. The point is illustrated by the outcome of the voting on the proposed corporate combination in *Rath v. Rath Packing Co.*, 136 N.W.2d 410 (Iowa 1965), when the voting of shares (rounded to the nearest thousand) was as follows:

In 1950, the statutes of Delaware and New Jersey, while making no provision for class voting, gave non-voting shares a right to vote on mergers. While this may have been thought to be protective of the interests of preferred shareholders, it was a flawed approach. Because the typical corporation has outstanding a number of common shares far larger than the number of preferred shares, legislation that gives a voting right (but no class vote) to the preferred is likely to be of little consequence.[309]

Voted For		Voted Against		Shares Voted		Shares Not Voted		Shares Outstanding
598,000	+	177,000	=	775,000	+	218,000	=	993,000
77%	+	23%	=	100%				
60%	+	(18%		+		22%)	=	100%

See id. at 411-12. When the court held the proposed combination to be a de facto merger, requiring a favorable vote of two-thirds of the outstanding shares, the transaction was defeated—even though it was favored by 77% of the shares voted and by 60% of the shares outstanding. *See id.* at 417.

309. The point is illustrated by *Moss Estate, Inc. v. Metal & Thermit Corp.*, 179 A.2d 54 (N.J. Super. Ct. Ch. Div. 1962), in which a proposed merger of Udylite (a Delaware corporation) into M&T (a New Jersey corporation) was attacked by holders of voting preferred stock of the latter corporation. The merger contemplated the conversion of Udylite common stock (there being no Udylite preferred) into M&T common stock at a time when M&T had no shares of authorized but unissued stock available for this purpose. *See id.* at 56, 61. Under the New Jersey statutes then in effect, a charter amendment to increase authorized stock required the affirmative vote of two-thirds in interest of each class of shareholders having voting powers, whereas a merger required the affirmative vote of the holders of two-thirds of all the capital stock (whether voting or non-voting) of each of the merging corporations. *See id.* 56-57. M&T's outstanding stock consisted of 809,197 shares of common and 6462 shares of voting preferred, with plaintiffs holding 2257 shares of the latter class. *See id.* at 61. Thus, as holders of 34.9% of M&T's voting preferred, plaintiffs could veto a charter amendment (to increase the number of shares of M&T's authorized common stock for use in converting the Udylite stock) because such an amendment required a two-thirds class vote. On the other hand, even though the merger statute (as well as M&T's charter) gave plaintiffs the right to vote on the proposed merger, it did not provide for class voting; thus, plaintiffs' ownership of less than 0.3% of M&T's total capital stock gave them no prospect of vetoing the proposed merger, notwithstanding the merger statute's requirement of a two-thirds vote. Plaintiffs brought suit seeking a declaratory judgment that the merger could not be accomplished without an amendment of M&T's charter requiring approval of two-thirds in interest of each class of its shareholders having voting powers. *See id.* at 57. The court held against the plaintiffs, saying the following:

> [The New Jersey statute] provides that the joint agreement to merge or consolidate must be approved by *a vote of the holders of two-thirds of all the capital stock* of each of the merging or consolidating corporations. This clearly means *all capital stock* voting or non-voting. It is not a *class vote*. . . .
>
> . . . .
>
> Clearly, the agreement of merger and consolidation may establish an authorized capital stock of the consolidated corporation different from the

In 1950, none of the three subject states' statutes provided for a class vote to approve a merger, while the Model Business Corporation Act did. Given the fact that the 1950 merger statutes of the three states provided for "converting" the shares of the constituent corporations,[310] and given the additional fact that the terms of a merger would be determined by directors more than likely elected by and responsive to the holders of common stock, preferred shareholders (without the veto power of a class vote) could be subjected to substantial changes in their rights.[311] While the holders of preferred stock would have appraisal rights and the protection afforded by judicial concepts of fiduciary duty and fairness,[312] there needed to be a greater compulsion upon those structuring merger transactions to make such transactions acceptable to all classes of involved shareholders.[313] That compulsion is best supplied by requiring that each affected class of shareholders be given the veto power entailed in a class vote.

c. Permissible Consideration

(1) Statutory Provisions

The New Jersey merger statute, as enacted in 1896[314] and as it

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> authorized capital stock of any corporate party to the merger, and without limitation or restriction by the certificate of incorporation of any former corporation which is a party to the merger and consolidation and without any requirement of amendment of the certificate of incorporation of such merging corporations.

Id. at 62-63.

310. For New Jersey, see *infra* note 315. For Delaware, see *infra* note 318. For North Carolina, see *infra* text accompanying note 321.

311. For a collection of cases illustrating the kinds of changes that can be made in the rights of preferred shareholders, see Richard M. Buxbaum, *Preferred Stock—Law and Draftsmanship*, 42 CAL. L. REV. 243, 298-309 (1954).

312. *See supra* notes 288-91 and accompanying text.

313. Folk says the following:

> Nevertheless, it is important to maintain some internal or external control to offset the power of the directors, unless one assumes that directors, especially when backed by a shareholder majority, should have unrestrained discretion. Appraisal rights in the hands of "recalcitrant" or "troublesome" shareholders have, in the past, served as a countervailing power to force the insiders to tailor their plans to minimize the number of dissenters by getting the best deal possible. A high vote requirement (including a class vote) plays the same sort of role. When either weapon is removed, the insiders lack the real self-interest to fashion a plan acceptable to a sufficient number of shareholders.

Folk, *supra* note 117, at 1293 (footnote omitted).

314. The 1896 New Jersey statute required that the merger agreement prescribe "the manner of converting the capital stock of each of said merging or consolidating

existed in 1950,[315] allowed the merger consideration to be "stock or obligations" of the surviving corporation. The Delaware merger statute, from its enactment in 1899 until 1941, limited the permissible merger consideration to "shares" of the surviving corporation;[316] but, in 1941, the statute was amended[317] to broaden "shares" to "shares or other securities" of the surviving corporation.[318]

The North Carolina merger statute, as enacted in 1925, limited the permissible merger consideration to "stock."[319] In 1950, following a rewriting in 1943,[320] the North Carolina statute required that the merger agreement prescribe "the manner of converting the shares of each of the constituent corporations into shares of the surviving or consolidated corporation."[321] However, added to this provision, by the 1943 rewriting,[322] was a new sentence providing that "[t]he agreement of merger or consolidation may also provide for the distribution of cash, property, or securities, in whole or in part, in lieu of shares of the surviving or consolidated corporation, to stockholders of the constituent corporations or any class of them."[323]

The Model Business Corporation Act, as published in 1950, required that the plan of merger set forth "[t]he manner and basis of

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corporations into the stock or obligations of such new or consolidated corporation." Act of Apr. 21, 1896, ch. 185, § 105.I, 1896 N.J. Laws 277, 310.

315. In 1950, the New Jersey statute required that the merger agreement prescribe "[t]he manner of converting the capital stock of each of such merging or consolidating corporations into the stock or obligations of the new or consolidated corporation." N.J. STAT. ANN. § 14:12-2.e (West 1939).

316. The 1899 Delaware statute required that the merger agreement prescribe "the manner of converting the shares of each of the old corporations into the new." Act of Mar. 10, 1899, ch. 273, § 54, 21 Del. Laws 445, 461.

This provision (as contained in re-numbered section 59 of the Delaware corporation statute) was amended in 1927 to read: "the manner of converting the shares of each of the constituent corporations into shares of the consolidated corporation." Act of Mar. 2, 1927, ch. 85, § 18, 35 Del. Laws 220, 245-46.

317. *See* Act of Apr. 9, 1941, ch. 132, § 12, 43 Del. Laws 448, 458-59.

318. In 1950, the Delaware statute required that the merger agreement prescribe "the manner of converting the shares of each of the constituent corporations into shares or other securities of the corporation resulting from or surviving such consolidation or merger." REV. CODE OF DEL. § 2091 (1935), *as amended by* Act of Apr. 9, 1941, ch. 132, § 12, 43 Del. Laws 448, 458-59.

319. Section 1224-a of North Carolina's 1925 merger statute required that the merger agreement prescribe "the manner and basis of converting the shares of each of the old corporations into stock of the new corporation." Act of Feb. 27, 1925, ch. 77, § 1, 1925 N.C. Sess. Laws 81, 81.

320. *See* Act of Feb. 26, 1943, ch. 270, § 1, 1943 N.C. Sess. Laws 257, 258.

321. Former N.C. GEN. STAT. § 55-165 (1950).

322. *See* Act of Feb. 26, 1943, ch. 270, § 1, 1943 N.C. Sess. Laws 257, 258.

323. Former N.C. GEN. STAT. § 55-165 (1950).

converting the shares of each merging corporation into shares or other securities or obligations of the surviving corporation."[324]

(2) Cases and Commentary

If a merger statute required that a shareholder of the disappearing corporation receive shares of the surviving corporation, such shareholder would be assured of a continuing equity interest in the combined enterprise resulting from the merger.[325] Moreover, if the transaction was properly structured as a tax-free reorganization, a low-basis shareholder not only would avoid an immediate capital gains tax but also would have the continuing potential for a stepped-up basis at the time of death.[326]

In providing for the use of "obligations" of the surviving corporation as permissible merger consideration, the New Jersey statute suggested the possibility of a freeze-out by the use of short-term or redeemable debt securities.[327] However, this possibility was frowned upon in a 1928 statement by the New Jersey Chancery Court.[328]

The pre-1941 Delaware requirement of "shares," and the pre-1943 North Carolina requirement of "stock," seemed to avoid this

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324. MODEL BUS. CORP. ACT § 64(c) (1950), *in* 6 BUS. LAW. 1, 52 (1950).

325. *See* Rosenblatt v. Getty Oil Co., 493 A.2d 929, 933 (Del. 1985) ("The consensus was that the fairest way to achieve [the merger of a parent corporation and its majority-owned subsidiary] would be an exchange of common stock, continuing shareholder participation in a larger post-merger company."); Citron v. E.I. Du Pont de Nemours & Co., 584 A.2d 490, 493 (Del. Ch. 1990) ("[T]he merger consideration would consist of DuPont stock rather than cash, so that Remington's shareholders would incur no immediate tax liability and could continue as DuPont stockholders if they chose.").

326. *See* 26 U.S.C. §§ 354, 358, 368 (1994) (containing the provisions of the Internal Revenue Code relating to tax-free reorganizations); *id.* § 1014 (containing the provision of that Code relating to stepped-up basis at death).

327. This possibility was noted in *Coyne v. Park & Tilford Distillers Corp.*, 154 A.2d 893 (Del. 1959), when the court commented on the effect of the 1941 amendment of Delaware's long-form merger statute expanding the permissible consideration from "shares" to "shares or other securities." *See id.* at 895.

328. In *Outwater v. Public Service Corp.*, 143 A. 729 (N.J. Ch. 1928), *aff'd per curiam*, 146 A. 916 (N.J. 1929), the court said:

> It is not overlooked that under the merger act the merger agreement may provide for "converting the capital stock of each of said merging or consolidating corporations into the stock or *obligations* of such new or consolidated corporation," thus implying that obligations may be given in exchange. . . . However, fairness in mergers dictates that, when obligations are given in exchange for stocks of the character here involved, they at least should bear a corresponding permanent investment value . . . ; otherwise, a merger would be a simple medium for a compulsory sale, and that is not permissible.

Id. at 732 (quoting state merger act).

problem. However, even these unrestricted words did not foreclose a resort to redeemable preferred stock with the attendant potential for a freeze-out. In *Outwater v. Public Service Corp.*,[329] minority shareholders succeeded in enjoining a merger when the consideration consisted of preferred stock redeemable within three years.[330] However, in *Matteson v. Ziebarth*,[331] the use of redeemable preferred stock as merger consideration was sustained in the context of a corporation in difficulty that resorted to this device as the means of eliminating an obstreperous minority shareholder.

d. Right of Appraisal[332]

(1) Valuation Standard

(a) Statutory Provisions

New Jersey's 1896 appraisal statute provided that a dissenting

329. 143 A. 729 (N.J. Ch. 1928), *aff'd per curiam*, 146 A. 916 (N.J. 1929).

330. The court said:

> But there is a more serious inequity; the preferred stock lacks permanency. It is redeemable within three years at the option of the Electric & Gas Company. Thus the merger, in effect, is nothing less than a forced sale by the majority stockholders [sic] to itself at a price fixed by it and payable at its pleasure. The preferred stock is but the equivalent of a 6 per cent. promissory note payable in three years at the option of the buyer. The merger legislation countenances no such perversion of the contractual obligations of stockholders inter sese.

Id. at 731.

331. 242 P.2d 1025, 1031-32 (Wash. 1952) (en banc).

332. Among the early articles concerning the right of appraisal were the following: Norman D. Lattin, *Remedies of Dissenting Stockholders Under Appraisal Statutes*, 45 HARV. L. REV. 233 (1931); Irving J. Levy, *Rights of Dissenting Shareholders to Appraisal and Payment*, 15 CORNELL L.Q. 420 (1930); Benjamin M. Robinson, *Dissenting Shareholders: Their Right to Dividends and the Valuation of Their Shares*, 32 COLUM. L. REV. 60 (1932); and Joseph L. Weiner, *Payment of Dissenting Stockholders*, 27 COLUM. L. REV. 547 (1927).

Significant portions of most appraisal statutes relate to procedural matters such as the requirements to be met by dissenting shareholders in perfecting their appraisal rights and the procedures to be followed in conducting the appraisal. Those procedural aspects of appraisal statutes are not addressed in this Article. This does not imply that the procedural aspects are unimportant. The matter of whether the appraisal is to be conducted by a court or by appointed appraisers, the question of who is to bear the expense of an appraisal, the subject of whether (and from what point in time) interest is payable on the amount of the appraisal award, and other aspects as well, are all of significance to the dissenting shareholder. These procedural matters are discussed in the following: James H. Kerr, Jr. & J. Spencer Letts, *Appraisal Procedures for Dissenting Delaware Stockholders*, 20 BUS. LAW. 1083 (1965); and Note, *Appraisal of Corporate Dissenters' Shares: Apportioning the Proceeding's Financial Burdens*, 60 YALE L.J. 337 (1951).

shareholder's stock was to be valued at "full market value" and "without regard to any depreciation or appreciation thereof in consequence" of the merger,[333] and this requirement continued in effect through 1950.[334] The Delaware statute, in 1899, required that a dissenting shareholder be paid "the value of [his] stock at the date of consolidation";[335] and, in 1950, it required that the dissenter be paid "the value of his stock on the date of the recording of [the merger agreement], exclusive of any element of value arising from the expectation or accomplishment" of the merger.[336] The North Carolina merger statute, when enacted in 1925, required that a dissenting shareholder be paid "the value of [his] stock at the date of the consolidation";[337] and, in 1950, it required that the dissenter be paid "the fair value of his stock without regard to any depreciation or appreciation thereof in consequence" of the merger.[338] The 1950 Model Business Corporation Act specified the entitlement of a dissenting shareholder as "the fair value of his shares as of the day prior to the date on which the vote was taken approving the merger or consolidation."[339]

(b) Cases and Commentary

The only significant difference in these valuation standards lay in the fact that New Jersey's specified "full market value" while those of the other two states (and the Model Business Corporation Act) specified "value" or "fair value."[340]

It appears that there has been no reported North Carolina decision involving the matter of valuation in the appraisal context.[341] Given the language of the New Jersey statute, it is not surprising that the courts of that state held (at least when there was a market for the

333. Act of Apr. 21, 1896, ch. 185, § 108, 1896 N.J. Laws 277, 312.

334. *See* former N.J. STAT. ANN. §§ 14:12-6 to -7 (West 1939) (quoted *infra* in note 353).

335. Act of Mar. 10, 1899, ch. 273, § 56, 21 Del. Laws 445, 462-63.

336. REV. CODE OF DEL. § 2093 (1935), *as amended by* Act of May 23, 1949, ch. 136, § 7, 47 Del. Laws 206, 211-13 (quoted *infra* in note 362).

337. Section 1224-c of North Carolina's 1925 merger statute, as enacted by Act of Feb. 27, 1925, ch. 77, § 1, 1925 N.C. Sess. Laws 81, 84.

338. Former N.C. GEN. STAT. § 55-167 (1950) (quoted *infra* in note 365).

339. MODEL BUS. CORP. ACT § 71 (1950), *in* 6 BUS. LAW. 1, 58-59 (1950) (quoted *infra* in note 366).

340. The view has been expressed that "value" and "fair value" are practically synonymous. *See* Chicago Corp. v. Munds, 172 A. 452, 455 (Del. Ch. 1934).

341. *See* ROBINSON, *supra* note 226, at 532 ("There is no reported North Carolina decision determining the fair value of dissenters' shares.").

stock) that only market value, and not the value of the corporation's properties and rights, should be considered.[342] On the other hand, because of the contrasting language of the Delaware statute, it was held by a Delaware court that appraisers acted erroneously when they looked solely to market value and not to other factors such as net asset value.[343]

By 1950, the Delaware courts had established a number of points concerning valuation in appraisal proceedings. Just as it had been decided that market value alone was not dispositive,[344] it was decided also that asset value alone was not determinative[345] and, indeed, could not be given excessive weight.[346] Further, it was held that valuation was to be determined on a going-concern basis rather than a liquidation basis.[347] Finally, it was established that a dissenter was entitled to receive his proportionate interest in the entire corporate enterprise valued as a going concern.[348]

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342. *See In re* Capital Stock of Morris Canal & Banking Co., 141 A. 784, 785 (N.J. 1928), *followed in* Prall v. United States Leather Co., 143 A. 382 (N.J. Sup. Ct. 1928), *aff'd on opinion below*, 146 A. 916 (N.J. 1929).

343. *See Munds*, 172 A. at 454; *see also* Cole v. Wells, 113 N.E. 189, 191 (Mass. 1916) ("It is obvious that 'the value of the stock' means not merely the market price if the stock is traded in by the public, but the intrinsic value, to determine which all the assets and liabilities must be ascertained.").

344. *See Munds*, 172 A. at 454; *accord* Jacques Coe & Co. v. Minneapolis-Moline Co., 75 A.2d 244, 247 (Del. Ch. 1950).

345. *See* Root v. York Corp., 50 A.2d 52, 58 (Del. Ch. 1946).

346. *See In re* General Realty & Utils. Corp., 52 A.2d 6, 15 (Del. Ch. 1947).

347. *See id.* The point had been made earlier in *Munds*, 172 A. at 455.

348. *See Munds*, 172 A. at 455 ("What [the dissenter] has been deprived of is his proportional share of an active enterprise which but for the compulsion of others he could continue to be associated with in the indefinite future. What he is deprived of is what he should be paid for.").

The Delaware Supreme Court made the same point in *Tri-Continental Corp. v. Battye*, 74 A.2d 71 (Del. 1950), as follows:

> The basic concept of value under the appraisal statute is that the stockholder is entitled to be paid for that which has been taken from him, viz., his proportionate interest in a going concern. By value of the stockholder's proportionate interest in the corporate enterprise is meant the true or intrinsic value of his stock which has been taken by the merger. In determining what figure represents this true or intrinsic value, the appraiser and the courts must take into consideration all factors and elements which reasonably might enter into the fixing of value. Thus, market value, asset value, dividends, earning prospects, the nature of the enterprise and any other facts which were known or which could be ascertained as of the date of merger and which throw any light on future prospects of the merged corporation are not only pertinent to an inquiry as to the value of the dissenting stockholders' interest, but must be considered by the agency fixing the value.

Id. at 72.

(2) *Entitlement and Exceptions*

(a) Statutory Provisions

The 1896 New Jersey statute granted the right of appraisal to a dissenting shareholder of a merging corporation only if that corporation had "the right to exercise any franchise, for public use."[349] However, in 1902, a new provision was added, granting the appraisal right to a dissenting shareholder of either corporation upon the merger of "any two or more corporations, which do not have the right to exercise any franchise for public use."[350] Following minor amendments in 1920[351] and 1936,[352] New Jersey's two appraisal statutes, as codified in 1937 and in effect in 1950,[353] gave appraisal rights to dissenting shareholders of each corporation entering into a merger.[354]

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349. Act of Apr. 21, 1896, ch. 185, § 108, 1896 N.J. Laws 277, 312. This limitation probably was based on the New Jersey doctrine that the statutory grant of a right of appraisal constituted an exercise of the state's power of eminent domain, *see supra* text accompanying notes 96-100, and the short-lived notion that such doctrine could be applied only with respect to a corporation in the nature of a public utility.

350. Act of Apr. 10, 1902, ch. 241, § 1, 1902 N.J. Laws 700, 700-01.

351. *See* Act of Apr. 9, 1920, ch. 142, § 1, 1920 N.J. Laws 284, 284-85.

352. *See* Act of May 26, 1936, ch. 114, 1936 N.J. Laws 281; Act of May 26, 1936, ch. 115, 1936 N.J. Laws 283.

353. In 1950, one section of the New Jersey statute provided in part as follows:

> If any of the corporations authorized by this title to merge or consolidate shall have the right to exercise any franchise, for public use, and any stockholder thereof not voting in favor of such agreement shall dissent therefrom . . . , such dissenting stockholder or such consolidated corporation may . . . apply by petition to the circuit court . . . for the appointment of three disinterested appraisers to appraise the full market value of his stock, without regard to any depreciation or appreciation thereof in consequence of the merger or consolidation.
>
> The award of the appraisers, or that of a majority of them, when confirmed by the court, shall be final and conclusive on all parties, and such consolidated corporation shall pay to such stockholder the value of his stock as aforesaid.

Former N.J. STAT. ANN. § 14:12-6 (West 1939).

In 1950, the next section of the New Jersey statute was (for the most part) the same except for its introductory language, which was as follows:

> Upon the merger or consolidation of any two or more corporations, which do not have the right to exercise any franchise for public use, into a single corporation, . . . if any stockholder in any of such merging or consolidating corporations not voting in favor of such agreement of merger or consolidation, shall dissent therefrom . . . .

Former N.J. STAT. ANN. § 14:12-7 (West 1939).

354. Although such a construction was probably unintended, a logical analysis of the two provisions would seem to lead to the conclusion that, if a corporation having the right

The 1899 Delaware corporation statute provided appraisal rights for dissenting shareholders of both parties to a corporate merger.[355] The appraisal statute was rewritten in 1927[356] and again in 1935,[357] but it continued to give appraisal rights to dissenting shareholders of each of the merging corporations.[358] Following an addition to the statute in 1941,[359] it was rewritten in 1943,[360] and again in 1949,[361] but with the same basic entitlement to appraisal.[362]

North Carolina's 1925 merger statute gave the right of appraisal to dissenting shareholders of each of the merging corporations.[363] Notwithstanding changes made in 1943,[364] this continued to be true under the North Carolina appraisal statute through 1950.[365]

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to exercise any franchise for public use merged with another corporation not having such right, a dissenting shareholder of the latter corporation would have no appraisal right under either of the two provisions.

355. *See* Act of Mar. 10, 1899, ch. 273, § 56, 21 Del. Laws 445, 462-63.

356. *See* Act of Mar. 2, 1927, ch. 85, § 20, 35 Del. Laws 220, 248-49.

357. *See* Act of Apr. 18, 1935, ch. 148, § 8, 40 Del. Laws 524, 538-39.

358. *See* REV. CODE OF DEL. § 2093 (1935).

359. *See* Act of Apr. 9, 1941, ch. 132, § 16, 43 Del. Laws 448, 468.

360. *See* Act of Apr. 15, 1943, ch. 125, § 6, 44 Del. Laws 422, 425-29.

361. *See* Act of May 23, 1949, ch. 136, § 7, 47 Del. Laws 206, 211-13.

362. In 1950, the Delaware statute provided in part as follows:

> The corporation resulting from or surviving any consolidation or merger as aforesaid shall within ten days after the date on which the agreement of consolidation or merger has been filed and recorded ... notify each stockholder in any corporation of this State consolidating or merging as aforesaid, who objected thereto in writing and whose shares were not voted in favor of such consolidation or merger, and who [perfected his right to appraisal], ... and if any such stockholders [sic] shall ... demand in writing, from the corporation resulting from or surviving such consolidation or merger, payment for his stock, such resulting or surviving corporation shall ... pay to him the value of his stock on the date of the recording of said agreement of consolidation or merger, exclusive of any element of value arising from the expectation or accomplishment of such consolidation or merger. If ... the corporation and any such stockholder fail to agree as to the value of such stock, any such stockholder, or the corporation resulting from or surviving such consolidation or merger, may by petition filed in the Court of Chancery ... demand a determination of the value of the stock of all such stockholders by an appraiser to be appointed by the Court.

REV. CODE OF DEL. § 2093 (1935), *as amended by* Act of May 23, 1949, ch. 136, § 7, 47 Del. Laws 206, 211-13.

363. See section 1224-c of North Carolina's 1925 merger statute, as enacted by Act of Feb. 27, 1925, ch. 77, § 1, 1925 N.C. Sess. Laws 81, 84-85.

364. *See* Act of Feb. 26, 1943, ch. 270, § 1, 1943 N.C. Sess. Laws 257, 262-63.

365. In 1950, the North Carolina statute provided as follows:

> If any stockholder, entitled to vote, in any corporation of this State consolidating or merging as aforesaid shall vote against the same, or if any stockholder in any such corporation, not entitled to vote, shall ... object in writing to such merger or consolidation, and if any such stockholder shall ...

The 1950 Model Business Corporation Act also provided appraisal rights for dissenting shareholders of both the surviving and the disappearing corporation.[366]

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demand in writing from the surviving or resulting corporation payment of his stock, such surviving or resulting corporation shall . . . pay to him the fair value of his stock without regard to any depreciation or appreciation thereof in consequence of the merger or consolidation. In case the fair value of said stock is not paid . . . , or such stockholder and the surviving or resulting corporation do not . . . enter into a written agreement for the payment of said stock, then such stockholder . . . shall apply by petition to the superior court . . . for the appointment of three appraisers to appraise the fair value of such stock. . . . The award of the appraisers (or a majority of them), if no exceptions be filed thereto . . . , shall be confirmed by the court, and when confirmed shall be final and conclusive. . . .

On the making of said demand in writing . . . , any such stockholder shall cease to be a stockholder in said constituent corporation and shall have no rights with respect to such stock, except the right to receive payment therefor, as aforesaid . . . .

Any stockholder in either or any of the constituent corporations, entitled to vote, who does not vote against the merger or consolidation, and any stockholder, not entitled to vote, who does not object thereto in writing . . . , shall cease to be a stockholder in such constituent corporation and shall be deemed to have assented to the merger or consolidation . . . , together with stockholders voting in favor of the merger or consolidation, in the manner and on the terms specified in the agreement of merger or consolidation; and any stockholder in either or any of said constituent corporations voting against said merger or consolidation, or objecting thereto in writing . . . , but who does not demand payment for his stock . . . , or who does not apply to the court to have the value thereof determined . . . , shall likewise cease to be a stockholder in such constituent corporation and shall likewise be deemed to have consented to said merger or consolidation.

Former N.C. GEN. STAT. § 55-167 (1950).

366. The 1950 Model Act provided in part as follows:

If a shareholder of a corporation which is a party to a merger or consolidation shall file with such corporation, prior to or at the meeting of shareholders . . . , a written objection to such plan of merger or consolidation, and shall not vote in favor thereof, and such shareholder . . . shall make written demand on the surviving or new corporation . . . for payment of the fair value of his shares as of the day prior to the date on which the vote was taken approving the merger or consolidation, then, if the merger or consolidation is effected, the surviving or new corporation shall pay to such shareholder . . . the fair value thereof. . . . Any shareholder failing to make demand . . . shall be bound by the terms of the merger or consolidation.

. . . .

If . . . the shareholder and the surviving or new corporation do not [agree on the value of the shares], then the dissenting shareholder may . . . file a petition in any court of competent jurisdiction asking for a finding and determination of the fair value of such shares, and shall be entitled to judgment against the surviving or new corporation for the amount of such fair value as of the day prior to the date on which such vote was taken approving such merger or consolidation . . . . Unless the dissenting shareholder shall file such petition . . . , such shareholder and all persons claiming under him shall be bound by the terms

(b) Cases and Commentary

Except for the short-lived New Jersey limitation noted above,[367] the statutes of the three subject states during the first half of the twentieth century gave appraisal rights not only to shareholders of the corporation that disappeared in a merger but also to shareholders of the surviving corporation. It was pointed out above[368] that there was little reason for requiring approval of a merger by vote of the shareholders of the surviving corporation if the merger was of small consequence and contemplated no change in the rights of such shareholders. Similarly, there was no good reason for according the appraisal right to shareholders of the surviving corporation in such circumstances.

(3) Exclusivity of Appraisal[369]

(a) Statutory Provisions

It made a significant difference to both proponents and opponents of a merger whether availability of the appraisal remedy precluded a resort by dissenters to equitable remedies such as injunction or rescission. Thus, one might expect the statutes of the three subject states to address the question whether appraisal constituted the dissenter's exclusive remedy. There was a basis for saying that the statute of North Carolina and a provision of the Model Business Corporation Act, even as early as 1950, addressed this question—if only obliquely.[370] However, it was not until after

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of the merger or consolidation.

MODEL BUS. CORP. ACT § 71 (1950), *in* 6 BUS. LAW. 1, 58-60 (1950).

367. *See supra* text accompanying notes 349-50.

368. *See supra* text accompanying notes 304-06.

369. See generally William R. Worth, Note, *Corporations—Appraisal Statutes—Exclusiveness of Statutory Remedy*, 47 MICH. L. REV. 1010 (1949), and the later articles and notes cited *infra* in note 779.

370. The concluding paragraph of North Carolina's appraisal statute as in effect in 1950, *see supra* note 365, provided that any shareholder of either corporation who did not vote against the merger or (if a holder of non-voting stock) did not object thereto in writing, or any shareholder who voted against the merger or objected thereto in writing but did not demand payment for his stock or apply to the court to have the value thereof determined, would "cease to be a stockholder" and "be deemed to have" assented or consented to the merger. *See* former N.C. GEN. STAT. § 55-167 (1950). While the part of this statute about ceasing to be a shareholder was clearly in error (since it applied to shareholders of the surviving corporation as well as to those of the disappearing corporation), the part about being deemed to have assented or consented would seem to amount to a statutory declaration that such a shareholder could not challenge the merger.

The concluding sentence of the first paragraph of the appraisal provision of the 1950

1950 that any of the three subject states explicitly addressed, by way of statute, the matter of exclusivity of the appraisal remedy.

(b) Cases and Commentary

During the first half of the twentieth century, the courts of New Jersey and Delaware[371] began to address the issue of exclusivity of appraisal in terms that carried forward after 1950. For example, in the 1907 decision of *Colgate v. United States Leather Co.*,[372] the New Jersey Chancery Court held that a suit to enjoin a merger—on the ground (among others) that the merger was unfair and inequitable to preferred shareholders—was not precluded by the existence of a right of appraisal.[373]

In 1931, in *Cole v. National Cash Credit Ass'n*,[374] the Delaware Chancery Court voiced (in different words) the now-familiar Delaware doctrine that appraisal is a dissenter's exclusive remedy in the absence of illegality or fraud.[375] Thus, when a merger was neither unlawful nor inequitable, dissenting shareholders were "put to their

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Model Business Corporation Act, *see supra* note 366, read: "Any shareholder failing to make demand . . . shall be bound by the terms of the merger or consolidation." MODEL BUS. CORP. ACT § 71, *in* 6 BUS. LAW. at 58-60.

371. No pre-1950 North Carolina decision on the point has been found.

372. 67 A. 657 (N.J. Ch. 1907), *rev'd on other grounds*, 72 A. 126 (N.J. 1909).

373. *See supra* note 290 (first paragraph) (quoting *Colgate*).

374. 156 A. 183 (Del. Ch. 1931).

375. The court said:

> As a general proposition dissenting stockholders are thus put to an election by the statute [between going along with the merger or exercising the right of appraisal]. There may be circumstances, however, under which a court of equity will say that the duty to make the election does not arise. For instance where the merger is not authorized by law, a dissenting stockholder is under no duty to make his election. He may enjoin its consummation. Furthermore, if consent to the merger be induced by fraud practiced upon a consenting company, a stockholder is under no duty to elect whether he will abide by a merger so induced or take his money. In such a case equity holds that no just alternatives are presented to him for a choice. Where also the merger proposes illegally to wipe out a right to accumulated dividends on preferred stock, a court of equity will enjoin it on the application of a preferred stockholder. In such a case the stockholder's election is invited between two alternatives one of which is highly unfair. From these and other cases which may be cited it thus appears that the election which is given to the stockholder is one that he is not, under any and all circumstances, required to exercise. The exercise of the statutory right of merger is always subject to nullification for fraud. The cases so hold.

Id. at 187 (citations omitted).

In *Adams v. United States Distributing Corp.*, 34 S.E.2d 244 (Va. 1945), the court said: "[T]he weight of authority is to the effect that unless the corporate merger be tainted with fraud or illegality . . . the dissenting stockholder must pursue the remedy prescribed by the appraisal statute." *Id.* at 250.

election" either to seek appraisal or to go along with the merger.[376] However, when a proposed merger would be unlawful or illegal—as when consummation of the merger would be in violation of antitrust laws[377] or when the language of the statute was inadequate to sustain the merger[378]—existence of the appraisal remedy would not preclude a suit attacking the transaction. Moreover, with respect to the "fraud" exception to the exclusivity of appraisal, it was recognized that, even in the absence of actual fraud, relief other than appraisal could be sought by a dissenter upon a showing of constructive fraud.[379]

2. Parent-Subsidiary Merger[380]

A 1937 addition to the Delaware merger statutes[381] provided a

376. *See* Federal United Corp. v. Havender, 11 A.2d 331, 342-43 (Del. 1940); *accord* Langfelder v. Universal Labs., 68 F. Supp. 209, 212-13 (D. Del. 1946).

377. *See* General Inv. Co. v. Lake Shore & Michigan S. Ry. Co., 250 F. 160, 174 (6th Cir. 1918).

378. *See* Jones v. Rhea, 107 S.E. 814, 818 (Va. 1921).

379. *See* Cole v. National Cash Credit Ass'n, 156 A. 183, 187 (Del. Ch. 1931). However, in a suit by a dissenting shareholder seeking to enjoin consummation of a merger (as an alternative to the appraisal remedy) on the ground of inadequacy of the merger consideration, proof of constructive fraud required a showing that the alleged inadequacy was so gross as to lead the court to conclude that it was due not to an honest error of judgment but rather to bad faith or a reckless indifference to the rights of others interested. *See id.* at 188. Other cases voicing similar statements of the showing required for proof of constructive fraud include *Hottenstein v. York Ice Machinery Corp.*, 136 F.2d 944, 952 (3d Cir. 1943), and *Porges v. Vadsco Sales Corp.*, 32 A.2d 148, 151 (Del. Ch. 1943).

380. The term "parent-subsidiary merger" is used herein to denote only a merger of a parent corporation with its wholly owned subsidiary. Such a transaction differs from the "short-form merger" discussed later in this Article. *See infra* text accompanying notes 455-521.

381. *See* Act of Apr. 13, 1937, ch. 131, § 2, 41 Del. Laws 276, 277-78. This statute added a new section 59A to chapter 65 of the 1935 Revised Code of Delaware, providing as follows:

> Any corporation now or hereafter organized under the provisions of this Chapter or existing under the laws of this State, for the purpose of carrying on any kind of business, owning all the stock of any other corporation now or hereafter organized under the provisions of this Chapter or existing under the laws of this State, or now or hereafter organized under the laws of any other State . . . , if the laws under which said other corporation is formed shall permit a merger as herein provided, may file in the office of the Secretary of State a certificate of such ownership . . . setting forth a copy of the resolution of its board of directors to merge such other corporation, and to assume all of its obligations and the date of the adoption thereof . . . . The parent corporation shall not thereby acquire power to engage in any business, or to exercise any right, privilege or franchise, of a kind which it could not lawfully engage in or exercise under the provisions of the law by or pursuant to which such parent

simplified procedure whereby a wholly owned subsidiary (domestic or foreign) could be merged into a Delaware parent corporation without any involvement (by way of voting or appraisal rights) on the part of the parent's shareholders.[382] A similar provision was added to the New Jersey merger statutes, but not until 1952.[383] North Carolina did not provide a simplified procedure for parent-subsidiary mergers until its 1955 Business Corporation Act was enacted (effective July 1, 1957).[384] When the Model Business Corporation Act was published

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> corporation is organized .... Any plan of consolidation or merger which requires or contemplates any changes other than those herein specifically authorized with respect to the parent corporation, shall be accomplished under the provisions of Section 59 of this chapter [relating to long-form mergers]. The provisions of Section 61 of this chapter [relating to the right of appraisal] shall not apply to any merger effected under this Section.

Id. § 2, 41 Del. Laws at 277-78. This section was amended (in minor respects) by Act of Apr. 18, 1945, ch. 157, § 5, 45 Del. Laws 594, 598-600, and by Act of June 15, 1951, ch. 353, § 9, 48 Del. Laws 918, 926-28. When the Delaware Code Annotated was promulgated in 1953, this provision (as amended) became section 253 of title 8. By Act of June 5, 1957, ch. 121, § 6, 51 Del. Laws 186, 188-90, it was replaced by Delaware's short-form merger statute. *See infra* text accompanying notes 455-57.

382. While negation of appraisal rights was expressed in the last sentence of the statute, as quoted *supra* in note 381, negation of shareholder voting rights was a matter of statutory silence on the point.

383. *See* Act of Apr. 16, 1952, ch. 33, § 1, 1952 N.J. Laws 122, 122-23. It became section 14:12-10 of former title 14, and it provided in part as follows:

> Any corporation, except as hereinafter in this section specified, now or hereafter organized under any law or laws of this State for the purpose of carrying on any kind of business, owning all the stock of any other corporation of this State or owning all the stock of any other corporation now or hereafter organized under the laws of any other State ... if the laws of the State under which said corporation of another State is formed shall permit a merger as herein provided, may merge into itself said other corporation, notwithstanding that said corporations may not have been organized for the purpose of carrying on business of the same or a similar nature, by filing in the office of the Secretary of State a certificate of such ownership ... setting forth a copy of the resolution of its board of directors to merge such other corporation and to assume all obligations of such other corporation and the date of the adoption thereof.... The parent corporation shall not thereby acquire power to engage in any business, or to exercise any right, privilege or franchise, of a kind which it could not lawfully engage in or exercise under its certificate of incorporation or charter in effect immediately prior to such merger.... The provisions of sections 14:12-6 and 14:12-7 of the Revised Statutes [relating to the right of appraisal] shall not apply to any merger effected under this section.

Id. § 1, 1952 N.J. Laws at 122-23. By Act of June 19, 1967, ch. 117, § 1, 1967 N.J. Laws 561, 561-63, this provision was replaced by New Jersey's short-form merger statute. *See infra* text accompanying note 475.

384. *See* Act of May 26, 1955, ch. 1371, 1955 N.C. Sess. Laws 1432 (effective July 1, 1957); *supra* note 252 (second paragraph). The 1955 Business Corporation Act, as amended by Act of June 20, 1959, ch. 1316, § 37, 1959 N.C. Sess. Laws 1500, 1506, which deleted the word "domestic" from the phrase "surviving domestic corporation" appearing

in 1950, its only reference to a parent-subsidiary merger was contained in a sentence denying appraisal rights in that context.[385]

C. *Liberalization of Merger Requirements After 1950*

1. Changes in Required Director Action

a. Statutory Provisions

North Carolina was the first of the three subject states to eliminate the requirement that directors of the merging corporations enter into a merger agreement.[386] Its 1955 Business Corporation Act[387] provided that "[t]he board of directors of each corporation shall, by resolution adopted by each such board, approve a plan of merger."[388] Its 1989 Business Corporation Act[389] provides that "[o]ne

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in the original Act, contained the following provision:

> Unless otherwise provided in the charter or bylaws, no approval by shareholders of the surviving corporation shall be required for a merger if at the time of approval of the plan of merger by the board of directors of each of the corporations, domestic or foreign, who are parties thereto, the surviving corporation is the owner of all the outstanding shares of the other corporation, or corporations, domestic or foreign, who are parties to the merger, and the plan of merger does not provide for any changes in the charter of, or the issuance of any shares by, the surviving corporation; and in such case the articles of merger shall contain statements showing compliance with the conditions of this Section, and, in lieu of statements relating to the vote of shareholders of the surviving corporation, need only state the approval by its board of directors.

Former N.C. GEN. STAT. § 55-108.1 (1960). The 1955 Business Corporation Act also included the following:

> The provisions of this section [relating to appraisal rights] shall not apply to a merger if on the date of the filing of the articles of merger the surviving corporation is the owner of all the outstanding shares of the other corporation or corporations, domestic or foreign, participating in the merger and if such merger makes no changes in the relative rights of the shareholders of the surviving corporation.

Former N.C. GEN. STAT. § 55-113(i) (1960). These provisions were not replaced by a short-form merger statute until North Carolina adopted its 1989 Business Corporation Act (effective July 1, 1990). *See* Act of June 8, 1989, ch. 265, 1989 N.C. Sess. Laws 566 (effective July 1, 1990); *supra* note 252 (third paragraph).

385. The concluding sentence of section 71 of the 1950 Model Act provided as follows: "The provisions of this section [relating to appraisal rights] shall not apply to a merger if on the date of the filing of the articles of merger the surviving corporation is the owner of all the outstanding shares of the other corporations, domestic or foreign, that are parties to the merger." MODEL BUS. CORP. ACT § 71 (1950), *in* 6 BUS. LAW. 1, 60 (1950).

386. *See supra* notes 285-86 and accompanying text.

387. Act of May 26, 1955, ch. 1371, 1955 N.C. Sess. Laws 1432 (effective July 1, 1957); *see supra* note 252 (second paragraph).

388. Former N.C. GEN. STAT. § 55-106(b) (1960).

389. Act of June 8, 1989, ch. 265, 1989 N.C. Sess. Laws 566 (effective July 1, 1990); *see*

or more corporations may merge into another corporation if the board of directors of each corporation adopts . . . a plan of merger."[390]

Since being rewritten in 1967,[391] Delaware's General Corporation Law has required only that "[t]he board of directors of each corporation which desires to merge . . . shall adopt a resolution approving an agreement of merger."[392] Since the rewriting of New Jersey's Business Corporation Act in 1968 (effective January 1, 1969),[393] that Act has required only that "[t]he board of each corporation shall approve a plan of merger."[394]

The 1984 Model Business Corporation Act provides for the merging of corporations "if the board of directors of each corporation adopts . . . a plan of merger."[395] It also contains (as does the North Carolina statute based thereon) a provision requiring that the board "recommend the plan of merger . . . to the shareholders, unless the board . . . determines that because of conflict of interest or other special circumstances it should make no recommendation."[396]

b. Cases and Commentary

The requirement that directors adopt or approve a plan or agreement of merger means that, instead of their deciding merely to submit the matter to shareholders, the directors themselves must make a decision to adopt or approve the plan or agreement before submitting it to the shareholders. This point was highlighted in *Smith v. Van Gorkom*,[397] when the court said:

> In the specific context of a proposed merger of domestic corporations, a director has a duty under [the statute], along with his fellow directors, to act in an informed and deliberate manner in determining whether to

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supra note 252 (third paragraph).

390. N.C. GEN. STAT. § 55-11-01(a) (1990).

391. *See* Act of July 3, 1967, ch. 50, 56 Del. Laws 151; *supra* note 251 (second paragraph).

392. DEL. CODE ANN. tit. 8, § 251(b) (Supp. 1996).

393. *See* Act of Nov. 21, 1968, ch. 350, 1968 N.J. Laws 1011 (effective Jan. 1, 1969); *supra* note 250 (second paragraph).

394. N.J. STAT. ANN. § 14A:10-1(2) (West Supp. 1997).

395. MODEL BUS. CORP. ACT ANN. § 11.01(a) (1996).

396. *Id.* § 11.03(b)(1); *see also* N.C. GEN. STAT. § 55-11-03(b)(1) (Supp. 1996) (containing the North Carolina counterpart).

It should be noted that the provision requiring that directors "adopt" the plan of merger, *see supra* text accompanying notes 390 and 395, contains no such exception based on conflict of interest or other special circumstances. *See* N.C. GEN. STAT. § 55-11-01(a) (1990); MODEL BUS. CORP. ACT ANN. § 11.01(a) (1996).

397. 488 A.2d 858 (Del. 1985).

> approve an agreement of merger before submitting the proposal to the stockholders. Certainly in the merger context, a director may not abdicate that duty by leaving to the shareholders alone the decision to approve or disapprove the agreement.[398]

(1) Directors' Fiduciary Duty

It is a matter of considerable importance to shareholders that merger decisions by a board be made subject to the directors' fiduciary duty. This is especially true in the case of extraneous-purpose mergers—those in which the purpose is something other than the fusion of two going businesses[399] and when (more often than not) a wholly owned subsidiary is used as the merger vehicle.[400]

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398. *Id.* at 873, *quoted in* Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 370 (Del. 1993); Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140, 1142 n.2 (Del. 1990); Sealy Mattress Co. v. Sealy, Inc., 532 A.2d 1324, 1337 (Del. Ch. 1987); *see also* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 n.8 (Del. 1985) (stating that director action is a prerequisite to the ultimate disposition of matters such as mergers).

399. *See* RALPH J. BAKER & WILLIAM L. CARY, CASES AND MATERIALS ON CORPORATIONS 1474-76 (3d ed. 1959) (Notes on the Use of Fusion Techniques for Special Purposes).

400. Because the clear intent of state merger statutes is to authorize the fusion of going businesses, the question inevitably arises as to whether it constitutes a misuse of those statutes to effect a merger between a going business and a shell corporation.

In the mid-1930s, it came to be established law in Delaware that dividend arrearages on preferred stock could not be eliminated through a recapitalization by way of a charter amendment. *See* Consolidated Film Indus. v. Johnson, 197 A. 489, 493 (Del. 1937); Keller v. Wilson & Co., 190 A. 115, 125 (Del. 1936). Then, in the well-known case of *Havender v. Federal United Corp.*, 2 A.2d 143 (Del. Ch. 1938), *aff'd on reargument*, 6 A.2d 618 (Del. Ch. 1939), *rev'd*, 11 A.2d 331 (Del. 1940), the Delaware courts had occasion to consider whether such a result could be accomplished by way of the merger of a parent corporation with its wholly owned subsidiary. The chancellor held that dividend arrearages could not be thus abrogated, because "the merger was not conceived in any genuine purpose which mergers are designed to serve." *Havender*, 2 A.2d at 147. On reargument, the successor chancellor reached the same conclusion as to the dividend arrearages, because the transaction "was not within the contemplation of [the merger] statute, when fairly and reasonably construed." *Havender*, 6 A.2d at 623. However, the Delaware Supreme Court reversed, holding that "a merger of a parent corporation with a subsidiary wholly owned by it is within the purview of Section 59 [then Delaware's long-form merger statute]." *Havender*, 11 A.2d at 337. While the wholly owned subsidiary involved in *Havender* was already in existence when the merger transaction was conceived, use of a shell corporation newly created for purposes of a merger was but a short step away. *See* Hottenstein v. York Ice Mach. Corp., 136 F.2d 944, 953 (3d Cir. 1943) (involving a Delaware corporation).

In other (more recent) decisions, it has been held that a merger with a wholly owned subsidiary—newly created for the purpose—can be validly effected to accomplish some extraneous purpose. *See* Bove v. Community Hotel Corp., 249 A.2d 89, 92 (R.I. 1969) (elimination of preferred stock and dividend arrearages thereon); Matteson v. Ziebarth, 242 P.2d 1025, 1031 (Wash. 1952) (en banc) (elimination of an obstructive minority

Principal among these is the freeze-out merger, whose purpose is elimination of the minority interest in a controlled corporation.[401] Other extraneous-purpose mergers include those whose objective is to change a company's state of incorporation,[402] to eliminate dividend

shareholder).

However, there is authority to the contrary. In *Bryan v. Brock & Blevins Co.*, 490 F.2d 563 (5th Cir. 1974), in upholding an injunction that barred the cash-out of a minority shareholder through the device of a merger of his corporation into a newly created shell corporation, the court sustained a construction of the Georgia merger statute that "would read out of the statute a situation where there was no pre-existing corporation to be merged, but instead where such corporation was created solely for the purpose of accomplishing an illegal result." *Id.* at 570. Use of a shell corporation as the merger vehicle in a cash-out merger was frowned upon also in *Young v. Valhi, Inc.*, 382 A.2d 1372, 1378-79 (Del. Ch. 1978).

401. A controlled corporation exists when a corporation or an individual (or cohesive group) owns a controlling interest in the stock of a corporation and is thereby in a position to have the board of directors of the controlled corporation do the bidding of the controlling party.

Such a situation may arise when the controlling party has acquired a majority stock interest at the time of the controlled corporation's organization or thereafter by way of a purchase of its stock through a tender offer or private negotiation. Examples of this situation are found in such cases as *Bryan v. Brock & Blevins Co.*, 490 F.2d 563 (5th Cir. 1974), *Singer v. Magnavox Co.*, 380 A.2d 969 (Del. 1977), *overruled in part by* Weinberger v. UOP, Inc., 457 A.2d 701, 715 (Del. 1983) (rejecting the business purpose requirement with respect to parent-subsidiary mergers), and *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983).

Such a situation may arise also when the controlling party, having once owned all of the controlled corporation's stock, retains control after a going public transaction that puts shares in the hands of minority shareholders. Examples of this situation are found in such cases as *Berkowitz v. Power/Mate Corp.*, 342 A.2d 566 (N.J. Super. Ct. Ch. Div. 1975), and *Merritt v. Colonial Foods, Inc.*, 505 A.2d 757 (Del. Ch. 1986).

For brief surveys of freeze-out techniques, see Russell M. Robinson, II, *Elimination of Minority Shareholders*, 61 N.C. L. REV. 515 (1983), and Note, *Freezing Out Minority Shareholders*, 74 HARV. L. REV. 1630 (1961).

402. For example, it was by way of a merger that, in 1970, R.J. Reynolds Tobacco Company ("Tobacco"), a New Jersey corporation, became a wholly owned subsidiary of R.J. Reynolds Industries, Inc. ("Industries"), a Delaware corporation, and the shareholders of Tobacco became (instead) shareholders of Industries. This transaction took the form of a reverse triangular merger whereby a wholly owned subsidiary of Industries was merged into Tobacco, the shareholders of Tobacco (other than dissenters) received in exchange for their Tobacco shares identical shares of Industries, and Industries received (in exchange for the stock of its disappearing subsidiary) all of the shares of a new class of Tobacco common stock. *See* R.J. REYNOLDS TOBACCO CO. PROXY STATEMENT (Mar. 16, 1970) (on file with the *North Carolina Law Review*).

A similar transaction was employed when, in 1983, Gulf Oil Corporation, a Pennsylvania corporation, became a wholly owned subsidiary of Gulf Corporation, a Delaware corporation, and the shareholders of the Pennsylvania corporation became (instead) shareholders of the Delaware corporation. *See* GULF OIL CORP. PROXY STATEMENT (Oct. 26, 1983) (on file with the *North Carolina Law Review*).

For another example of use of the merger device to change a corporation's domicile, see *infra* note 619.

arrearages on preferred stock,[403] or to terminate a derivative suit against company management.[404]

(a) Scope of Duty

In the full-blown version of the fiduciary duty of directors, there are two basic ingredients. The first is that the duty is owed to shareholders as well as to the corporation. The second is that it entails both a duty of care and a duty of loyalty.

To their credit, the courts of Delaware have adhered to the full-blown version of the directors' fiduciary duty—from the bold 1939 pronouncement in *Guth v. Loft, Inc.*[405] to the present. While Delaware has not addressed this matter in its corporation statute, its courts have been unequivocal in stating that directors owe a fiduciary duty both to the corporation and to its shareholders[406] and that such fiduciary duty entails duties of both care and loyalty.[407]

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403. The classic case is *Federal United Corp. v. Havender*, 11 A.2d 331 (Del. 1940). A more recent case is *Bove v. Community Hotel Corp.*, 249 A.2d 89 (R.I. 1969).

404. There have been cases in which a corporation was merged out of existence for the purpose or with the effect of terminating a derivative suit against the management of the disappearing corporation. *See, e.g.*, Yanow v. Teal Indus., Inc., 422 A.2d 311, 323 (Conn. 1979); Merritt v. Colonial Foods, Inc., 505 A.2d 757, 763 (Del. Ch. 1986); Braasch v. Goldschmidt, 199 A.2d 760, 767 (Del. Ch. 1964). *But see* Gaillard v. Natomas Co., 219 Cal. Rptr. 74, 76 (Ct. App. 1985) (holding that a shareholder could continue a derivative action following a merger and the resulting involuntary loss of shareholder status); Alford v. Shaw, 327 N.C. 526, 534-35, 398 S.E.2d 445, 449-50 (1990) (following *Gaillard*). For a case discussing the circumstances in which a derivative suit may or may not be pursued after the corporation, on whose behalf the suit was brought, has been merged out of existence, see *Gabhart v. Gabhart*, 370 N.E.2d 345, 356-58 (Ind. 1977).

405. 5 A.2d 503, 510 (Del. 1939); *see supra* note 288 (first paragraph) (quoting *Guth*).

406. *See* Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 360 (Del. 1993) ("In exercising these [managerial] powers, directors are charged with an unyielding fiduciary duty to protect the interests of the corporation and to act in the best interests of its shareholders."); Kaplan v. Peat, Marwick, Mitchell & Co., 540 A.2d 726, 729 (Del. 1988) ("The exercise of [the board's] managerial power is tempered by fundamental fiduciary obligations owed by the directors to the corporation and its shareholders."); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985) ("[O]ur analysis begins with the basic principle that corporate directors have a fiduciary duty to act in the best interests of the corporation's stockholders."); Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985) ("In carrying out their managerial roles, directors are charged with an unyielding fiduciary duty to the corporation and its shareholders."); Pogostin v. Rice, 480 A.2d 619, 624 (Del. 1984) ("It follows that the existence and exercise of [the board's managerial] power carries with it certain fundamental fiduciary obligations to the corporation and its shareholders."); Aronson v. Lewis, 473 A.2d 805, 811 (Del. 1984) ("The existence and exercise of [the board's managerial] power carries with it certain fundamental fiduciary obligations to the corporation and its shareholders.").

407. *See* Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1280 (Del. 1989) ("In discharging this function [of managing the business and affairs of a corporation], the directors owe fiduciary duties of care and loyalty to the corporation and its shareholders

The New Jersey courts have not addressed the fiduciary duty of directors as extensively as have the Delaware courts. Nonetheless, they have, in post-1950 decisions, said that directors have a fiduciary duty to shareholders as well as to the corporation.[408] When New Jersey's corporation law was rewritten in 1968,[409] the new statute contained the following provision: "Directors ... shall discharge their duties in good faith and with that degree of diligence, care and skill which ordinarily prudent people would exercise under similar circumstances in like positions."[410] In a 1976 New Jersey case, this statutory provision was cited in support of the statement that corporate directors "have fiduciary obligations to the corporate entity and the stockholders."[411]

When North Carolina's corporation law was rewritten in 1955 (effective July 1, 1957),[412] the new statute provided that "[o]fficers and directors shall be deemed to stand in a fiduciary relation to the corporation and to its shareholders and shall discharge the duties of

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. . . ."); Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1341 (Del. 1987) ("In meeting this [management] responsibility the board is charged with fiduciary obligations of care and loyalty."); Polk v. Good, 507 A.2d 531, 536 (Del. 1986) ("In performing their duties the directors owe fundamental fiduciary duties of loyalty and care to the corporation and its shareholders."); Revlon, Inc. v. MacAndrews & Forbes Holdings, 506 A.2d 173, 179 (Del. 1986) ("In discharging [the function of managing the business and affairs of a corporation] the directors owe fiduciary duties of care and loyalty to the corporation and its shareholders."). *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985), was a case involving the duty of care. *Guth v. Loft, Inc.*, 5 A.2d 503 (Del. 1939), was a case involving the duty of loyalty.

In *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345 (Del. 1993), the court said that "[d]uty of care and duty of loyalty are the traditional hallmarks of a fiduciary who endeavors to act in the service of a corporation and its stockholders. Each of these duties is of equal and independent significance." *Id.* at 367 (citation omitted). The court further stated that "[a] breach of either the duty of loyalty or the duty of care rebuts the [business judgment rule] presumption that the directors have acted in the best interests of the shareholders, and requires the directors to prove that the transaction was entirely fair." *Id.* at 371.

408. *See* Hill Dredging Corp. v. Risley, 114 A.2d 697, 712 (N.J. 1955) (" 'The directors of a private corporation bear a fiduciary relationship to the corporation and to its stockholders.' " (quoting, with approval, the opinion of the Superior Court, Chancery Division)); Pilat v. Broach Sys., Inc., 260 A.2d 13, 16 (N.J. Super. Ct. Law Div. 1969).

409. *See* Act of Nov. 21, 1968, ch. 350, 1968 N.J. Laws 1011 (effective Jan. 1, 1969); *supra* note 250 (second paragraph).

410. N.J. STAT. ANN. § 14A:6-14(1) (West Supp. 1997). The word "people" was substituted for the word "men" by Act of Aug. 4, 1988, ch. 94, § 33, 1988 N.J. Laws 676, 709 (effective Dec. 1, 1988).

411. 68th Street Apts., Inc. v. Lauricella, 362 A.2d 78, 84 (N.J. Super. Ct. Law Div. 1976), *aff'd per curiam*, 374 A.2d 1222 (N.J. Super. Ct. App. Div. 1977).

412. *See* Act of May 26, 1955, ch. 1371, 1955 N.C. Sess. Laws 1432 (effective July 1, 1957); *supra* note 252 (second paragraph).

their respective positions in good faith, and with that diligence and care which ordinarily prudent men would exercise under similar circumstances in like positions."[413] In a 1961 decision, the North Carolina Supreme Court stated that "[t]his statutory provision, in effect since 1957, is declaratory of the law prior to the effective date of that Act";[414] and other courts referred subsequently to the fiduciary duties of care and loyalty owed by the directors of a North Carolina corporation to shareholders as well as to the corporation.[415] When North Carolina's corporation law was rewritten in 1989,[416] the new statute stated the duty of directors in the following language:

> A director shall discharge his duties as a director, including his duties as a member of a committee:
>
> (1) In good faith;
>
> (2) With the care an ordinarily prudent person in a like position would exercise under similar circumstances; and
>
> (3) In a manner he reasonably believes to be in the best interests of the corporation.[417]

The commentary on this provision states that, although the word "fiduciary" was not used in describing the duty owed by a director to a corporation, there was no intent "to change North Carolina law in this area" or "to modify in any way the duty of directors recognized under the former law."[418]

The above-quoted provision of North Carolina's 1989 Business Corporation Act is the same as a provision of the 1984 Model Business Corporation Act,[419] which was derived from an addition made to the Model Act in 1974.[420] It does not employ the term

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413. Former N.C. GEN. STAT. § 55-35 (1982).

414. Fulton v. Talbert, 255 N.C. 183, 184, 120 S.E.2d 410, 411 (1961) (relying on *Teague v. Teague Furniture Co.*, 201 N.C. 803, 807, 161 S.E. 530, 532 (1931), and *Pender v. Speight*, 159 N.C. 612, 615, 75 S.E. 851, 852 (1912)).

415. *See* Umstead v. Durham Hosiery Mills, Inc., 578 F. Supp. 342, 345 (M.D.N.C. 1984); Meiselman v. Meiselman, 58 N.C. App. 758, 774, 295 S.E.2d 249, 259 (1982), *modified and aff'd*, 309 N.C. 279, 307 S.E.2d 551 (1983); Loy v. Lorm Corp., 52 N.C. App. 428, 436, 278 S.E.2d 897, 903 (1981) ("Directors owe a duty of fidelity and due care in the management of a corporation and must exercise their authority solely for the benefit of the corporation and all its shareholders.").

416. *See* Act of June 8, 1989, ch. 265, 1989 N.C. Sess. Laws 566 (effective July 1, 1990); *supra* note 252 (third paragraph).

417. N.C. GEN. STAT. § 55-8-30(a) (1990).

418. *Id.* § 55-8-30 commentary at 169.

419. *See* MODEL BUS. CORP. ACT ANN. § 8.30(a) (1996).

420. *See* MODEL BUS. CORP. ACT ANN. § 35, ¶ 2, at 270 n.1 (Supp. 1977); *Report of Committee on Corporate Laws: Changes in the Model Business Corporation Act*, 30 BUS.

"fiduciary" in describing the directors' duty,[421] and it does not say that the duty is owed to shareholders as well as to the corporation.[422] In this regard, the North Carolina statute has the potential for being less protective of shareholder rights than is the doctrine espoused by the Delaware judiciary.[423]

LAW. 501, 501-02 (1975).

421. The explanation for omission of the term "fiduciary," given when the 1974 addition to the Model Business Corporation Act was made, was as follows:

> The Committee also chose not to use the term "fiduciary" in the standard for directors' conduct, although it recognized that the term has been employed in certain of the existing statutes on the subject. The Committee took the view that those responsibilities of directors which are fiduciary in nature would be sufficiently comprehended in the affirmative standard adopted so as to make unnecessary the use of a term which presents the possibility of importing into the area of corporation law more than is appropriate of the attributes and obligations of a fiduciary as firmly established in the law of trusts.

MODEL BUS. CORP. ACT ANN. § 35, ¶1 commentary at 256 (Supp. 1977); *see Report of Committee on Corporate Laws: Changes in the Model Business Corporation Act, supra* note 420, at 506.

The explanation, given in the Official Comment on the 1984 Model Business Corporation Act, was as follows: "Likewise, section 8.30 does not use the term "fiduciary" in the standard for directors' conduct, because that term could be confused with the unique attributes and obligations of a fiduciary imposed by the law of trusts, some of which are not appropriate for directors of a corporation." MODEL BUS. CORP. ACT ANN. § 8.30 commentary at 8-168 (1996).

One must observe that the courts of Delaware appear to believe that they have the competence to surmount these supposed difficulties. *See supra* notes 405-07 and accompanying text.

422. There appears to be no explanation for this in the Official Comment on the 1984 Model Business Corporation Act. The only explanation given in the North Carolina Commentary is as follows:

> Former G.S. 55-35 provided that officers and directors stand in a fiduciary relation "to the corporation and to its shareholders." The drafters decided not to bring forward the words "and to its shareholders" in order to avoid an interpretation that there is a duty running directly from directors to the shareholders that would give shareholers [sic] a direct right of action on claims that should be asserted derivatively.

N.C. GEN. STAT. § 55-8-30 commentary at 169 (1990).

423. In the writer's view, North Carolina's 1989 Business Corporation Act and the 1984 Model Business Corporation Act (upon which the North Carolina Act is based) should contain an unmistakable declaration that "officers and directors owe fiduciary duties of care and loyalty to the corporation and to its shareholders." As was stated in a recent article:

> Trust, as George Shultz said in another connection, is the "coin of the realm." Trust that the people with whom you deal will not only obey the law but also fulfill the fiduciary responsibilities inherent in their relationships is as essential to the working of the capitalist system as a sound currency and a reliable legal system. Those who weaken that trust are sabotaging capitalism.

Herbert Steth, *Blame Junk Bond Dealers, Not Junk Bonds*, WALL ST. J., Feb. 23, 1990, at A10.

(b) Content of Duty of Loyalty

The duty of care is, of course, a matter of importance in safeguarding the rights of shareholders. Of greater importance—especially in the context of extraneous-purpose mergers—is the duty of loyalty.[424]

Some of the numerous components of the duty of loyalty need to be highlighted. In their dealings affecting shareholders, directors must act in good faith[425] and with complete candor.[426] Further, the duty of loyalty requires that directors not use their fiduciary position to benefit themselves to the detriment of any shareholder.[427]

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424. *See* Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993) ("This Court has traditionally and consistently defined the duty of loyalty of officers and directors to their corporation and its shareholders in broad and unyielding terms ...."); Anadarko Petroleum Corp. v. Panhandle E. Corp., 545 A.2d 1171, 1174 (Del. 1988) ("It is a basic principle of Delaware General Corporation Law that directors are subject to the fundamental fiduciary duties of loyalty and disinterestedness. Specifically, directors cannot stand on both sides of the transaction nor derive any personal benefit through self-dealing.").

425. In *Sealy Mattress Co. v. Sealy, Inc.*, 532 A.2d 1324 (Del. Ch. 1987), the court said: "The corporation's directors were obliged to make an informed, deliberate judgment, in good faith, that the merger terms, including the price, were fair and that the merger would not become a vehicle for economic oppression." *Id.* at 1335.

In *Alpert v. 28 Williams Street Corp.*, 473 N.E.2d 19 (N.Y. 1984), the court said that directors and majority shareholders "have an obligation to all shareholders to adhere to fiduciary standards of conduct and to exercise their [managerial] responsibilities in good faith when undertaking any corporate action, including a merger." *Id.* at 25.

In *Wilson v. McClenny*, 262 N.C. 121, 136 S.E.2d 569 (1964), the court referred to the "good faith [the law] exacts from directors and other fiduciaries." *Id.* at 129, 136 S.E.2d at 575.

426. In *Lynch v. Vickers Energy Co.*, 383 A.2d 278 (Del. 1977), the court insisted that disclosure to shareholders should be complete rather than merely adequate. *See id.* at 281. Then, in *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983), after citing *Lynch*'s rule of complete candor, the court said: "This is merely stating in another way the long-existing principle of Delaware law that these Signal designated directors on UOP's board still owed UOP and its shareholders an uncompromising duty of loyalty." *Id.* at 710.

The fiduciary duty of full disclosure received attention in a number of later Delaware decisions. *See, e.g.*, Arnold v. Society for Sav. Bancorp, Inc., 650 A.2d 1270, 1276-77 (Del. 1994); Zirn v. VLI Corp., 621 A.2d 773, 778-79 (Del. 1993); Stroud v. Grace, 606 A.2d 75, 85-88 (Del. 1992); Kahn v. Household Acquisition Corp., 591 A.2d 166, 171 (Del. 1991); Rosenblatt v. Getty Oil Co., 493 A.2d 929, 944-45 (Del. 1985).

In *Alpert v. 28 Williams Street Corp.*, 473 N.E.2d 19 (N.Y. 1984), the court said: "Moreover, all corporate responsibilities [of directors] must be discharged in good faith and with 'conscientious fairness, morality and honesty in purpose.' Also imposed are the obligations of candor and of good and prudent management of the corporation." *Id.* at 26 (citations omitted) (quoting Kavanaugh v. Kavanaugh Knitting Co., 123 N.E. 148, 151 (N.Y. 1919)).

427. *See* Jones v. Missouri-Edison Elec. Co., 144 F. 765, 771 (8th Cir. 1906); Treadway Cos., Inc. v. Care Corp., 490 F. Supp. 660, 666 (S.D.N.Y. 1980) ("A director [of a New Jersey corporation] must act to further the best interests of the corporation, and may not

Moreover, this duty requires that directors refrain from any disparate treatment of holders of a given class of the corporation's stock,[428] unless there is some overriding corporate purpose to be served by

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utilize his powers to further a personal interest."), *aff'd in part and rev'd in part on other grounds*, 638 F.2d 357 (2d Cir. 1980); Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361-62 (Del. 1993); Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939) ("Corporate officers and directors are not permitted to use their position of trust and confidence to further their private interests. While technically not trustees, they stand in a fiduciary relation to the corporation and its stockholders."); Berkowitz v. Power/Mate Corp., 342 A.2d 566, 571 (N.J. Super. Ct. Ch. Div. 1975) ("Those who control the affairs and conduct of a corporation . . . have a fiduciary duty to all the stockholders and the powers they have by virtue of their majority status are powers held by them in trust. They cannot use their powers for their own personal advantage and to the detriment of the minority stockholders." (citation omitted)); Abbot v. American Hard Rubber Co., 33 Barb. 578, 593-94 (N.Y. App. Div. 1861) ("It requires no authority to establish the fact, that the directors of the 'American Hard Rubber Company' could not have transferred the property of the corporation directly to themselves, or to a corporation in which they were stockholders and directors."); *see also* Crosby v. Beam, 548 N.E.2d 217, 220-21 (Ohio 1989) (stating that majority shareholders owe a fiduciary duty to minority shareholders and that control "cannot be used to give the majority benefits which are not shared by the minority").

428. *See* Eagleson v. Pacific Timber Co., 270 F. 1008, 1010 (D. Del. 1920); Alaska Plastics, Inc. v. Coppock, 621 P.2d 270, 276-77 (Alaska 1980); Alpert v. 28 Williams St. [illegible] N.E.2d 19, 26-28 (N.Y. 1984) ("The fiduciary must treat all shareholders, [illegible] and minority, fairly. . . . As mentioned, there exists a fiduciary duty to treat all [illegible]olders equally."); Schwartz v. Marien, 335 N.E.2d 334, 337 (N.Y. 1975) [illegible]nbers of a corporate board of directors . . . owe a fiduciary responsibility to the [illegible]lders in general and to individual shareholders in particular to treat all [illegible]lders fairly and evenly."); A.A. Berle, Jr., *Corporate Powers as Powers in Trust*, [illegible]. L. REV. 1049, 1049 (1931).

[illegible] other cases applying the rule against disparate treatment of shareholders, see [illegible]es 900-01 and accompanying text.

[illegible] North Carolina Commentary on the basic merger provision of its 1989 Business [illegible]tion Act contains the following:

> The third sentence of the second paragraph of the "Official Comment" to [illegible]on 11.01 of the [1984] Model Act indicates that a plan of merger can [illegible]iminate among holders of shares of the same class in the kind of property [illegible] receive in a merger. The drafters believed that this sentence does not [illegible]ct the current law in North Carolina. They believed that the current law [illegible] not permit discrimination among the holders of shares of a single class in [illegible]kind of property that can be received in a merger; all the shares of a single [illegible] must be treated the same, both in value and kind. Therefore, the drafters [illegible] their disagreement with this sentence in the "Official Comment."

[illegible]. STAT. § 55-11-01 commentary at 224 (1990).

[illegible]*pare* Lewis v. Clark, 911 F.2d 1558, 1560-61 (11th Cir. 1990) (per curiam) [illegible] to condone disparate treatment of majority and minority shareholders in a cash-[illegible]er), *with* NoDak Bancorporation v. Clarke, 998 F.2d 1416, 1424 (8th Cir. 1993) [illegible] the *Lewis* view and concluding that "freeze out mergers are completely [illegible]le as long as the dissenting shareholders are given their appropriate appraisal [illegible]).

different treatment of such shareholders.[429]

But the overarching component of the duty of loyalty—perhaps subsuming those to which reference has just been made—is the requirement of fairness. While sometimes stated as an independent standard for the validity of a merger,[430] the requirement of fairness would seem to be a logical derivation from the directors' fiduciary duty of loyalty.[431] Recent statements of this requirement of fairness have recognized two components of the requirement—fair dealing and fair price.[432]

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429. *See* Alpert v. 28 Williams St. Corp., 473 N.E.2d 19, 27-28 (N.Y. 1984) (holding that only a proper corporate purpose would serve to override the duty of treating all shareholders evenly and thereby justify a cash-out merger's variant treatment of minority shareholders); Schwartz v. Marien, 335 N.E.2d 334, 338 (N.Y. 1975) ("Departure from precisely uniform treatment of stockholders may be justified, of course, where a bona fide business purpose indicates that the best interests of the corporation would be served by such departure.").

In *Nixon v. Blackwell*, 626 A.2d 1366 (Del. 1993) (en banc), the court said:

> It is well established in our jurisprudence that stockholders need not always be treated equally for all purposes. See *Unocal Corp. v. Mesa Petroleum Co.* (discriminatory exchange offer held valid); and *Cheff v. Mathes* (selective stock repurchase held valid).

Id. at 1376-77 (citations omitted). In both *Unocal* and *Cheff*, the variant treatment of shareholders was condoned on the basis of a perceived threat to corporate policy and effectiveness. *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954-57 (Del. 1985); Cheff v. Mathes, 199 A.2d 548, 554-56 (Del. 1964).

430. *See* Havender v. Federal United Corp., 6 A.2d 618, 622 (Del. Ch. 1939) ("The defendant necessarily concedes ... that if the plan adopted in a corporate merger is not fair and equitable to the interested stockholders, it will always be enjoined by a Court of Equity."), *rev'd on other grounds*, 11 A.2d 331 (Del. 1940); Brundage v. New Jersey Zinc Co., 226 A.2d 585, 596 (N.J. 1967) (referring to "the settled and continuing New Jersey doctrine that a merger, even though it complies procedurally with the statutory requirements, must also satisfy basic equitable requirements of good faith and fair treatment").

431. *See* Harman v. Masoneilan Int'l, Inc., 442 A.2d 487, 492 (Del. 1982) ("In *Sterling*, ... this Court recognized as a 'settled' rule of law in Delaware that a majority shareholder and its director designees occupy a fiduciary relationship to the minority shareholders from which springs a duty of fairness in dealing with the minority's property interests." (citing Sterling v. Mayflower Hotel Corp., 93 A.2d 107, 109-10 (Del. 1952))).

432. In *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983), the court said:

> The concept of fairness has two basic aspects: fair dealing and fair price. The former embraces questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained. The latter aspect of fairness relates to the economic and financial considerations of the proposed merger, including all relevant factors: assets, market value, earnings, future prospects, and any other elements that affect the intrinsic or inherent value of a company's stock.

Id. at 711.

Similarly, in *Alpert v. 28 Williams Street Corp.*, 473 N.E.2d 19 (N.Y. 1984), the court said:

(c) Charter Option Exculpatory Provisions

Reference needs to be made to the "charter option" statutes enacted in the aftermath of the 1985 decision in *Smith v. Van Gorkom*.[433] In general, those statutes authorize the inclusion in corporate charters (originally or by amendment) of exculpatory provisions that limit or eliminate personal liability of directors for money damages for breach of their duty of care (except in the case of certain specified actions).[434] The Delaware statute expressly states that such a charter provision shall not eliminate or limit the liability of a director for "any breach of the director's duty of loyalty to the corporation or its stockholders,"[435] and the New Jersey statute has a

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> In reviewing a freeze-out merger, the essence of the judicial inquiry is to determine whether the transaction, viewed as a whole, was "fair" as to all concerned. This concept has two principal components: the majority shareholders must have followed "a course of fair dealing toward minority holders"; and they must also have offered a fair price for the minority's stock.

Id. at 26 (citations omitted).

433. 488 A.2d 858 (Del. 1985); *see also* R. Franklin Balotti & Mark J. Gentile, *Elimination or Limitation of Director Liability for Delaware Corporations*, 12 DEL. J. CORP. L. 5, 6-11 (1987) (describing the decline in availability of directors' liability insurance, and the reluctance of individuals to serve as directors, in the aftermath of *Van Gorkom* and subsequent decisions).

434. *See* Committee on Corporate Laws, *Changes in the Revised Model Business Corporation Act—Amendment Pertaining to the Liability of Directors*, 45 BUS. LAW. 695, 696-97 (1990).

435. The Delaware statute, added by Act of June 18, 1986, ch. 289, § 2, 65 Del. Laws 544, 544 (effective July 1, 1986), provides as follows:

> (b) In addition to the matters required to be set forth in the certificate of incorporation by subsection (a) of this section, the certificate of incorporation may also contain any or all of the following matters:
>
> . . . .
>
> (7) A provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, provided that such provision shall not eliminate or limit the liability of a director: (i) For any breach of the director's duty of loyalty to the corporation or its stockholders; (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law; (iii) under § 174 of this title [regarding liability for unlawful distributions]; or (iv) for any transaction from which the director derived an improper personal benefit. No such provision shall eliminate or limit the liability of a director for any act or omission occurring prior to the date when such provision becomes effective. . . .

DEL. CODE ANN. tit. 8, § 102(b) (Supp. 1996).

In *Zirn v. VLI Corp.*, 621 A.2d 773 (Del. 1993), it was held that the fiduciary duty of disclosure is embraced by the duty of loyalty and therefore is within the first exception set forth in section 102(b)(7). *See id.* at 783. Surprisingly, however, in *Arnold v. Society for Savings Bancorp, Inc.*, 650 A.2d 1270 (Del. 1994) (en banc), the court backed away from the concept that the disclosure duty is embraced within the duty of loyalty, taking the position (instead) that "fiduciary disclosure requirements ... were ... not excepted

similar limitation.[436] The comparable North Carolina statute, on the other hand, purports to authorize a charter provision limiting or eliminating the personal liability of a director for monetary damages for breach of "any duty" as a director (with some stated exceptions).[437] The breadth of this statute has been criticized,[438] and it may be that the reference to "any duty" will be construed to extend

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expressly from coverage" by section 102(b)(7). *Id.* at 1286-88.

436. The New Jersey statute, added by Act of Feb. 4, 1987, ch. 35, § 1, 1987 N.J. Laws 108, 110, and amended by Act of Feb. 4, 1989, ch. 17, § 1, 1989 N.J. Laws 102, 103, provides as follows:

> The certificate of incorporation may provide that a director or officer shall not be personally liable, or shall be liable only to the extent therein provided, to the corporation or its shareholders for damages for breach of any duty owed to the corporation or its shareholders, except that such provision shall not relieve a director or officer from liability for any breach of duty based upon an act or omission (a) in breach of such person's duty of loyalty to the corporation or its shareholders, (b) not in good faith or involving a knowing violation of law or (c) resulting in receipt by such person of an improper personal benefit. As used in this subsection, an act or omission in breach of a person's duty of loyalty means an act or omission which that person knows or believes to be contrary to the best interests of the corporation or its shareholders in connection with a matter in which he has a material conflict of interest.

N.J. STAT. ANN. § 14A:2-7(3) (West Supp. 1997).

437. The North Carolina statute, as derived from Act of July 22, 1987, ch. 626, § 1, 1987 N.C. Sess. Laws 1113, 1113 (effective Oct. 1, 1987), and amended by Act of July 24, 1993, ch. 552, § 6, 1993 N.C. Sess. Laws 2912, 2915 (effective Oct. 1, 1993), provides as follows:

> (b) The articles of incorporation may set forth any provision that under this Chapter is required or permitted to be set forth in the bylaws, and may also set forth:
>
> . . . .
>
> (3) A provision limiting or eliminating the personal liability of any director arising out of an action whether by or in the right of the corporation or otherwise for monetary damages for breach of any duty as a director. No such provision shall be effective with respect to (i) acts or omissions that the director at the time of such breach knew or believed were clearly in conflict with the best interests of the corporation, (ii) any liability under G.S. 55-8-33 [regarding liability for unlawful distributions], (iii) any transaction from which the director derived an improper personal benefit, or (iv) acts or omissions occurring prior to the date the provisions [sic] became effective. As used herein, the term "improper personal benefit" does not include a director's reasonable compensation or other reasonable incidental benefit for or on account of his service as a director, officer, employee, independent contractor, attorney, or consultant of the corporation. . . .

N.C. GEN. STAT. § 55-2-02(b) (Supp. 1996). The phrase "any duty" read "his duty" in the 1987 version of the statute.

438. *See* Thomas Lee Hazen, *Corporate Directors' Accountability: The Race to the Bottom—The Second Lap*, 66 N.C. L. REV. 171, 173, 181 (1987).

only to the duty of care and not to the duty of loyalty.[439]

Following a proposal made in 1990,[440] a charter option provision was added to the Model Business Corporation Act. As in the case of the North Carolina statute, the Model Act provision contains no express exception with respect to a breach of the duty of loyalty.[441]

One can agree that, on the facts of the case, the court in *Van Gorkom* erred in not according to the defendant directors the protection of the business judgment rule.[442] But one can still regret the legislative response in the form of these charter option provisions—especially when it is recognized that "in some cases the votes of the directors themselves as shareholders may be sufficient to approve adoption of the [exculpatory] provision."[443]

(2) Inherited Duty Owed by Controlling Shareholders

The doctrine concerning the fiduciary duty owed by controlling shareholders to the minority, espoused so well in 1923 in *Allied Chemical & Dye Corp. v. Steel & Tube Co. of America*,[444] has continued to be valid.[445] While it is generally understood that a

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439. Robinson states: "The practical effect of the statute can be generally described as permitting the shareholders of a corporation to limit or eliminate breach of the duty of care as the basis of a claim for money damages." ROBINSON, *supra* note 226, at 394.

440. *See* Committee on Corporate Laws, *supra* note 434, at 699-700.

441. The Model Act provides as follows:

> (b) The articles of incorporation may set forth:
>
> ....
>
> (4) a provision eliminating or limiting the liability of a director to the corporation or its shareholders for money damages for any action taken, or any failure to take any action, as a director, except liability for (A) the amount of a financial benefit received by a director to which he is not entitled; (B) an intentional infliction of harm on the corporation or the shareholders; (C) a violation of section 8.33 [regarding liability for unlawful distributions]; or (D) an intentional violation of criminal law ....
>
> ....

MODEL BUS. CORP. ACT ANN. § 2.02(b) (1996).

442. *See* Daniel R. Fischel, *The Business Judgment Rule and the* Trans Union *Case*, 40 BUS. LAW. 1437, 1438, 1445-55 (1985).

443. MODEL BUS. CORP. ACT ANN. § 2.02 commentary at 2-18 (1996).

444. 120 A. 486, 491 (Del. Ch. 1923) (quoted *supra* in note 289 (second paragraph)).

445. *See* Yanow v. Teal Indus., Inc., 422 A.2d 311, 322 (Conn. 1979) ("The rule of corporation law and of equity invoked is well-settled: the majority has the right to control, but when it does so, it occupies a fiduciary relationship toward the minority, as much as the corporation itself or its officers and directors."); Singer v. Magnavox Co., 380 A.2d 969, 976 (Del. 1977) ("It is a settled rule of law in Delaware that Development, as the majority stockholder of Magnavox, owed to the minority stockholders of that corporation, a fiduciary obligation in dealing with the latter's property."), *overruled on other grounds by* Weinberger v. UOP, Inc., 457 A.2d 701, 715 (Del. 1983); Epstein v. Celotex Corp., 238 A.2d 843, 847 (Del. Ch. 1968) (quoting with approval the second half

shareholder (including a majority holder) is free to vote shares in the shareholder's own self-interest,[446] it is also recognized that, when a controlling shareholder (whether an individual or cohesive group, or the parent of a subsidiary) selects the directors and controls their board decisions, the controlling shareholder thereby takes on the fiduciary duties owed by those directors.[447] In such a context, the

of the court's statement from *Allied Chemical*, 120 A. at 491, as set forth *supra* in note 289 (second paragraph)); Brundage v. New Jersey Zinc Co., 226 A.2d 585, 599 (N.J. 1967) ("G & W [parent] was undoubtedly a dominating influence in putting through the merger. As holder of the majority stock in Zinc [subsidiary] on whose board of directors it was represented, it had affirmative fiduciary responsibilities to Zinc's minority stockholders."); Freese v. Smith, 110 N.C. App. 28, 37, 428 S.E.2d 841, 847 (1993) ("In North Carolina, it is well established that a controlling shareholder owes a fiduciary duty to minority shareholders.").

446. *See* Williams v. Geier, 671 A.2d 1368, 1380-81 (Del. 1996) (en banc) ("Stockholders (even a controlling stockholder bloc) may properly vote in their own economic interest, and majority stockholders are not to be disenfranchised because they may reap a benefit from corporate action which is regular on its face."); Bershad v. Curtiss-Wright Corp., 535 A.2d 840, 845 (Del. 1987) ("Stockholders in Delaware corporations have a right to control and vote their shares in their own interest. They are limited only by any fiduciary duty owed to other stockholders."); Tanzer v. International Gen. Indus., Inc., 379 A.2d 1121, 1124 (Del. 1977) ("In sum, for more than fifty years our Courts have held, consistent with the general law on the subject, that a stockholder in a Delaware corporation has a right to vote his shares in his own interest, including the expectation of personal profit, limited, of course, by any duty he owes to other stockholders."); Norton v. Union Traction Co., 110 N.E. 113, 120 (Ind. 1915) ("As a general rule, stockholders are not regarded as trustees for one another, but each may, as a member of the corporate body, exercise the right of voting, even on a proposition in which he has an interest not in common with other stockholders."); Boss v. Boss, 200 A.2d 231, 235 (R.I. 1964) ("It is true that a director represents all the stockholders and in the exercise of his office as director stands in a fiduciary relation to them which prevents him from using his office for his personal benefit at their expense, but when voting as a stockholder he 'has the legal right to vote with a view to his own benefit ....' " (quoting 13 AM. JUR. *Corporations* § 997 (Supp. 1963))).

447. *See* Perlman v. Feldmann, 219 F.2d 173, 176 (2d Cir. 1955) ("[T]he same rule [as that applicable to a director] should apply to [the individual defendant's] fiduciary duties as majority stockholder, for in that capacity he chooses and controls the directors, and thus is held to have assumed their liability."); Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1344 (Del. 1987) ("Under Delaware law a shareholder owes a fiduciary duty only if it owns a majority interest in or exercises control over the business affairs of the corporation."); Robotham v. Prudential Ins. Co., 53 A. 842, 848 (N.J. Ch. 1903) ("But these [cited] authorities only hold, in effect, that the fiduciary relation arises when the majority stockholder assumes control of the corporation and dictates the action of the directors."); Kavanaugh v. Kavanaugh Knitting Co., 123 N.E. 148, 151-52 (N.Y. 1919) ("When a number of stockholders constitute themselves ... the managers of corporate affairs or interests, they stand in much the same attitude towards the other or minority stockholders that the directors sustain generally towards all the stockholders, and the law requires of them the utmost good faith."); Levy v. American Beverage Corp., 38 N.Y.S.2d 517, 525 (App. Div. 1942) ("A majority stockholder does not become a fiduciary for other stockholders by reason merely of ownership of his stock. It is only where he steps out of his role as a stockholder, and acts in the management and conduct

controlling shareholder—by exercising the decision-making authority of the board—inherits the duties of care and loyalty owed by directors to the corporation and its shareholders.[448]

Moreover, it has continued to be the case, as in earlier years,[449] that, when a controlling shareholder brings about an interested-party merger, such controlling shareholder bears the burden of proving the entire fairness of the transaction.[450] The burden of persuasion on the

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of the corporation, ... that he is said actually to become a fiduciary instead of a mere stockholder.").

In *Jones v. Missouri-Edison Electric Co.*, 144 F. 765 (8th Cir. 1906), the court said:

> A combination of the holders of a majority or of three-fifths of the stock of a corporation to elect directors, to dictate their acts and the acts of the corporation for the purpose of carrying out a predetermined plan places the holders of such stock in the shoes of the corporation and constitutes them actual, if not technical trustees for the holders of the minority of the stock. The devolution of power imposes correlative duty. The members of such a combination become in practical effect the corporation itself because they draw to themselves and use the powers of the corporation.

Id. at 771. And, in *Lynch v. Vickers Energy Corp.*, 351 A.2d 570 (Del. Ch. 1976), *rev'd on other grounds*, 383 A.2d 278 (Del. 1977), the court said:

> [T]here is no doubt but that in situations in which the holder of a majority of the voting shares of a corporation ... seeks to impose its will upon minority stockholders, the conduct of such majority must be tested by those same standards of fiduciary duty which directors must observe in their relations with all their stockholders....

Id. at 573.

448. *See* Zahn v. Transamerica Corp., 162 F.2d 36, 42, 45-46 (3d Cir. 1947); Lebold v. Inland Steel Co., 125 F.2d 369, 372-73 (7th Cir. 1941); Gaines v. Long Mfg. Co., 234 N.C. 340, 344-45, 67 S.E.2d 350, 353-54 (1951); David Finch & Robert Long, Comment, *The Fiduciary Relation of the Dominant Shareholder to the Minority Shareholders*, 9 HASTINGS L.J. 306, 308 (1958).

In *Jones v. H.F. Ahmanson & Co.*, 460 P.2d 464 (Cal. 1969), the court said: "Majority shareholders may not use their power to control corporate activities to benefit themselves alone or in a manner detrimental to the minority. Any use to which they put the corporation or their power to control the corporation must benefit all shareholders proportionately...." *Id.* at 471. And, in *Linge v. Ralston Purina Co.*, 293 N.W.2d 191 (Iowa 1980) (en banc), the court said: "By being in a position to manage corporate affairs through control of the board of directors, a majority shareholder is in the same [fiduciary] relationship to minority shareholders as the directors themselves." *Id.* at 194.

449. *See supra* note 291 and accompanying text.

450. Probably the most frequently cited statement of this principle is that contained in *Sterling v. Mayflower Hotel Corp.*, 93 A.2d 107 (Del. 1952), the court saying:

> Plaintiffs invoke the settled rule of law that Hilton as majority stockholder of Mayflower and the Hilton directors as its nominees [on Mayflower's board] occupy, in relation to the minority, a fiduciary position in dealing with Mayflower's property. Since they stand on both sides of the [merger] transaction, they bear the burden of establishing its entire fairness, and it must pass the test of careful scrutiny by the courts.

Id. at 109-10; *see also* Kahn v. Lynch Communication Sys., Inc., 638 A.2d 1110, 1115 (Del. 1994) ("A controlling or dominating shareholder standing on both sides of a transaction,

issue of entire fairness can be shifted by the controlling shareholder to a complaining minority shareholder of the controlled corporation,[451] but only (i) if the terms of the merger are negotiated in good faith by a committee of independent and disinterested directors of the controlled corporation capable of engaging in arm's length negotiation,[452] or (ii) if consummation of the merger is conditioned upon the favorable vote of a majority of the shares owned by minority shareholders and they have been fully informed concerning the transaction.[453]

2. Changes in Requirements for Shareholder Approval[454]

a. Authorization of Short-Form Merger

One of the liberalizing steps taken by the three subject states after 1950 was authorization of the short-form merger. While seemingly a simple subject, the enabling statutes were actually somewhat complicated, and there were significant variations among the three states.

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as in a parent-subsidiary context, bears the burden of proving its entire fairness."); Freese v. Smith, 110 N.C. App. 28, 37, 428 S.E.2d 841, 847 (1993) ("Once a minority shareholder challenges the actions of the majority, the burden shifts to the majority to establish the fairness and good faith of its actions.").

451. *See* Citron v. E.I. Du Pont de Nemours & Co., 584 A.2d 490, 500-02 (Del. Ch. 1990).

452. *See* Weinberger v. UOP, Inc., 457 A.2d 701, 709 n.7 (Del. 1983) ("Although perfection is not possible, or expected, the result here could have been entirely different if UOP had appointed an independent negotiating committee of its outside directors to deal with Signal at arm's length.").

However, the burden is not shifted by utilization of a special negotiating committee if the court concludes that the committee lacked true bargaining power. *See* Kahn v. Lynch Communication Sys., Inc., 638 A.2d 1110, 1117, 1120-21 (Del. 1994).

453. *See* Rosenblatt v. Getty Oil Co., 493 A.2d 929, 937 (Del. 1985) ("[A]pproval of a merger, as here, by an informed vote of a majority of the minority shareholders, while not a legal prerequisite, shifts the burden of proving the unfairness of the merger entirely to the plaintiffs.").

However, the burden is not shifted by a "majority of the minority" vote if the court concludes that there was a failure to inform minority shareholders of all material facts. *See Weinberger*, 457 A.2d at 703.

454. This Article does not address the new section 251(g) of title 8 of the Delaware Code Annotated, which was added to Delaware's General Corporation Law by Act of June 23, 1995, ch. 79, § 15, 70 Del. Laws 118, 120-21 (effective July 1, 1995).

(1) Statutory Provisions

(a) Delaware

In 1957, Delaware amended section 253 of its General Corporation Law,[455] changing it from a statute authorizing only parent-subsidiary mergers (when the parent owns all of the stock of the subsidiary)[456] to one authorizing short-form mergers (when the parent owns at least 90% of the outstanding shares of each class of the subsidiary's stock).[457] The key feature of the short-form merger is that (with the exceptions noted below) it can be effected solely by action of the parent's board of directors—with neither voting nor appraisal rights accorded to the parent's shareholders, and with only appraisal rights accorded to minority shareholders of the subsidiary.

One difference between Delaware's 1937 parent-subsidiary merger statute and its 1957 short-form merger statute involved the

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455. *See* Act of June 5, 1957, ch. 121, § 6, 51 Del. Laws 186, 188-90.

456. *See supra* notes 381-82 and accompanying text.

457. The Delaware short-form merger statute provides as follows:

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

DEL. CODE ANN. tit. 8, § 253(a) (Supp. 1996).

matter of mergers with foreign corporations. The earlier statute made the simplified procedure for a parent-subsidiary merger available only when the parent was a Delaware corporation, even though the subsidiary could be a corporation of another state if that state's laws authorized such a merger.[458] On the other hand, the short-form merger statute, as enacted in 1957, could be utilized even if the parent was a corporation of another state, provided that that state's laws authorized such a merger.[459]

In a significant departure from the then-existing Delaware limitation with respect to long-form mergers,[460] the 1957 statute made

458. *See supra* notes 381-82 and accompanying text.

459. The 1957 version of section 253(a)—as enacted by Act of June 5, 1957, ch. 121, § 6, 51 Del. Laws 186, 188—began as follows:

> Any corporation organized or existing under the laws of this State, or under the laws of any other state or jurisdiction subject to the laws of the United States, if the laws of such other state or jurisdiction shall permit such a merger, owning at least ninety per centum of the outstanding shares of each class of the stock of any other corporation organized or existing under the laws of this State, or under the laws of any other state or jurisdiction subject to the laws of the United States, if the laws of such other state or jurisdiction shall permit such a merger, may....

Id. The 1967 rewrite of section 253(a)—as enacted by Act of July 3, 1967, ch. 50, sec. 1, § 253(a), 56 Del. Laws 151, 209-10—changed the introductory language to read more nearly like that of the current version, *see supra* note 457. By Act of Jan. 2, 1968, ch. 186, § 18, 56 Del. Laws 610, 613-14 (1967), "the District of Columbia" was added for treatment like another state. Further (minor) changes in the introductory language of section 253(a) were made by Act of June 23, 1969, ch. 148, § 24, 57 Del. Laws 433, 447 (effective July 15, 1969).

By Act of July 3, 1967, ch. 50, sec. 1, § 253(e), 56 Del. Laws 151, 211, the following subsection was added:

> A merger may be effected under this section although one or more of the corporations parties to the merger is a corporation organized under the laws of a jurisdiction other than one of the United States; provided that the laws of such jurisdiction permit such a merger; and provided further that the surviving or resulting corporation shall be a corporation of this State.

Former DEL. CODE ANN. tit. 8, § 253(e) (Cum. Supp. 1968). Enactment of this provision had the effect of overturning a dictum in *Braasch v. Goldschmidt*, 199 A.2d 760 (Del. Ch. 1964), to the effect that "[t]he statute [i.e., section 253 as it read then], by necessary implication, precludes mergers between domestic corporations and alien corporations, that is, those created under the laws of a foreign country," *id.* at 763. *See* ERNEST L. FOLK, III, THE DELAWARE GENERAL CORPORATION LAW, A COMMENTARY AND ANALYSIS 354 (1972). By Act of June 23, 1969, ch. 148, § 24, 57 Del. Laws 433, 447-48 (effective July 15, 1969), the first proviso of section 253(e), as quoted above (although erroneously referred to in the amending statute as subsection (c)), was changed to read: "provided that the laws of such jurisdiction permit a corporation of such jurisdiction to merge with a corporation of another jurisdiction." By Act of July 1, 1993, ch. 61, § 8, 69 Del. Laws 54, 54, the second proviso of section 253(e), as quoted above, was deleted.

460. *See supra* notes 316-18 and accompanying text.

cash a permissible form of consideration in a short-form merger.[461] It provided that, when the parent owned less than all of the subsidiary's outstanding stock, the resolution of the parent's board was to state the terms and conditions of the merger, "including the securities, cash or other consideration to be issued, paid or delivered by the parent corporation upon surrender of each share of the merged corporation not owned by the parent corporation."[462]

The 1957 Delaware short-form merger statute permitted only upstream (subsidiary into parent) mergers.[463] However, when Delaware's General Corporation Law was rewritten in 1967,[464] the new version of its short-form merger statute permitted downstream (parent into subsidiary) as well as upstream mergers.[465] The 1967 statute provided that, when the parent is not the surviving corporation, "the resolution shall include provision for the pro rata issuance of stock of the surviving corporation to the holders of the stock of the parent corporation on surrender of the certificates therefor."[466] It further required that a downstream merger be approved by the holders of a majority of the stock of the parent corporation; however, the required vote was changed, in 1969, to "a majority of the outstanding stock of the parent corporation entitled

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461. *See* Act of June 5, 1957, ch. 121, § 6, 51 Del. Laws 186, 188-90.

462. *Id.* § 6, 51 Del. Laws at 188. By Act of July 3, 1967, ch. 50, sec. 1, § 253, 56 Del. Laws 151, 209, the quoted language was changed to read: "including the securities, cash or other property to be issued, paid or delivered by the surviving corporation upon surrender of each share of the subsidiary corporation or corporations not owned by the parent corporation." By Act of June 23, 1969, ch. 148, § 24, 57 Del. Laws 433, 447, it was changed further to read: "including the securities, cash, property, or rights to be issued, paid, delivered or granted by the surviving corporation upon surrender of each share of the subsidiary corporation or corporations not owned by the parent corporation." This is the language of the current statute. *See* DEL. CODE ANN. tit. 8, § 253(a) (Supp. 1996) (quoted *supra* in note 457).

463. *See* Act of June 5, 1957, ch. 121, § 6, 51 Del. Laws 186, 188-89.

464. *See* Act of July 3, 1967, ch. 50, 56 Del. Laws 151; *supra* note 251 (second paragraph).

465. *See* former DEL. CODE ANN. tit. 8, § 253(a) (Cum. Supp. 1968). This feature, as enacted by Act of July 3, 1967, ch. 50, sec. 1, § 253(a), 56 Del. Laws 151, 209-10, continues in effect. *See supra* note 457.

466. Former DEL. CODE ANN. tit. 8, § 253(a) (Cum. Supp. 1968) (as enacted by Act of July 3, 1967, ch. 50, sec. 1, § 253(a), 56 Del. Laws 151, 210). This provision was amended (in a minor respect) by Act of July 8, 1983, ch. 112, § 36, 64 Del. Laws 285, 290 (effective July 1, 1983). For the current (almost identical) language, see *supra* note 457.

By Act of July 9, 1987, ch. 136, § 26, 66 Del. Laws 335, 338 (effective July 1, 1987), a clarification of the downstream provision was made to cover cases in which the parent was not a Delaware corporation. The clarifying language appears at the end of the second sentence quoted *supra* in note 457.

to vote thereon."[467]

Shareholders of a Delaware parent corporation are not accorded a statutory right of appraisal in a short-form merger, and this is true even in a downstream merger when the parent is the disappearing corporation.[468] However, shareholders of a Delaware subsidiary that is a party to a short-form merger do enjoy a statutory right of appraisal,[469] and this is true even when such subsidiary is the surviving corporation in a downstream merger.[470]

The Delaware short-form merger statute contains an express limitation on its use. As enacted in 1957, that statute carried forward from Delaware's 1937 parent-subsidiary merger statute[471] the provision that "[a]ny plan of consolidation or merger which requires or contemplates any changes other than those herein specifically authorized with respect to the parent corporation, shall be

467. Act of June 23, 1969, ch. 148, § 24, 57 Del. Laws 433, 447-48 (effective July 15, 1969).

468. Section 253(c) of the Delaware statute provides: "Section 262 [the appraisal provision] of this title shall not apply to any merger effected under this [short-form merger] section, except as provided in subsection (d) of this section." DEL. CODE ANN. tit. 8, § 253(c) (1991). Moreover, subsection (d) provides appraisal rights only for "the stockholders of the subsidiary Delaware corporation party to the merger." *Id.* § 253(d) (quoted *infra* in note 470 (first paragraph)).

Appraisal rights were similarly denied to shareholders of the parent corporation when the short-form merger statute was enacted in 1957. *See* Act of June 5, 1957, ch. 121, § 6, 51 Del. Laws 186, 189-90.

469. Provision was made for such appraisal rights in Delaware's 1957 short-form merger statute as enacted by Act of June 5, 1957, ch. 121, § 6, 51 Del. Laws 186, 189-90. Changes in statutory language, not affecting the substance of appraisal rights for shareholders of a Delaware subsidiary, were made by Act of July 3, 1967, ch. 50, sec. 1, § 253(d), 56 Del. Laws 151, 210-11, Act of Apr. 24, 1976, ch. 371, § 2, 60 Del. Laws 1070, 1074 (effective July 1, 1976), and Act of June 6, 1981, ch. 25, § 13, 63 Del. Laws 36, 37 (effective July 6, 1981) (adopting the language set forth *infra* in note 470 (first paragraph)).

470. The Delaware short-form merger statute provides as follows:

> In the event all of the stock of a subsidiary Delaware corporation party to a merger effected under this section is not owned by the parent corporation immediately prior to the merger, the stockholders of the subsidiary Delaware corporation party to the merger shall have appraisal rights as set forth in § 262 of this title.

DEL. CODE ANN. tit. 8, § 253(d) (1991).

Additionally, the Delaware appraisal statute provides: "In the event all of the stock of a subsidiary Delaware corporation party to a merger effected under § 253 of this title is not owned by the parent corporation immediately prior to the merger, appraisal rights shall be available for the shares of the subsidiary Delaware corporation." *Id.* § 262(b)(3).

The case of *Temple v. Combined Properties Corp.*, 410 A.2d 1375 (Del. Ch. 1979), provides an interesting example of a short-form merger in which steps were taken to make the subsidiary the surviving corporation. *See id.* at 1376-77.

471. *See supra* note 381.

accomplished under the provisions [relating to long-form mergers]."[472] As subsequently amended,[473] the comparable provision now reads: "Any merger which effects any changes other than those authorized by this section or made applicable by this subsection shall be accomplished under [the sections relating to long-form mergers]."[474]

(b) New Jersey

In 1967, ten years later than Delaware, New Jersey amended its corporation statute to permit short-form mergers as well as parent-subsidiary mergers.[475] The short-form merger provision applied only to a New Jersey corporation "owning at least 90% of the outstanding shares of each class of stock" of another New Jersey corporation or of a corporation of another state if the laws of such other state "shall permit a merger as herein provided."[476] It permitted only upstream mergers, and it required that the resolution of the parent's directors "state the terms and conditions of the merger, including the securities, cash or other consideration to be issued, paid or delivered by the parent corporation upon surrender of each share of the subsidiary not owned by the parent corporation."[477] It accorded appraisal rights to minority shareholders of the subsidiary (if it was a New Jersey corporation), but it denied such rights to shareholders of the parent corporation.[478]

When the New Jersey corporation statute was rewritten in 1968,[479] its short-form merger provision[480] contained some significant changes, and those changes were carried forward when the short-form merger statute was later revised and redesignated.[481] While the

472. Act of June 5, 1957, ch. 121, § 6, 51 Del. Laws 186, 189.

473. When Delaware's General Corporation Law was rewritten by Act of July 3, 1967, ch. 50, 56 Del. Laws 151, *see supra* note 251 (second paragraph), the first sentence of section 253(c) provided: "Any merger which effects any changes other than those herein specifically authorized with respect to the parent corporation shall be accomplished under the provisions [relating to long-form mergers]." The language (but not the substance) of this provision was changed by Act of June 25, 1973, ch. 106, § 10, 59 Del. Laws 209, 214 (effective July 1, 1973).

474. DEL. CODE ANN. tit. 8, § 253(c) (1991).

475. *See* Act of June 19, 1967, ch. 117, § 1, 1967 N.J. Laws 561, 561-63.

476. Former N.J. STAT. ANN. § 14:12-10 (West Supp. 1968).

477. *Id.*

478. *See id.*

479. *See* Act of Nov. 21, 1968, ch. 350, 1968 N.J. Laws 1011 (effective Jan. 1, 1969); *supra* note 250 (second paragraph).

480. *See* former N.J. STAT. ANN. § 14A:10-5 (West 1969).

481. *See* Act of Jan. 7, 1974, ch. 366, § 55, 1973 N.J. Laws 964, 1021-23 (effective May

short-form merger statute is itself worded in terms of a merger between a domestic parent and a domestic subsidiary,[482] another statutory provision authorizes short-form mergers if either the parent or the subsidiary is a New Jersey corporation.[483] The short-form merger statute requires that the parent's board of directors approve a plan of merger but states that approval by the subsidiary's board is not required.[484] The statute addresses the matter of permissible merger consideration by stating that the plan of merger must set forth the matters required by section 14A:10-1,[485] which permits shares to be converted "into shares, obligations, or other securities of the surviving corporation . . . , or of any other corporation . . . , or, in whole or in part, into cash or other property."[486] Since January 1, 1969, the statute has permitted downstream as well as upstream mergers.[487] The statute does not require a vote by shareholders of the subsidiary except in the unlikely event that the subsidiary's charter

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1, 1974); Act of Aug. 4, 1988, ch. 94, §§ 59, 71, 1988 N.J. Laws 676, 737-39, 756 (effective Dec. 1, 1988). The latter act changed the designation of the short-form merger statute from section 14A:10-5 to section 14A:10-5.1.

482. The New Jersey short-form merger statute provides as follows:

> A domestic corporation owning at least 90% of the outstanding shares of each class and series of another domestic corporation or corporations, may merge the other corporation or corporations into itself, or may merge itself, or itself and any subsidiary corporation or corporations, into any subsidiary corporation, without approval of the shareholders of any of the corporations, except as provided in subsections 14A:10-5.1(5) and 14A:10-5.1(6). The board of the parent corporation shall approve a plan of merger setting forth those matters required to be set forth in plans of merger under section 14A:10-1. Approval by the board of any subsidiary corporation shall not be required.

N.J. STAT. ANN. § 14A:10-5.1(1) (West Supp. 1997).

The 1968 version of this statute contained the same substantive provisions. *See* former N.J. STAT. ANN. § 14A:10-5(1) (West 1969).

483. The New Jersey statute provides as follows:

> One or more foreign corporations and one or more domestic corporations may be merged in the manner provided in section 14A:10-5.1, provided that, if the parent corporation is a foreign corporation, it shall, notwithstanding the provisions of the laws of its jurisdiction of incorporation, comply with the provisions of subsection 14A:10-5.1(2) with respect to notice to shareholders of any domestic subsidiary corporation which is a party to the merger [concerning appraisal rights].

N.J. STAT. ANN. § 14A:10-7(4) (West Supp. 1997).

The 1968 version of this statute contained the same substantive provisions. *See* former N.J. STAT. ANN. § 14A:10-7(4) (West 1969).

484. *See* N.J. STAT. ANN. § 14A:10-5.1(1) (West Supp. 1997) (quoted *supra* in note 482 (first paragraph)).

485. *See id.*

486. *Id.* § 14A:10-1(2)(c).

487. *See id.* § 14A:10-5.1(1) (quoted *supra* in note 482 (first paragraph)).

requires approval of a merger by vote of a percentage of shares higher than that (90% or more) owned by the parent; and it requires a vote by shareholders of the parent only (i) when the parent's charter requires shareholder approval of a merger, (ii) when the parent is to be the surviving corporation and the plan of merger provides for a change in the parent's charter (other than a change permitted to be made by the board alone), or (iii) when the subsidiary is to be the surviving corporation.[488] Under New Jersey's appraisal statute,[489] shareholders of a New Jersey corporation that disappears in a short-form merger (whether the subsidiary in an upstream merger or the parent in a downstream merger) are accorded a right of appraisal (unless taken away on grounds discussed below[490]); however, in the absence of a charter provision to the contrary, shareholders of a New Jersey corporation that survives in a short-form merger (whether the parent in an upstream merger or

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488. The New Jersey statute provides as follows:

> (5) Approval of the shareholders of any subsidiary corporation shall be obtained pursuant to its certificate of incorporation, if the certificate requires approval of a merger by the affirmative vote of the holders of more than the percentage of the shares of any class or series of the corporation then owned by the parent corporation.
>
> (6) Approval of the shareholders of the parent corporation shall be obtained:
>
> (a) Whenever its certificate of incorporation requires shareholder approval of a merger; or
>
> (b) Pursuant to section 14A:10-3 where
>
> (i) the plan of merger contains a provision which would change any part of the certificate of incorporation of the parent corporation into which a subsidiary corporation is being merged, unless the change is one that can be made by the board without shareholder approval as referred to in subsection 14A:9-2(2); or
>
> (ii) a subsidiary corporation is to be the surviving corporation.

Id. § 14A:10-5.1(5)-(6).

489. That statute provides as follows:

> (1) Any shareholder of a domestic corporation shall have the right to dissent from any of the following corporate actions
>
> (a) Any plan of merger or consolidation to which the corporation is a party, provided that, unless the certificate of incorporation otherwise provides
>
> . . .
>
> (ii) a shareholder of a surviving corporation shall not have the right to dissent from a plan of merger, if the merger did not require for its approval the vote of such shareholders as provided in section 14A:10-5.1 . . . .
>
> . . . .

Id. § 14A:11-1(1).

490. *See infra* notes 756-57 and accompanying text, and notes 761-62 and accompanying text.

the subsidiary in a downstream merger) are denied the right of appraisal if the vote of such shareholders is not required for approval of the merger.[491]

(c) North Carolina

North Carolina was late in following Delaware and New Jersey with respect to short-form mergers. Its 1955 Business Corporation Act[492] made provision for parent-subsidiary mergers[493] but not for short-form mergers, and that state of affairs continued until 1990. When the Act was rewritten in 1989 (effective July 1, 1990),[494] provision was made for short-form mergers in language that followed almost verbatim that of the 1984 Model Business Corporation Act;[495] however, North Carolina's short-form merger statute was amended in 1997.[496]

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491. *See supra* note 489; *see also supra* note 488 and accompanying text (explaining the rules covering required shareholder voting).

492. *See supra* note 252 (second paragraph).

493. *See supra* note 384 and accompanying text.

494. *See supra* note 252 (third paragraph).

495. *See* MODEL BUS. CORP. ACT ANN. § 11.04 (1996).

496. The North Carolina statute now provides as follows:

> (a) Subject to Article 9 [the North Carolina Shareholder Protection Act], a parent corporation owning at least 90 percent (90%) of the outstanding shares of each class of a subsidiary corporation may merge the subsidiary into itself without approval of the shareholders of the parent or subsidiary. Subject to Article 9, a parent corporation owning at least ninety percent (90%) of the outstanding shares of each class of a subsidiary corporation may merge itself into the subsidiary without approval of the shareholders of the subsidiary if the merger is approved by the directors and shareholders of the parent corporation in accordance with G.S. 55-11-01 and G.S. 55-11-03.
>
> (b) The board of directors of the parent shall adopt a plan of merger that sets forth:
>
> (1) The names of the parent and subsidiary; and
>
> (2) The manner and basis of converting the shares of each corporation into shares, obligations, or other securities of the surviving or any other corporation or into cash or other property in whole or part.
>
> ....
>
> (d) The parent may not deliver articles of merger to the Secretary of State for filing until at least 30 days after the date it mailed a copy or summary of the plan of merger to each shareholder of the subsidiary who did not waive the mailing requirement. This subsection does not apply to a merger in which the subsidiary was a public corporation before becoming a subsidiary qualifying for a merger under this section and is still a public corporation on the effective date of the merger.
>
> (e) Articles of merger under this section may not contain amendments to the articles of incorporation of the surviving corporation (except for amendments enumerated in G.S. 55-10-02).
>
> (f) The provisions of G.S. 55-13-02(c) [relating to the denial of appraisal

As enacted in 1989, the North Carolina statute did not authorize downstream short-form mergers, but that was changed by the 1997 amendment.[497] The statute requires director action only by the board of the parent,[498] and no approval by shareholders of either corporation is required except for those of a parent involved in a downstream merger.[499] Permissible consideration in a short-form merger is stated to be "shares, obligations, or other securities of the surviving or any other corporation or ... cash or other property in whole or part."[500] As enacted in 1989, the new Act's provision governing entitlement to the right of appraisal was worded in such a way that shareholders of a parent involved in a short-form merger were not excluded from such entitlement; however, a "technical amendment" was adopted in 1990[501] to exclude parent company shareholders from such entitlement.[502] Minority shareholders of the subsidiary involved in a short-form merger have the right of dissent and appraisal unless their "shares are then redeemable by the corporation at a price not greater than the cash to be received in exchange for such shares."[503] The North Carolina statute provides that short-form merger articles "may not contain amendments to the articles of incorporation of the surviving corporation (except for amendments enumerated [for board adoption without shareholder

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> rights for marketable shares] do not apply to subsidiary corporations that are parties to mergers consumated under this section.

N.C. GEN. STAT. § 55-11-04 (1990), *as amended by* Act of Aug. 26, 1997, ch. 485, § 29 (effective Oct. 1, 1997).

497. *See* N.C. GEN. STAT. § 55-11-04(a) (1990) (as amended in 1997) (quoted *supra* in note 496).

498. *See id.* § 55-11-04(b) (quoted *supra* in note 496).

499. *See id.* § 55-11-04(a) (quoted *supra* in note 496).

500. *Id.* § 55-11-04(b)(2) (quoted *supra* in note 496).

501. *See* Act of July 27, 1990, ch. 1024, § 12.18, 1989 N.C. Sess. Laws 593, 601 (effective July 1, 1990). The amendment inserted the parenthetical phrase in section 55-13-02(a)(1) (as quoted *infra* in note 502).

502. The North Carolina statute now provides as follows:

> (a) In addition to any rights granted under Article 9 [the North Carolina Shareholder Protection Act], a shareholder is entitled to dissent from, and obtain payment of the fair value of his shares in the event of, any of the following corporate actions:
>
> (1) Consummation of a plan of merger to which the corporation (other than a parent corporation in a [short-form] merger under G.S. 55-11-04) is a party unless ... (ii) such shares are then redeemable by the corporation at a price not greater than the cash to be received in exchange for such shares;
>
> ....

N.C. GEN. STAT. § 55-13-02(a) (Supp. 1996).

503. *Id.* § 55-13-02(a)(1)(ii) (quoted *supra* in note 502).

action] in G.S. 55-10-02)."[504]

(d) Model Business Corporation Act

In 1960, section 68A was "offered as an optional section" of the Model Business Corporation Act.[505] It provided for upstream short-form mergers, without approval by the shareholders of either corporation, when one corporation owned at least 95% of the outstanding shares of each class of another corporation.[506] In the 1969 version of the Model Act, the optional designation was eliminated, and the 95% was changed to 90%.[507]

The 1984 Model Business Corporation Act continues to provide for short-form mergers; but, unlike the North Carolina statute as amended in 1997, it authorizes only upstream mergers.[508] The Model Act's appraisal provision relating to mergers[509] also differs from that of North Carolina.[510]

(2) Cases and Commentary

There is much to be said in favor of the flexibility afforded by the modern statutes in allowing, by way of a short-form merger, the elimination of minority shareholders of a subsidiary 90% or more of whose stock is owned by its parent. Such mergers lead to the " 'greater economies, more efficient management' " and "simplification of . . . intercorporate structures" referred to by New York's highest court in the earliest of the reported cases involving a short-form cash-out merger.[511] Moreover, when the minority interest

504. N.C. GEN. STAT. § 55-11-04(e) (1990) (as amended in 1997) (quoted *supra* in note 496).

505. MODEL BUS. CORP. ACT ANN. § 68A (1960).

506. The language was as follows: "Any corporation owning at least ninety-five per cent of the outstanding shares of each class of another corporation may merge such other corporation into itself without approval by a vote of the shareholders of either corporation." *Id.*

507. *See* MODEL BUS. CORP. ACT ANN. § 75 (1971).

508. *See* MODEL BUS. CORP. ACT ANN. § 11.04 (1996).

509. That provision entitles a shareholder to the right of dissent and appraisal in the event of

> consummation of a plan of merger to which the corporation is a party (i) if shareholder approval is required for the merger by section 11.03 or the articles of incorporation and the shareholder is entitled to vote on the merger or (ii) if the corporation is a subsidiary that is merged with its parent under section 11.04.

MODEL BUS. CORP. ACT ANN. § 13.02(a)(1) (1996).

510. *See* N.C. GEN. STAT. § 55-13-02(a)(1) (Supp. 1996) (quoted *supra* in note 502).

511. *See* Beloff v. Consolidated Edison Co., 87 N.E.2d 561, 565 (N.Y. 1949) (quoting 1936 legislative history).

in a subsidiary is less than 10%, it is probably more efficient for that interest to be terminated at fair value than for the parent to be exposed to petty challenges of intercorporate transactions involving the subsidiary.[512] Nonetheless, it is important that there be adequate safeguards for protecting the interests of shareholders involved in short-form mergers.

(a) Perspective of Subsidiary's Shareholders

Protection of the rights of shareholders is more important—but more difficult—in the case of the subsidiary involved in a short-form merger. Recognizing that the board of the subsidiary will (in all likelihood) be controlled by a parent owning 90% or more of the subsidiary's stock, the short-form merger statutes of all three of the subject states dispense with action by the subsidiary's directors. Similarly, recognizing that the subsidiary's minority shareholders will have insufficient votes to block such a merger, those statutes also dispense with approval by the subsidiary's shareholders (with a limited exception in New Jersey[513]). Moreover, the short-form merger statutes of all three states permit the stock of the subsidiary's minority shareholders to be converted into cash. Because no other protection is available for minority shareholders of a subsidiary involved in a cash-out short-form merger (beyond that based on the fiduciary duty of the parent as controlling shareholder[514]), it is especially important that the right of appraisal be available to such shareholders. That right is given to shareholders of a Delaware subsidiary, whether it is the disappearing or the surviving corporation; and the same is true under the North Carolina statute (with a limited exception[515]). Under the New Jersey statute, the right of appraisal (if not taken away on grounds discussed below[516]) is given to minority shareholders of a domestic subsidiary if it is the disappearing corporation; however, the right is denied to those shareholders if such subsidiary is the surviving corporation (except in the unlikely event that its charter "requires approval of a merger by the affirmative vote of the holders of more than the percentage of the

512. See, for example, *Sinclair Oil Corp. v. Levien*, 280 A.2d 717 (Del. 1971), where the minority interest in the subsidiary amounted to only about 3%. *See id.* at 719.

513. *See* N.J. STAT. ANN. § 14A:10-5.1(5) (West Supp. 1997) (quoted *supra* in note 488).

514. *See supra* text accompanying notes 444-53.

515. *See supra* text accompanying note 503.

516. *See infra* notes 756-57 and accompanying text, and notes 761-62 and accompanying text.

shares of any class or series of the corporation then owned by the parent corporation").[517]

If minority shareholders of the subsidiary can be cashed out in a downstream short-form merger, it seems a clear mistake of statutory policy to deny such shareholders a right of appraisal. Indeed, it would be a salutary rule to require—in all cash-out mergers—that the cashed out shareholders be accorded a right of appraisal as a check on the price proffered for their shares.

(b) Perspective of Parent's Shareholders

Under the statutes of the three subject states, the rights of shareholders of the parent corporation are (for the most part) protected in the case of an upstream short-form merger. One basic thrust of the Delaware and North Carolina statutes is to preclude use of the short-form merger to effect any significant change in the charter rights of the parent's shareholders; therefore, it is of little consequence that both statutes deny voting and appraisal rights to those shareholders when the merger is upstream. Following a different tack, the New Jersey statutes accord both voting rights and appraisal rights to shareholders of the parent when an upstream merger contemplates a change in the charter rights of those shareholders. Contrary to the theory underlying the small-scale merger statutes of the three states (discussed below[518]), none of the three short-form merger statutes accords voting and appraisal rights to the parent's shareholders in the event (unlikely though it may be) that the parent's outstanding common stock is increased by more than 20% (40% in New Jersey) in an upstream short-form merger using parent company common stock as the merger consideration.

In a downstream short-form merger, the statutes of all three of the subject states require an approving vote by the parent company's shareholders. While the Delaware short-form merger statute requires that shareholders of the parent receive shares of stock of the subsidiary in a downstream merger, thereby assuring them a continuing equity interest in the combined enterprise, the statutes of New Jersey and North Carolina contain no such requirement and, instead, permit virtually any kind of consideration to be used in a short-form merger (downstream as well as upstream). On the other hand, while the New Jersey statute accords appraisal rights to

517. N.J. STAT. ANN. § 14A:11-1(1)(a)(ii) (West Supp. 1997) (quoted *supra* in note 489); *see also id.* § 14A:10-5.1(5) (quoted *supra* in note 488).

518. *See infra* text accompanying notes 522-52.

shareholders of the parent in a downstream short-form merger, the Delaware and North Carolina statutes deny such rights to parent company shareholders in a short-form merger whether downstream or upstream.

This latter feature of the Delaware short-form merger statute could lead to an anomalous result—if not forestalled by Delaware's judicial doctrine concerning fiduciary duty.[519] The directors of a Delaware corporation, if successful in mustering approval from the holders of a majority of its outstanding stock entitled to vote (or if they themselves were to hold such a majority), could change the corporation's domicile by merging it on a share-for-share basis into a wholly owned subsidiary newly created under the laws of another state,[520] with no appraisal right being accorded to dissenting shareholders of the parent even though their rights as shareholders could be significantly different under the laws of the new corporation's state of incorporation.[521]

b. Relaxation for Small-Scale Merger

Prior to 1967, all three of the subject states required for any long-form merger, regardless of scale, that it be approved by vote of the shareholders of the surviving corporation (as well as those of the disappearing corporation) and that dissenting shareholders of the surviving corporation (as well as those of the disappearing corporation) be accorded the right of appraisal. This meant that, if Exxon or IBM acquired—by way of a merger—a corporation only a small fraction of its size, approval by the Exxon or IBM shareholders was required and those who dissented were accorded appraisal rights. Given the broad powers of directors to effect other kinds of transactions without reference to shareholders, this hardly made sense.

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519. *See supra* text accompanying notes 405-07 and 444-53.

520. Because the Delaware short-form merger statute expressly authorizes a Delaware parent to merge into a non-Delaware subsidiary, *see* DEL. CODE ANN. tit. 8, § 253(a) (Supp. 1996) (quoted *supra* in note 457), such a transaction would not be precluded by the statutory limitation on use of the short-form merger, *see* DEL. CODE ANN. tit. 8, § 253(c) (1991) (quoted *supra* in text accompanying note 474).

521. For example, the new state of incorporation might be one whose statutes were so ill-conceived that a charter amendment, making a class of non-callable preferred stock subject to call, could be adopted by vote of the holders of other classes of stock capable of outvoting the affected class. *See* Cowan v. Salt Lake Hardware Co., 221 P.2d 625, 626-28 (Utah 1950). This is to be contrasted with the state of affairs in Delaware, whose statute governing charter amendments gives a class vote to any class (whether voting or non-voting) if a proposed amendment would "alter or change . . . special rights of the shares of such class so as to affect them adversely." DEL. CODE ANN. tit. 8, § 242(b)(2) (1991).

(1) Statutory Provisions

Delaware changed this state of affairs, in the 1967 rewrite of its General Corporation Law,[522] by adding a new subsection (f) to its basic long-form merger statute and by making a corresponding change in its appraisal statute. Section 251(f) of the Delaware statute[523] now provides as follows:

> Notwithstanding the requirements of subsection (c) of this section [requiring approval by shareholders of both corporations involved in a long-form merger], unless required by its certificate of incorporation, no vote of stockholders of a constituent corporation surviving a merger shall be necessary to authorize a merger if (1) the agreement of merger does not amend in any respect the certificate of incorporation of such constituent corporation,[524] (2) each share of stock of such constituent corporation outstanding immediately prior to the effective date of the merger is to be an identical outstanding or treasury share of the surviving corporation after the effective date of the merger,[525] and (3) either no shares of

522. *See* Act of July 3, 1967, ch. 50, 56 Del. Laws 151; *supra* note 251 (second paragraph).

523. *See* DEL. CODE ANN. tit. 8, § 251(f) (1991).

524. As originally enacted in 1967, this no-charter-amendment test included the requirement that the agreement of merger "not change the name or authorized shares of any class" of the surviving corporation. Act of July 3, 1967, ch. 50, sec. 1, § 251(f), 56 Del. Laws 151, 207. That requirement was deleted from the no-charter-amendment test by Act of June 23, 1969, ch. 148, § 22, 57 Del. Laws 433, 443-45 (effective July 15, 1969).

525. This continuity-of-stock-ownership test was not included when subsection (f) was first enacted in 1967. *See* Act of July 3, 1967, ch. 50, sec. 1, § 251(f), 56 Del. Laws 151, 207-08. As added by Act of May 16, 1970, ch. 421, § 9, 57 Del. Laws 1194, 1200-01 (effective July 1, 1970), it read: "(2) each share of stock of such constituent corporation outstanding immediately prior to the merger becoming effective shall remain outstanding immediately after the merger as an identical share of the surviving corporation . . . ."

Folk says the following concerning the 1970 amendment:

> The . . . condition—a sort of "continuity of stock interest" requirement applicable to the surviving corporation—was added by the 1970 amendments . . . . This condition is designed to limit the operation of § 251(f) to the type of transaction it was intended to cover: that is, where a large corporation is absorbing a smaller entity, and the stockholders of the large surviving corporation continue to hold their shares unchanged despite the merger, and experience only a relatively minor dilution of their stock interests as a consequence of the newly issued stock. The condition was added in order to preclude the misuse of § 251(f) to consummate a three-party merger in which the stockholders of the acquired corporation were arguably not entitled to vote on the merger because that corporation was the technical survivor of the merger. This is the so-called "reverse three-party" or "reverse phantom" merger. . . . For the present, it is important to note that the 1970 amendment

> common stock of the surviving corporation and no shares, securities or obligations convertible into such stock are to be issued or delivered under the plan of merger, or the authorized unissued shares or the treasury shares of common stock of the surviving corporation to be issued or delivered under the plan of merger plus those initially issuable upon conversion of any other shares, securities or obligations to be issued or delivered under such plan do not exceed 20% of the shares of common stock of such constituent corporation outstanding immediately prior to the effective date of the merger. . . .[526]

And section 262(b)(1) of the Delaware statute[527] now provides that "no appraisal rights shall be available for any shares of stock of the constituent corporation surviving a merger if the merger did not require for its approval the vote of the stockholders of the surviving corporation as provided in subsection (f) of § 251 of this title."[528]

New Jersey followed Delaware's lead in 1968 (effective January 1, 1969).[529] The New Jersey statute[530] now contains the following

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> adding § 251(f)(2) made clear that, in a reverse three-party merger, the stockholders of the acquired corporation, despite its nominal status as a surviving corporation, would have a right to vote.

FOLK, *supra* note 459, at 320-21.

By Act of July 9, 1971, ch. 235, § 5, 58 Del. Laws 707, 709 (effective July 1, 1971), the continuity-of-stock-ownership test was changed to read as quoted in the text. The only alteration of significance made by the 1971 amendment was to change "each share . . . shall remain outstanding" to read "each share . . . is to be an identical outstanding or treasury share"—to cover the remote contingency that the disappearing corporation might have held some shares of the surviving corporation's stock. *See* FOLK, *supra* note 459, at 321.

526. DEL. CODE ANN. tit. 8, § 251(f) (1991). As originally enacted in 1967, the limited-dilution test was numbered "(2)" and provided as follows:

> the authorized unissued shares or the treasury shares of any class of the surviving corporation to be issued or delivered under the plan of merger do not exceed 15 per cent of the shares of the surviving corporation of the same class outstanding immediately prior to the effective date of the merger.

Act of July 3, 1967, ch. 50, sec. 1, § 251(f), 56 Del. Laws 151, 207-08. By Act of May 16, 1970, ch. 421, § 9, 57 Del. Laws 1194, 1200-01 (effective July 1, 1970), this provision was re-numbered "(3)" and amended to read as quoted in the text.

527. DEL. CODE ANN. tit. 8, § 262(b)(1) (Supp. 1996).

528. The predecessor to this provision, as enacted by Act of July 3, 1967, ch. 50, 56 Del. Laws 151, was located in section 262(k) and provided as follows:

> [N]or shall this section [the appraisal statute] apply to any of the shares of stock of the constituent corporation surviving a merger if the merger did not require for its approval the vote of the stockholders of the surviving corporation, as provided in subsection (f) of section 251 of this title.

Former DEL. CODE ANN. tit. 8, § 262(k) (Cum. Supp. 1968).

529. *See* Act of Nov. 21, 1968, ch. 350, § 14A:10-3, 1968 N.J. Laws 1011, 1095-96 (effective Jan. 1, 1969); *supra* note 250 (second paragraph).

provisions:

> (4) Notwithstanding the provisions set forth in subsections 14A:10-3(1) and 14A:10-3(2), the approval of the shareholders of a surviving corporation shall not be required to authorize a merger (unless its certificate of incorporation otherwise provides)[531] if
>
> (a) The plan of merger does not make an amendment of the certificate of incorporation of the surviving corporation which is required by the provisions of this act to be approved by the shareholders;[532]
>
> (b) Each shareholder of the surviving corporation whose shares were outstanding immediately before the effective date of the merger will hold the same number of shares, with identical designations, preferences, limitations, and rights, immediately after;[533]
>
> (c) The number of voting shares outstanding immediately after the merger, plus the number of voting shares issuable on conversion of other securities or on exercise of rights and warrants issued pursuant to the merger, will not exceed by more than 40% the total number of voting shares of the surviving corporation outstanding immediately before the merger;[534] and

530. *See* N.J. STAT. ANN. § 14A:10-3(4)-(5) (West Supp. 1997).

531. The parenthetical statement "unless its certificate of incorporation otherwise provides" was added by Act of Jan. 7, 1974, ch. 366, § 53, 1973 N.J. Laws 964, 1019-20 (effective May 1, 1974).

532. As enacted by Act of Nov. 21, 1968, ch. 350, § 14A:10-3, 1968 N.J. Laws 1011, 1096, this provision read as follows: "(a) the agreement of merger does not change the name or authorized shares or series of any class or otherwise amend the certificate of incorporation of the surviving corporation . . . ." By Act of Jan. 7, 1974, ch. 366, § 53, 1973 N.J. Laws 964, 1019-20, it was amended to read as quoted in the text.

533. As enacted in 1968 and amended in 1974, section 14A:10-3(4) contained no continuity-of-stock-ownership test. The test was added when that section was rewritten by Act of Aug. 4, 1988, ch. 94, § 57, 1988 N.J. Laws 676, 734-36 (effective Dec. 1, 1988). For the history of the comparable provision in Delaware, see *supra* note 525.

The Commissioners' Comment—1988 Amendments includes the following observation:

> Finally, subsection 14A:10-3(4) has been amended to include an explicit requirement that the shareholdings of the shareholders of the surviving corporation not be disturbed. See new paragraph 14A:10-3(4)(b). The Commission was of the view that such a requirement would have been read into the present statute by our courts and that the addition of this new paragraph is a clarification, rather than a change.

N.J. STAT. ANN. § 14A:10-3 commentary (1988) at 16 (West Supp. 1997).

534. As enacted by Act of Nov. 21, 1968, ch. 350, § 14A:10-3, 1968 N.J. Laws 1011,

> (d) The number of participating shares outstanding immediately after the merger, plus the number of participating shares issuable on conversion of other securities or on exercise of rights and warrants issued pursuant to the merger, will not exceed by more than 40% the total number of participating shares of the surviving corporation outstanding immediately before the merger.[535]
>
> (5) As used in subsection 14A:10-3(4):
>
> (a) "Participating shares" means shares that entitle their holders to participate without limitation in distributions.
>
> (b) "Voting shares" means shares that entitle their holders to vote unconditionally in elections of directors.[536]

And section 14A:11-1(1)(a)(ii) of the New Jersey statute[537] provides as follows:

1096, this provision read as follows:

> (b) the authorized unissued shares and the treasury shares of each class and series of the surviving corporation to be issued or delivered under the plan of merger do not exceed 15 per cent of the shares of each such class or series of the surviving corporation outstanding immediately prior to the effective date of the merger.

Former N.J. STAT. ANN. § 14A:10-3(4)(b) (West 1969). By Act of Jan. 7, 1974, ch. 366, § 53, 1973 N.J. Laws 964, 1020, it was amended to read as follows:

> (b) either (i) no shares of common stock of the surviving corporation and no securities convertible into such common shares are to be issued or delivered under the plan of merger or (ii) the number of common shares of the surviving corporation to be issued or delivered under such plan, plus those initially issuable upon conversion of any other securities to be issued or delivered under such plan, does not exceed 20% of the following: the number of common shares of the surviving corporation outstanding immediately prior to the merger becoming effective plus the number of such common shares, if any, initially issuable upon conversion of any other securities then outstanding.

Id. By Act of Aug. 4, 1988, ch. 94, § 57, 1988 N.J. Laws 676, 734-36, it was replaced by subsection (c) as quoted in the text.

535. This provision and subsection (5) were added by Act of Aug. 4, 1988, ch. 94, § 57, 1988 N.J. Laws 676, 734-36.

536. N.J. STAT. ANN. § 14A:10-3(4)-(5) (West Supp. 1997). The provisions of this statute are based upon the provisions of section 11.03(g)-(h) of the 1984 Model Business Corporation Act, with one major difference. The difference is that 40% is the figure used in New Jersey Statutes Annotated section 14A:10-3(4)(c)-(d), while the corresponding figure used in Model Business Corporation Act section 11.03(g)(3)-(4) is 20%. *See* N.J. STAT. ANN. § 14A:10-3(4)(c)-(d) (West Supp. 1997); MODEL BUS. CORP. ACT ANN. § 11.03(g)(3)-(4) (1996); *see also* N.J. STAT. ANN. § 14A:10-12 commentary (1972) at 29 (West Supp. 1997) (quoted *infra* in note 864) (describing the history behind New Jersey's use of 40%).

537. *See* N.J. STAT. ANN. § 14A:11-1(1)(a)(ii) (West Supp. 1997).

> (1) Any shareholder of a domestic corporation shall have the right to dissent from any of the following corporate actions
>
> (a) Any plan of merger or consolidation to which the corporation is a party, provided that, unless the certificate of incorporation otherwise provides
>
> . . .
>
> (ii) a shareholder of a surviving corporation shall not have the right to dissent from a plan of merger, if the merger did not require for its approval the vote of such shareholders as provided in . . . subsection 14A:10-3(4) . . . .[538]
>
> . . . .

North Carolina followed in 1973. Former section 55-108.1(b),[539] added to the North Carolina statute in that year,[540] was (in substance) almost the same as section 251(f) of the Delaware statute as then in effect;[541] and, similarly, former section 55-113(i), as amended in 1973,[542] denied the right of appraisal to shareholders of the surviving corporation in a small-scale merger.[543] When North Carolina rewrote

538. *Id.* § 14A:11-1(1). This provision was adopted by Act of Nov. 21, 1968, ch. 350, § 14A:11-1, 1968 N.J. Laws 1011, 1106-07. The words "unless the certificate of incorporation otherwise provides" were added by Act of Jan. 7, 1974, ch. 366, § 60, 1973 N.J. Laws 964, 1029-30.

539. The North Carolina statute provided as follows:

> Unless otherwise provided in the charter or bylaws, no approval by shareholders of the surviving corporation shall be required for a merger if (i) the plan of merger does not provide for any changes in the charter of the surviving corporation, (ii) each share of the surviving corporation outstanding immediately prior to the merger becoming effective shall remain outstanding immediately after the merger as an identical share of the surviving corporation, and (iii) either no common shares of the surviving corporation and no shares, securities or obligations convertible into common shares are to be issued or delivered under the plan of merger, or the authorized unissued common shares or the treasury common shares of the surviving corporation to be issued or delivered under the plan of merger plus those initially issuable upon conversion of any other shares, securities or obligations to be issued or delivered under such plan do not exceed twenty percent (20%) of the common shares of the surviving corporation outstanding immediately prior to the effective date of the merger.

Former N.C. GEN. STAT. § 55-108.1(b) (1982).

540. *See* Act of May 14, 1973, ch. 469, § 33, 1973 N.C. Sess. Laws 545, 555 (effective Oct. 1, 1973).

541. *See supra* notes 522-26 and accompanying text.

542. *See* Act of May 14, 1973, ch. 469, § 37, 1973 N.C. Sess. Laws 545, 556 (effective Oct. 1, 1973).

543. The statute provided in part that "[t]he provisions of this section [relating to appraisal rights] shall . . . not apply to the shareholders of the surviving corporation if their approval of the merger is not required, as provided in G.S. 55-108.1(b)." Former

its Business Corporation Act in 1989,[544] it continued to make provision for small-scale mergers, eliminating the need for approval by the survivor's shareholders[545]—on terms virtually identical to those in the 1984 Model Business Corporation Act[546]—and denying appraisal rights to those shareholders.[547]

N.C. GEN. STAT. § 55-113(i) (1982).

544. *See* Act of June 8, 1989, ch. 265, 1989 N.C. Sess. Laws 566 (effective July 1, 1990); *supra* note 252 (third paragraph).

545. The North Carolina statute provided as follows:

> (g) Action by the shareholders of the surviving corporation on a plan of merger is not required if:
>
> (1) The articles of incorporation of the surviving corporation will not differ (except for amendments enumerated in G.S. 55-10-02) from its articles before the merger;
>
> (2) Each shareholder of the surviving corporation whose shares were outstanding immediately before the effective date of the merger will hold the same number of shares, with identical designations, preferences, limitations, and relative rights, immediately after the effective date of the merger;
>
> (3) The number of voting shares outstanding immediately after the merger, plus the number of voting shares issuable as a result of the merger (either by the conversion of securities issued pursuant to the merger or the exercise of rights and warrants issued pursuant to the merger), will not exceed by more than 20 percent (20%) the total number of voting shares of the surviving corporation outstanding immediately before the merger; and
>
> (4) The number of participating shares outstanding immediately after the merger, plus the number of participating shares issuable as a result of the merger (either by the conversion of securities issued pursuant to the merger or the exercise of rights and warrants issued pursuant to the merger), will not exceed by more than 20 percent (20%) the total number of participating shares outstanding immediately before the merger.
>
> (h) As used in subsection (g):
>
> (1) "Participating shares" means shares that entitle their holders to participate without limitation in distributions.
>
> (2) "Voting shares" means shares that entitle their holders to vote unconditionally in elections of directors.

N.C. GEN. STAT. § 55-11-03(g)-(h) (1990). The words "number of" were deleted from subsection (g)(2) by Act of July 24, 1993, ch. 552, § 14, 1993 N.C. Sess. Laws 2912, 2919 (effective Oct. 1, 1993).

546. *See* MODEL BUS. CORP. ACT ANN. § 11.03(g)-(h) (1996). The Model Act first made provision for the small-scale merger in 1978. *See id.* § 11.03 commentary at 11-32.

547. The North Carolina statute provides as follows:

> (a) In addition to any rights granted under Article 9 [the North Carolina Shareholder Protection Act], a shareholder is entitled to dissent from, and obtain payment of the fair value of his shares in the event of, any of the following corporate actions:
>
> (1) Consummation of a plan of merger to which the corporation (other than the parent corporation in a [short-form merger]) is a party unless (i) approval by the shareholders of that corporation is not required under G.S. 55-11-03(g) . . . .
>
> . . . .

(2) Cases and Commentary

Folk was quite correct in characterizing the statutory relaxation for the small-scale merger as "a major innovation in American corporate law."[548] What is surprising is that it did not come until 1967.

The small-scale merger provisions have no effect on the voting rights or the appraisal rights (whatever they may be) of shareholders of the corporation that disappears in a merger. They apply only to shareholders of the corporation that survives a merger and only in circumstances in which the rights of those shareholders remain free from any significant alteration. Given compliance with the no-charter-amendment test and the continuity-of-stock-ownership test, a corporate combination by way of a small-scale merger does not pose any threat to shareholders of the surviving corporation—notwithstanding the denial of voting and appraisal rights to those shareholders.

Because these two tests for utilization of the small-scale merger are likely to be met in any bona fide corporate combination, the key factor involved in the availability of this device is the degree of dilution involved for shareholders of the surviving corporation. The theory behind the Delaware small-scale merger statute is that dilution is excessive—and the small-scale merger device therefore unavailable—whenever the merger consideration is common stock (or securities convertible into common stock) in an amount that causes (or has the potential for causing) more than a 20% increase in the outstanding common stock of the surviving corporation. This is consistent with the "20% rule" of the New York Stock Exchange.[549]

N.C. GEN. STAT. § 55-13-02(a) (Supp. 1996).

The comparable provision of the Model Business Corporation Act reads:

> (1) consummation of a plan of merger to which the corporation is a party (i) if shareholder approval is required for the merger by section 11:03 or the articles of incorporation and the shareholder is entitled to vote on the merger....

MODEL BUS. CORP. ACT ANN. § 13.02(a)(1) (1996).

548. FOLK, *supra* note 459, at 318.

549. The rule provides as follows:

> 312.03 Shareholder approval ... prior to the issuance of securities (under (b), (c) or (d) below) will be prerequisite to listing when:
>
> ....
>
> (c) Common stock or securities convertible into or exercisable for common stock are to be issued in any transaction or series of related transactions, other than a public offering for cash, (i) if the common stock has or will have upon issuance voting power equal to or in excess of 20% of the voting power outstanding before the issuance of such stock or securities

The 1984 Model Business Corporation Act differs somewhat from the Delaware statute in that it makes the small-scale merger device (with its denial of voting and appraisal rights to shareholders of the surviving corporation) unavailable when the number of outstanding voting shares (not just common shares) or participating shares (those entitling their holders to participate without limitation in distributions) would be increased by more than 20%.[550] New Jersey followed this lead in 1988 (except that its statute uses 40% rather than 20%),[551] and North Carolina followed in 1989 (using 20%).[552]

c. Modification of Voting Standards

(1) Statutory Provisions

Even when Delaware's General Corporation Law was rewritten in 1967,[553] it continued to require, for shareholder approval of a long-form merger, "two-thirds of the total number of the outstanding shares of the capital stock" with "each share entitling the holder thereof to one vote."[554] Not until 1969 was that provision changed[555] to require only "a majority of the outstanding stock of the corporation entitled to vote thereon."[556] The Delaware statute has

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> convertible into or exercisable for common stock, or (ii) the number of shares of common stock to be issued is or will be equal to or in excess of 20% of the number of shares of common stock outstanding before the issuance of the stock.
>
> ....
>
> 312.05 Where shareholder approval is a prerequisite to the listing of any additional or new securities of a listed company, the minimum vote which will constitute shareholder approval for listing purposes is defined as approval by a majority of votes cast on a proposal in a proxy bearing on the particular matter, provided that the total vote cast on the proposal represents over 50% in interest of all securities entitled to vote on the proposal.

NEW YORK STOCK EXCHANGE LISTED COMPANY MANUAL ¶¶ 312.03(c), 312.05 (1995) (footnote defining "voting power outstanding" omitted).

550. *See* MODEL BUS. CORP. ACT ANN. § 11.03(g)(3)-(4), (h) (1996).

551. *See supra* text accompanying notes 534-35.

552. *See supra* notes 544-45.

553. *See* Act of July 3, 1967, ch. 50, 56 Del. Laws 151; *supra* note 251 (second paragraph).

554. Fomer DEL. CODE ANN. tit. 8, § 251(c) (Cum. Supp. 1968).

555. *See* Act of June 23, 1969, ch. 148, § 22, 57 Del. Laws 433, 443-45 (effective July 15, 1969).

556. DEL. CODE ANN. tit. 8, § 251(c) (Supp. 1996). The "outstanding stock ... entitled to vote" excludes (i) shares made non-voting by terms of the charter, *see id.* § 151(a), (ii) treasury shares or shares that have been called for redemption, *see* DEL. CODE ANN. tit. 8, § 160(c)-(d) (1991), and (iii) parent company stock belonging to a

never made provision for class voting on a merger.

Prior to the 1968 rewrite of its Business Corporation Act,[557] New Jersey's statute had required, for approval of a long-form merger, "the votes of the holders of two-thirds of all the capital stock" with "each share of stock entitling the holder to one vote" but with no provision for a class vote.[558] However, the statute also permitted a corporation to provide by its charter that any action requiring the vote of "two-thirds in interest of all of the stockholders" could be taken by "two-thirds in interest of the stockholders present and voting."[559] As enacted in 1968 and now in effect, the New Jersey statute on shareholder approval of a merger[560] provides as follows:

> (2) .... Such plan [of merger] shall be approved upon receiving the affirmative vote of a majority of the votes cast by the holders of shares of each such corporation entitled to

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subsidiary when the parent holds "a majority of the shares entitled to vote in the election of directors" of the subsidiary, *id.* § 160(c).

It seems clear that part (2) of the second sentence of section 216 of the Delaware General Corporation Law should be construed as being qualified by the introductory phrase of the first sentence of that section. The section provides as follows:

> Subject to this chapter in respect of the vote that shall be required for a specified action, the certificate of incorporation or bylaws of any corporation authorized to issue stock may specify the number of shares and/or the amount of other securities having voting power the holders of which shall be present or represented by proxy at any meeting in order to constitute a quorum for, and the votes that shall be necessary for, the transaction of any business, but in no event shall a quorum consist of less than one-third of the shares entitled to vote at the meeting. In the absence of such specification in the certificate of incorporation or bylaws of the corporation:
>
> (1) A majority of the shares entitled to vote, present in person or represented by proxy, shall constitute a quorum at a meeting of stockholders;
>
> (2) In all matters other than the election of directors, the affirmative vote of the majority of shares present in person or represented by proxy at the meeting and entitled to vote on the subject matter shall be the act of the stockholders;
>
> ...;
>
> (4) Where a separate vote by a class or classes is required, a majority of the outstanding shares of such class or classes, present in person or represented by proxy, shall constitute a quorum entitled to take action with respect to that vote on that matter and the affirmative vote of the majority of shares of such class or classes present in person or represented by proxy at the meeting shall be the act of such class.

Id. § 216.

557. *See* Act of Nov. 21, 1968, ch. 350, 1968 N.J. Laws 1011 (effective Jan. 1, 1969); *supra* note 250 (second paragraph).

558. Former N.J. STAT. ANN. § 14:12-3 (West 1939) (quoted *supra* in note 293).

559. *Id.* § 14:10-9; *see supra* note 295 and accompanying text.

560. *See* N.J. STAT. ANN. § 14A:10-3(2)-(3) (West Supp. 1997).

vote thereon,[561] and, in addition, if any class or series is entitled to vote thereon as a class, the affirmative vote of a majority of the votes cast in each class vote; except that, in the case of a corporation organized prior to January 1, 1969, the plan of merger ... shall be approved upon receiving the affirmative vote of two-thirds of the votes so cast. Any class or series of shares of any such corporation shall be entitled to vote as a class if the plan of merger ... contains any provision which, if contained in a proposed amendment to the certificate of incorporation, would entitle such class or series of shares to vote as a class[562] unless such provision is one which could be adopted by the board without shareholder approval as referred to in subsection 14A:9-2(2). The voting requirements of this section shall be subject to such greater requirements as are provided in this act for specific amendments or as may be provided in the certificate of incorporation.

(3) Subject to the provisions of section 14A:5-12,[563] a corporation organized prior to January 1, 1969, may adopt the majority voting requirements prescribed in subsection 14A:10-3(2) by an amendment of its certificate of incorporation adopted by the affirmative vote of two-thirds of the votes cast by the holders of shares entitled to vote thereon.[564]

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561. Excluded from "shares ... entitled to vote" are (i) shares lacking voting rights by terms of the charter, *see* N.J. STAT. ANN. § 14A:7-1(2)(f) (West 1969), (ii) the corporation's own shares held by it, *see* N.J. STAT. ANN. § 14A:5-13 (West Supp. 1997), and (iii) parent company shares held by a subsidiary when the parent "holds a majority of the shares entitled to vote for the election of directors" of the subsidiary, *id.*

562. *See* N.J. STAT. ANN. § 14A:9-3 (West 1969) (setting forth the class-voting provisions).

563. That section provides as follows:

(1) The provisions of the certificate of incorporation shall control whenever, with respect to any action to be authorized by the shareholders of a corporation, including the election of directors, the certificate of incorporation requires the affirmative vote of a greater proportion of the votes cast, including a unanimous vote, by the holders of shares entitled to vote thereon, or by the holders of shares of any class or series thereof, than is required by this act with respect to such action.

(2) An amendment of the certificate of incorporation which changes or deletes such a provision shall be authorized by the same vote as would be required to take action under the provision.

N.J. STAT. ANN. § 14A:5-12 (West Supp. 1997).

564. The Commissioners' Comment—1968 states in part:

Subsection 14A:10-3(2) departs from Title 14 and follows the second paragraph of section 67 of the Model Act by specifically requiring a class vote in addition to a vote of all the shareholders entitled to vote, whenever the plan of

In 1950, the North Carolina statute required only "a majority of the outstanding shares of stock entitled to vote" for approval of a long-form merger,[565] and no provision was made for a class vote. When that state enacted its 1955 Business Corporation Act,[566] the requirement of "a majority of the outstanding shares" was retained; however, it was provided that each outstanding share "shall be entitled to vote on the proposed plan of merger ... whether or not such share otherwise has voting rights," and provision was made for class voting "if the plan of merger ... contains any provision which, if contained in a proposed amendment to the charter, would entitle such class of shares to vote as a class."[567] When the North Carolina Act was rewritten in 1989,[568] the shareholder voting requirement for a merger was stated in the new Act as follows:

> (b) For a plan of merger ... to be approved:
>
> ....
>
> (2) The shareholders entitled to vote[[569]] must approve the plan.
>
> ....
>
> (e) Unless this Chapter, the articles of incorporation, a bylaw adopted by the shareholders or the board of directors

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> merger or consolidation contains a provision, which, if proposed as an amendment to the certificate of incorporation, would require approval by a class vote.
>
> Subsections 14A:10-3(2) and 14A:10-3(3) represent a substantial departure from both Title 14 and the Model Act. Both Title 14 and the Model Act require a two-thirds vote; the Revision permits a majority vote to corporations organized after the Revision's effective date, as well as to corporations organized prior to the Revision's effective date, who amend their certificates of incorporation in the manner provided by subsection 14A:10-3(3).

N.J. STAT. ANN. § 14A:10-3 commentary at 50 (West 1969).

565. Former N.C. GEN. STAT. § 55-165 (1950) (quoted *supra* in note 301).

566. Act of May 26, 1955, ch. 1371, 1955 N.C. Sess. Laws 1432 (effective July 1, 1957); *see supra* note 252 (second paragraph).

567. Former N.C. GEN. STAT. § 55-108(b) (1982). The occasions for class voting were enumerated in former section 55-101(a). *See id.* § 55-101(a).

568. *See* Act of June 8, 1989, ch. 265, 1989 N.C. Sess. Laws 566 (effective July 1, 1990); *supra* note 252 (third paragraph).

569. The "shareholders entitled to vote" exclude holders of shares which (by terms of the charter) are non-voting. *See* N.C. GEN. STAT. § 55-6-01(d)(1) (1990). Also excluded are holders of shares in the following categories: (i) in the absence of "special circumstances," parent company shares owned by a subsidiary when the parent owns "a majority of the shares entitled to vote for directors" of the subsidiary, *see id.* § 55-7-21(b), and (ii) redeemable shares that have been called for redemption, *see id.* § 55-7-21(d). There is no exclusion for treasury shares—other than in section 55-7-21(a), which provides for voting only by "outstanding" shares—because the new North Carolina statute does not recognize treasury shares, *see id.* § 55-6-31(a).

> (acting pursuant to subsection (c))[570] require a greater vote or a vote by voting groups,[571] the plan of merger ... to be authorized must be approved by each voting group entitled to vote separately on the plan by a majority of all the votes entitled to be cast on the plan by that voting group ....
>
> (f) Separate voting by voting groups is required:
>
> (1) On a plan of merger if the plan contains a provision that, if contained in a proposed amendment to articles of incorporation, would require action by one or more separate voting groups on the proposed amendment under G.S. 55-10-04, except where the consideration to be received in exchange for the shares of that group consists solely of cash;
>
> ....[572]

These provisions are based on the 1984 Model Business Corporation Act with two differences.[573]

The Model Act was amended, in 1962, by eliminating the provision giving non-voting shares the right to vote on mergers and by restating the voting requirement in terms of "shares entitled to vote thereon."[574] In 1969, the Model Act was further amended to

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570. *See* N.C. GEN. STAT. § 55-11-03(c) (Supp. 1996) ("The board of directors may condition its submission of the proposed merger ... on any basis."). The same provision appears in the Model Act. *See* MODEL BUS. CORP. ACT ANN. § 11.03(c) (1996).

571. The North Carolina statute defines this term as follows:

> "Voting group" means all shares of one or more classes or series that under the articles of incorporation or this Chapter are entitled to vote and be counted together collectively on a matter at a meeting of shareholders. All shares entitled by the articles of incorporation or this Chapter to vote generally on the matter are for that purpose a single voting group.

N.C. GEN. STAT. § 55-1-40(26) (Supp. 1996). This is the same as the definition in the Model Act. *See* MODEL BUS. CORP. ACT ANN. § 1.40(26) (1996).

572. N.C. GEN. STAT. § 55-11-03(b), (e)-(f) (Supp. 1996).

573. The Model Business Corporation Act's section 11.03(e) does not contain the phrase "a bylaw adopted by the shareholders," and its section 11.03(f)(1) does not contain the clause "except where the consideration to be received in exchange for the shares of that group consists solely of cash." *See* MODEL BUS. CORP. ACT ANN. § 11.03(e), (f)(1) (1996).

574. Among the comments to section 73 of the 1969 Model Act was the following:

> The Model Act as originally drafted provided that each share carried the right to vote on a proposed plan of merger or consolidation, whether or not entitled to vote under the articles of incorporation. In 1962 an amendment eliminated this provision on the ground that shareholders who had waived the right to vote on all other fundamental issues deserved no inalienable right to vote on mergers and consolidations, and voting on a proposed plan of merger or consolidation was made conditional upon receiving only the affirmative vote of holders of ... shares entitled to vote thereon.

MODEL BUS. CORP. ACT ANN. § 73 commentary at 365 (1971).

reduce the vote of shares required for a merger from two-thirds to a simple majority.[575] The Model Act continued to require class voting when the plan of merger proposed a change which, if made by way of a charter amendment, would give rise to a class vote.[576] The merger voting provisions of the 1984 Model Act are the same as the North Carolina provisions set forth above (with the differences there noted).[577]

(2) Cases and Commentary

The move from requiring a two-thirds vote to a simple majority vote for shareholder approval of a merger was a significant step in the right direction. The same can be said of the elimination of provisions giving non-voting shares a right to vote on a merger when no class vote was involved.[578]

The New Jersey statute seems mistaken in permitting a merger to be approved by less than a majority of the outstanding voting shares.[579] If a corporation has 1,000,000 voting shares outstanding and 500,001 of those shares are present or represented at a meeting (thereby satisfying the quorum requirement), the affirmative vote of 250,001 shares (even assuming that all of the 500,001 shares are voted) is sufficient under this statute to approve a merger—even though that constitutes only 25% (plus one share) of the outstanding voting stock.

While the current statutes of New Jersey and North Carolina (as well as the provisions of the 1984 Model Business Corporation Act)

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575. The comment on this point included the following: "[I]n 1969 an amendment reduced the required vote from two-thirds to a majority in recognition of the generally prevailing view that, unless otherwise provided in the articles, a minority should not be permitted to block the wishes of the majority." *Id.*

576. *See id.*

577. *See supra* text accompanying notes 569-73.

578. Both of these points have been alluded to earlier. *See supra* notes 307-13 and accompanying text.

The vice of requiring an approving vote of two-thirds (rather than a majority) of the outstanding shares is illustrated by *Aiple v. Twin City Barge & Towing Co.*, 143 N.W.2d 374 (Minn. 1966), and *Rath v. Rath Packing Co.*, 136 N.W.2d 410 (Iowa 1965). *See supra* notes 307-08. Nonetheless, the vote required for approval of a merger in New York as recently as 1984 was said to be "two thirds of the shareholders entitled to vote." Alpert v. 28 Williams St. Corp., 473 N.E.2d 19, 25 (N.Y. 1984).

579. The New Jersey statute provides that a plan of merger "shall be approved upon receiving the affirmative vote of a majority of the votes cast by the holders of shares . . . entitled to vote thereon." N.J. STAT. ANN. § 14A:10-3(2) (West Supp. 1997) (quoted *supra* in text accompanying notes 560-62).

call for class-voting on mergers in specified circumstances,[580] the Delaware statute does not. This aspect of Delaware law is not only unfortunate;[581] it is also strange, given the fact that the Delaware statute relating to charter amendments provides that "[t]he holders of the outstanding shares of a class shall be entitled to vote as a class upon a proposed amendment . . . if the amendment would . . . alter or change the powers, preferences, or special rights of the shares of such class so as to affect them adversely."[582] As everyone knows, rights of shareholders (particularly holders of preferred stock) can be adversely affected by a merger just as easily as by a charter amendment.[583]

While the 1989 rewrite of the North Carolina Business Corporation Act follows (for the most part) the 1984 Model Business Corporation Act, it departs from the Model Act in the provision calling for class voting on mergers.[584] The North Carolina provision denies the right of a class vote to the holders of a class if the shares of that class are to be converted into cash by terms of the merger[585]—leaving such holders with no power to veto the transaction but only a right of appraisal. What this permits (so far as the statute is concerned, and without regard to the doctrines of fiduciary duty and fairness) is that a class of non-redeemable preferred shares can be cashed out—that is, redeemed—by the directors and common shareholders through the simple expedient of a merger[586] with a wholly owned subsidiary.[587]

One of the unfortunate aspects of North Carolina's 1989

580. *See id.* (quoted *supra* in text accompanying notes 560-62); N.C. GEN. STAT. § 55-11-03(f)(1) (Supp. 1996) (quoted *supra* in text accompanying notes 570-72). For the Model Business Corporation Act, see *supra* text accompanying notes 576-77.

581. *See supra* text accompanying notes 310-13.

582. DEL. CODE ANN. tit. 8, § 242(b)(2) (1991).

583. *See, e.g.*, Rothschild Int'l Corp. v. Liggett Group, Inc., 474 A.2d 133, 136-37 (Del. 1984).

584. *See* N.C. GEN. STAT. § 55-11-03(f)(1) (Supp. 1996); *supra* note 573 (second clause).

585. This bizarre provision is virtually unexplained in the North Carolina Commentary, which says only this: "This provision [as set forth in the Model Business Corporation Act] was modified in subdivision (f)(1) to create an exception where the consideration to be received in exchange for the shares of the voting group consists solely of cash." N.C. GEN. STAT. § 55-11-03 commentary at 230 (1990).

586. Such a transaction probably would be effected by way of a long-form merger because of the limitation on use of a short-form merger. *See* N.C. GEN. STAT. § 55-11-04(e) (1990), *as amended by* Act of Aug. 26, 1997, ch. 485, § 29 (effective Oct. 1, 1997) (quoted *supra* in note 496).

587. This proposition assumes, in case the preferred is voting stock, that the common shares are more numerous and therefore capable of out-voting the preferred.

Business Corporation Act (and of the 1984 Model Business Corporation Act on which it is based) is that its voting provisions discarded the terminology of class voting—well understood by corporate lawyers for decades—and substituted the new and confusing terminology of "voting groups."[588]

3. Changes in Permissible Consideration

Although other states—with Florida leading the way in 1925—had earlier amended their statutes to permit the use of cash as merger consideration,[589] the merger statutes of the three subject states, other than that of North Carolina between 1943 and 1957,[590] did not authorize the use of cash prior to 1957.[591] Moreover, it was not until 1967 that any of the three states explicitly permitted—as valid merger consideration—stock of another corporation that was not a party to the merger.

a. Statutory Provisions

Use of cash as merger consideration was first authorized by Delaware and New Jersey in their short-form merger statutes.

588. A minor deficiency in section 55-11-03(b)(2) of the new North Carolina statute, and in section 11.03(b)(2) of the 1984 Model Business Corporation Act, both relating to shareholder approval of a plan of merger or share exchange, is that those sections provide only that "[t]he shareholders entitled to vote must approve the plan" and fail to add the words "as provided in subsections (e) and (f)" (those being the subsections that set forth the voting requirements). By way of contrast, section 55-10-03(b)(2) of the new North Carolina statute, and section 10.03(b)(2) of the 1984 Model Business Corporation Act, both relating to shareholder approval of a charter amendment, correctly provide that "[t]he shareholders entitled to vote ... must approve the amendment as provided in subsection (e)" (that being the subsection that sets forth the voting requirements). *Compare* N.C. GEN. STAT. § 55-11-03(b)(2) (Supp. 1996), *and* MODEL BUS. CORP. ACT ANN. § 11.03(b)(2) (1996), *with* N.C. GEN. STAT. § 55-10-03(b)(2) (Supp. 1996), *and* MODEL BUS. CORP. ACT ANN. § 10.03(b)(2) (1996).

589. *See* Weiss, *supra* note 4, at 632.

590. Use of cash was authorized by a 1943 rewriting of North Carolina's merger statute. *See supra* text accompanying notes 322-23. However, when that state enacted its 1955 Business Corporation Act, "cash" was dropped. *See* Act of May 26, 1955, ch. 1371, sec. 1, § 106(b)(4), 1955 N.C. Sess. Laws 1432, 1495 (effective July 1, 1957). The 1955 Act provided that the plan of merger was to set forth "[t]he manner and basis of converting the shares of each merging corporation into shares or other securities or obligations of the surviving corporation." *Id.*

591. There was New Jersey case law allowing the use of cash as part of the merger consideration. The New Jersey Commissioners' Comment—1968 contains the following:

> The use of cash as part consideration has been recognized in Windhurst v. Central Leather Co., but the statute may be subject to the limitations found in Outwater v. Public Service Corp. See Clarke v. Gold Dust Corp.

N.J. STAT. ANN. § 14A:10-1 commentary at 38 (West 1969) (citations omitted).

Delaware led the way in 1957,[592] followed by New Jersey in 1967;[593] but North Carolina did not adopt a short-form merger statute until 1989.[594]

When Delaware's General Corporation Law was rewritten in 1967, its basic long-form merger statute authorized as permissible consideration (in addition to shares or other securities of the surviving corporation) the use of either cash or securities of another corporation.[595] With some changes of wording,[596] Delaware's current long-form merger statute is virtually unlimited in what it permits as valid merger consideration.[597]

New Jersey followed, in 1968, by providing in its long-form merger statute that the consideration could consist of cash or securities of another corporation.[598] With some amendments,[599] New

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592. *See supra* text accompanying notes 460-62.

593. *See supra* text accompanying notes 475-77.

594. *See supra* text accompanying notes 492-95.

595. The 1967 Delaware statute provided that the merger agreement was to state:

> (4) the manner of converting the shares of each of the constituent corporations into shares or other securities of the corporation surviving or resulting from the merger or consolidation and, if any shares of any of the constituent corporations are not to be converted solely into shares or other securities of the surviving or resulting corporation, the amount of cash or securities of any other corporation which is to be paid or delivered to the holders of such shares in exchange for or upon the surrender of such shares, which cash or securities of any other corporation may be in addition to the shares or other securities of the surviving or resulting corporation into which any of the shares of any of the constituent corporations are to be converted; . . . .

Act of July 3, 1967, ch. 50, sec. 1, § 251(b)(4), 56 Del. Laws 151, 206-07.

596. *See* Act of Jan. 2, 1968, ch. 186, § 16, 56 Del. Laws 610, 612-13 (1967); Act of June 23, 1969, ch. 148, § 22, 57 Del. Laws 433, 443-44 (effective July 15, 1969); Act of July 8, 1983, ch. 112, § 30, 64 Del. Laws 285, 289 (effective July 1, 1983); Act of July 9, 1987, ch. 136, § 18, 66 Del. Laws 335, 338 (changing the designation of section 251(b)(4) to section 251(b)(5)); Act of July 8, 1992, ch. 337, § 1, 68 Del. Laws 1159, 1159 (effective July 1, 1992).

597. Delaware's General Corporation Law now provides that the merger agreement is to state:

> (5) the manner of converting the shares of each of the constituent corporations into shares or other securities of the corporation surviving or resulting from the merger or consolidation and, if any shares of any of the constituent corporations are not to be converted solely into shares or other securities of the surviving or resulting corporation, the cash, property, rights or securities of any other corporation or entity which the holders of such shares are to receive in exchange for, or upon conversion of such shares and the surrender of any certificates evidencing them, which cash, property, rights or securities of any other corporation or entity may be in addition to or in lieu of shares or other securities of the surviving or resulting corporation; . . . .

DEL. CODE ANN. tit. 8, § 251(b)(5) (Supp. 1996).

598. *See* Act of Nov. 21, 1968, ch. 350, § 14A:10-1(2)(c), 1968 N.J. Laws 1011, 1094

Jersey's Business Corporation Act now provides that the plan of merger is to set forth "[t]he manner and basis of converting the shares of each corporation into shares, obligations, or other securities of the surviving corporation ... or of any other corporation ... or, in whole or in part, into cash or other property."[600]

North Carolina's 1955 Business Corporation Act was amended in 1969,[601] and again in 1973,[602] to follow the Delaware and New Jersey approach concerning permissible merger consideration.[603] Its 1989 Business Corporation Act, employing the language of the 1984 Model Business Corporation Act,[604] provides that "[t]he plan of merger must set forth: ... (3) The manner and basis of converting the shares of each corporation into shares, obligations, or other securities of the surviving or any other corporation or into cash or other property in whole or part."[605]

b. Cases and Commentary

The statutory changes noted above have had two significant consequences. First, they made possible the cash-out merger; second,

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(effective Jan. 1, 1969). The Commissioners' Comment—1968 states in part:

> This section substantially follows section 65 of the Model Act except that paragraph 14A:10-1(2)(c) has been clarified to permit as consideration for the merger cash as in the New York Act (N.Y. Bus. Corp. Law § 902(a)(3)[)], or the securities or obligations of corporations not a party to the merger as in the Delaware Act (Del. Code Ann. tit. 8, § 252(b)(3) [sic] (Rev. 1967)).

N.J. STAT. ANN. § 14A:10-1 commentary at 37 (West 1969).

599. *See* Act of Jan. 7, 1974, ch. 366, § 51, 1973 N.J. Laws 964, 1018 (effective May 1, 1974); Act of Dec. 15, 1995, ch. 279, § 12, 1995 N.J. Laws 1692, 1706-07 (effective Mar. 14, 1996).

600. N.J. STAT. ANN. § 14A:10-1(2)(c) (West Supp. 1997).

601. *See* Act of June 11, 1969, ch. 751, § 37, 1969 N.C. Sess. Laws 773, 780.

602. *See* Act of May 14, 1973, ch. 469, § 31, 1973 N.C. Sess. Laws 545, 554 (effective Oct. 1, 1973).

603. The North Carolina statute provided that the plan of merger was to set forth:

> (4) The manner and basis of converting the shares of each of the constituent corporations into shares or other securities or obligations of the surviving corporation, and, if any shares of any of the constituent corporations are not to be converted solely into shares or other securities or obligations of the surviving corporation, the cash, property, rights or shares or other securities or obligations of any other corporation which the holders of such shares are entitled to receive in exchange for such shares or upon their conversion and the surrender of the certificates evidencing such shares, which cash, property, rights or shares or other securities or obligations of any other corporation may be in addition to or in lieu of the shares or securities or obligations of the surviving corporation....

Former N.C. GEN. STAT. § 55-106(b)(4) (1982).

604. *See* MODEL BUS. CORP. ACT ANN. § 11.01(b)(3) (1996).

605. N.C. GEN. STAT. § 55-11-01(b)(3) (1990).

they made possible the triangular merger.

(1) Cash-Out Merger[606]

(a) The Problem Entailed

Following the authorization of cash as permissible merger consideration, the cash-out merger became the device of choice[607] in eliminating minority shareholders from a controlled corporation.[608]

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606. Articles on this subject include the following: Arthur M. Borden, *Going Private—Old Tort, New Tort or No Tort?*, 49 N.Y.U. L. REV. 987 (1974); Victor Brudney, *A Note on "Going Private,"* 61 VA. L. REV. 1019 (1975); Victor Brudney & Marvin A. Chirelstein, *A Restatement of Corporate Freezeouts*, 87 YALE L.J. 1354 (1978); Dierdre A. Burgman & Paul N. Cox, *Reappraising the Role of the Shareholder in the Modern Public Corporation*: Weinberger*'s Procedural Approach to Fairness in Freezeouts*, 1984 WIS. L. REV. 593; Edward F. Greene, *Corporate Freeze-out Mergers: A Proposed Analysis*, 28 STAN. L. REV. 487 (1976); Carole B. Silver, *Fair Dealing Comes of Age in the Regulation of Going Private Transactions*, 9 J. CORP. L. 385 (1984); Marc I. Steinberg & Evalyn N. Lindahl, *The New Law of Squeeze-Out Mergers*, 62 WASH. U. L.Q. 351 (1984); and Weiss, *supra* note 4.

607. There is another device by which minority shareholders can be eliminated. It is not discussed herein because it does not involve a corporate combination. The device is the reverse stock split. The subject is discussed in the following: Paul H. Dykstra, *The Reverse Stock Split—That Other Means of Going Private*, 53 CHI.-KENT L. REV. 1 (1976); Michael J. Lawson, Comment, *Reverse Stock Splits: The Fiduciary's Obligations Under State Law*, 63 CAL. L. REV. 1226 (1975); and Michael R. Rickman, Note, *Reverse Stock Splits and Squeeze-outs: A Need for Heightened Scrutiny*, 64 WASH. U. L.Q. 1219 (1986).

The reverse stock split has been the subject of litigation on several occasions. *See* Teschner v. Chicago Title & Trust Co., 322 N.E.2d 54, 57-58 (Ill. 1974) (holding that a 1-for-600 reverse stock split was valid when there was no claim of fraud or deception, no showing of any improper purpose, and no charge that the price paid for a fractional share was inadequate); Lerner v. Lerner, 511 A.2d 501, 502-03, 511-12 (Md. 1986) (sustaining a preliminary injunction against a proposed 1-for-35 reverse stock split whereby one brother owning 25 of the 95 outstanding shares would have been cashed out and another brother owning the other 70 shares would have wound up with the only two shares outstanding); Leader v. Hycor, Inc., 479 N.E.2d 173, 174-75, 177-79 (Mass. 1985) (holding, when a 1-for-4000 reverse stock split was effected in 1980 following a going public transaction in 1969, that the evidence supported the trial court's rejection of the plaintiff's claim that the recapitalization was not designed to achieve a legitimate business purpose, and remanding on the question of fairness of the price at which fractional shares were to be paid out); Clark v. Pattern Analysis & Recognition Corp., 384 N.Y.S.2d 660, 662, 665 (Sup. Ct. 1976) (granting a temporary injunction when no legitimate business purpose was shown for eliminating the minority through a 1-for-4000 reverse stock split).

The new North Carolina statute gives a right of dissent and appraisal with respect to a reverse stock split. *See* N.C. GEN. STAT. § 55-13-02(a)(4)(v) (Supp. 1996) (quoted *infra* in note 1226).

608. A cash-out merger to eliminate minority shareholders would not occur in the context of a widely held public corporation in which no entity or cohesive group has a controlling stock interest. Nor could it occur in the context of a closely held corporation whose voting shares are evenly divided between two individuals or two cohesive groups (such as two families) or whose minority shareholders have successfully bargained for

To highlight the problem inherent in such cash-out mergers, it is important to contrast arm's length transactions and interested-party mergers.

When a cash merger is negotiated at arm's length between the managements of two previously unrelated corporations, all shareholders (of each class) of the disappearing corporation receive equal (pro rata) treatment, and consummation of the transaction requires a meaningful vote by holders of that company's voting shares. In these circumstances, there is little basis upon which a dissenting shareholder of the disappearing corporation might expect to obtain equitable relief.[609]

From the point of view of minority shareholders of a controlled corporation involved in a cash merger, matters are quite different. If the controlled corporation involves a parent-subsidiary relationship and the subsidiary is merged into its parent, or if the controlling interest is held by an individual or cohesive group and the controlled corporation is merged into another corporation (previously existing or newly created) that is wholly owned by the individual or group, two of the safeguards that protect the interests of shareholders of the disappearing corporation in an arm's length merger are missing. First, since the controlling party sits on both sides of the transaction and thereby dictates its terms, there is a lack of any bargaining (absent a negotiating committee charged with representation of the

veto powers at the time of the corporation's organization. Moreover, management-led recapitalizations employing the merger device—as, for example, in *Federal United Corp. v. Havender*, 11 A.2d 331, 333-34 (Del. 1940), and *Bove v. Community Hotel Corp.*, 249 A.2d 89, 91 (R.I. 1969)—have usually involved the use of new securities, rather than cash, as merger consideration. Thus, it is probably accurate to say that a cash-out merger is likely to occur only in the context of a controlled corporation, *see supra* note 401, when control—at both the board level and the shareholder level—is exercised either by another entity or by a cohesive group of shareholders.

609. When the merger terms have been arrived at through arm's length negotiation, the requirement of fairness has limited significance. A shareholder mounting a legal challenge to such a merger on fairness grounds will have the burden of establishing unfairness of the transaction. And, if the transaction is one requiring approval by the plaintiff's fellow shareholders, the court is likely to regard an approving shareholder vote as a sufficient mark of the fairness of the transaction from the perspective of that shareholder body. Moreover, if the right of appraisal is accorded to dissenting shareholders, the plaintiff is likely to be confronted with the contention that the appraisal remedy is exclusive in the absence of fraud or illegality. As a practical matter, a complaining shareholder of the disappearing corporation is reduced to the contention that the merger consideration is so grossly inadequate as to amount to constructive fraud. And the standard required for a showing of constructive fraud is so demanding that a complaining shareholder seldom succeeds in making the required showing. *See supra* note 379.

minority's interests[610]). Second, since the controlling party owns a controlling interest in the stock of the disappearing corporation, the outcome of the shareholder vote on the transaction is predetermined and therefore meaningless (unless consummation of the merger is conditioned upon the favorable vote of a majority of the minority[611]).

Of course, the two safeguards missing in an interested-party merger are absent even when the merger consideration consists of common stock of the surviving corporation. However, in a stock merger of a majority-owned subsidiary into its parent,[612] the minority holders—while eliminated as shareholders of the disappearing corporation to become a smaller minority of the parent's shareholders—would at least continue to have an equity interest in the combined enterprise.[613] Moreover, if parent company stock was used as the merger consideration, the transaction could be structured as a tax-free reorganization so that there would be no immediate tax consequences for the subsidiary's minority shareholders.[614] In a cash merger, on the other hand, the controlling party winds up with the wherewithal to continue the business of the controlled corporation, while the minority shareholders of that corporation wind up with nothing but cash and (possibly) a tax liability.

Thus, in a cash-out merger, the controlling party has not only caused the transaction to be effected but has also done so to its own benefit and to the detriment of the minority shareholders. In short, the controlling party has engaged in self-dealing[615] in breach of its fiduciary duty[616] and with more severe consequences for minority

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610. Use of this technique is discussed in Steinberg & Lindahl, *supra* note 606, at 367-71.

611. Weiss advances three arguments "against giving substantial weight to an approving vote by a majority of the minority shareholders." Weiss, *supra* note 4, at 676-77.

612. As a practical matter, in a merger transaction engineered by controlling individuals using their wholly owned corporation as the survivor, stock of the latter corporation would not be utilized, because nothing would be accomplished—the minority would not be eliminated.

613. *See supra* note 325 and accompanying text.

614. *See supra* text accompanying note 326.

615. In *Schreiber v. Bryan*, 396 A.2d 512 (Del. Ch. 1978), the court said:

> The traditional prerequisite for invoking the intrinsic fairness test, in a parent-subsidiary context, is that the parent controls the making of the transaction and the fixing of its terms. This rule has been narrowed, however, to require that there also be a showing of self-dealing, i.e., that the parent benefited to the exclusion of and to the detriment of the minority stockholders of the subsidiary.

Id. at 519 (citing Sinclair Oil Corp. v. Levien, 280 A.2d 717 (Del. 1971); Getty Oil Co. v. Skelly Oil Co., 267 A.2d 883 (Del. 1970)).

616. In *Alpert v. 28 Williams Street Corp.*, 473 N.E.2d 19 (N.Y. 1984), the court said:

shareholders than in the case of an interested-party merger using stock of the controlling corporation.

(b) The Judicial Response

The courts have had difficulty in dealing with cash-out mergers, and their decisions have gone in different directions.[617] The difficulty can be illustrated best by examining the tortuous evolution of the decisions in Delaware.

For some years after Delaware's authorization of the use of cash as merger consideration (1957 for short-form mergers and 1967 for long-form mergers), minority shareholders enjoyed no success in obtaining relief other than appraisal when they were eliminated as shareholders by way of a cash-out merger. Two years after enactment of the 1957 short-form merger statute, the Delaware Supreme Court, in *Coyne v. Park & Tilford Distillers Corp.*,[618] held that minority shareholders of a subsidiary could be cashed out by way of a short-form merger, notwithstanding the fact that they had acquired their stock prior to enactment of the statute authorizing the use of cash as merger consideration. Three years later, in *Stauffer v. Standard Brands Inc.*,[619] that court held that, in the absence of fraud or illegality, appraisal was the exclusive remedy of a minority

> Fair dealing and fair price alone will not render the [cash-out] merger acceptable. As mentioned, there exists a fiduciary duty to treat all shareholders equally. This duty arises as a concomitant to the power reposed in the majority over corporate governance. The fact remains, however, that in a freeze-out merger the minority shareholders are being treated in a different manner: the majority is permitted continued participation in the equity of the surviving corporation while the minority has no choice but to surrender their shares for cash. On its face, the majority's conduct would appear to breach this fiduciary obligation.

Id. at 27-28 (citations omitted).

617. In some cases, cash-out mergers have been sustained on the ground that appraisal constituted the only remedy available to dissenting shareholders. *See, e.g.*, Yanow v. Teal Indus., Inc., 422 A.2d 311, 320 (Conn. 1979); Beloff v. Consolidated Edison Co., 87 N.E.2d 561, 564 (N.Y. 1949). But in other cases, such mergers have been invalidated on the ground that there was no valid business purpose to sustain them. *See, e.g.*, Bryan v. Brock & Blevins Co., 490 F.2d 563, 570-71 (5th Cir. 1974); Gabhart v. Gabhart, 370 N.E.2d 345, 356 (Ind. 1977) (paying shareholders with five-year debentures instead of immediate cash). In others, invalidation has been based on fiduciary duty and the requirement of entire fairness. *See, e.g.*, Berkowitz v. Power/Mate Corp., 342 A.2d 566, 571-74 (N.J. Super. Ct. Ch. Div. 1975).

618. 154 A.2d 893 (Del. 1959); *see infra* text accompanying notes 1256-63.

619. 187 A.2d 78 (Del. 1962). In this case, Standard Brands, owning more than 90% of the stock of Planters (Pennsylvania), changed Planters's domicile by merging it into a newly created corporation, Planters (Delaware), and then cashed out Planters's minority shareholders by way of an upstream short-form merger. *See id.* at 79.

shareholder in a short-form cash-out merger.[620] Then, in a 1971 decision by Delaware's chancery court in *David J. Greene & Co. v. Schenley Industries, Inc.*,[621] involving a long-form merger in which a parent corporation eliminated the minority interest in a subsidiary through the use of cash and fifteen-year debentures, the court denied injunctive relief, holding that the plaintiffs' "recourse is to an appraisal" when "no fraud or blatant overreaching is demonstrated."[622]

Cashed-out plaintiffs had a similar lack of success when they sought relief under S.E.C. Rule 10b-5.[623] In *Santa Fe Industries, Inc. v. Green*,[624] the Supreme Court held that, when full disclosure had been made with respect to a cash-out merger, an alleged breach of fiduciary duty was not actionable under Rule 10b-5. After noting that some states required a "valid corporate purpose" for eliminating a minority interest through a short-form merger while others (specifically Delaware) did not,[625] the Court made the following observation: "There may well be a need for uniform federal fiduciary standards to govern mergers such as that challenged in this complaint."[626]

Against this backdrop, the Delaware Supreme Court, in 1977, embarked upon a short-lived embrace of the business purpose test for the evaluation of cash-out mergers. In *Singer v. Magnavox Co.*,[627] involving a long-form cash-out merger following acquisition of 84% of the corporate stock through a tender offer, the Delaware Supreme Court held that such a merger "accomplished without any purpose other than elimination of the minority stockholders"—that is, without any valid business purpose—is "violative of the fiduciary duty owed by the majority to the minority stockholders" and that such a merger, "made for the sole purpose of freezing out minority stockholders, is an abuse of the corporate process" and, further, that "defendants cannot meet their fiduciary obligations to plaintiffs

620. The *Stauffer* court said: "[T]he very purpose of the [short-form merger] statute is to provide the parent corporation with a means of eliminating the minority shareholder's interest in the enterprise." *Id.* at 80. This point was reiterated in *In re Delaware Racing Ass'n*, 213 A.2d 203, 209 (Del. 1965).

621. 281 A.2d 30 (Del. Ch. 1971).

622. *Id.* at 35.

623. 17 C.F.R. § 240.10b-5 (1997).

624. 430 U.S. 462 (1977).

625. *See id.* at 479 n.16.

626. *Id.* at 479-80.

627. 380 A.2d 969 (Del. 1977).

simply by relegating them to a statutory appraisal proceeding."[628] Later in that year, the same court decided *Tanzer v. International General Industries, Inc.*,[629] holding that a bona fide purpose was required to justify a long-form cash-out merger but that a purpose of the parent corporation—that of facilitating long-term debt financing—was sufficient.[630] Then, in 1979, the court held, in *Roland International Corp. v. Najjar*,[631] that the principles announced in *Singer* with respect to a long-form merger applied also to a short-form cash-out merger.[632] Thus, the Delaware Supreme Court had done a complete about-face with respect to its 1962 decision in *Stauffer v. Standard Brands Inc.*[633]

In 1983, that court did its second about-face in the space of six years. In *Weinberger v. UOP, Inc.*,[634] the court stated that "the business purpose requirement of the trilogy of *Singer*, *Tanzer*, *Najjar* ... shall no longer be of any force or effect."[635] In place of the business purpose test,[636] the *Weinberger* court focused on a fiduciary

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628. *Id.* at 980, 977.

629. 379 A.2d 1121 (Del. 1977).

630. A year later, the Delaware Chancery Court decided the case of *Young v. Valhi, Inc.*, 382 A.2d 1372 (Del. Ch. 1978). Notwithstanding alleged saving of corporate taxes and avoidance of future conflicts of interest, a cash-out merger with a newly created wholly owned subsidiary was enjoined when the court concluded that the basic purpose of the merger was to eliminate the minority interest. *See id.* at 1378-79.

631. 407 A.2d 1032, 1036 (Del. 1979). In this case, parties owning 97.6% of the stock of Roland transferred that stock to a newly created corporation, Landro, in exchange for all of Landro's stock, and then attempted to cash out the 329 minority shareholders of Roland by way of a short-form merger of Landro into Roland. *See id.* at 1033.

The decision in *Najjar* was foreshadowed by the chancellor's decision in *Kemp v. Angel*, 381 A.2d 241, 244-45 (Del. Ch. 1977) (expressing the view that the *Singer* doctrine should be applied to short-form, as well as long-form, cash-out mergers).

632. In *Harman v. Masoneilan International, Inc.*, 442 A.2d 487 (Del. 1982), the *Singer* business purpose doctrine was reiterated even when the merger consideration received by the minority shareholders consisted of stock rather than cash. *See id.* at 492-93.

633. *See supra* notes 619-20 and accompanying text.

634. 457 A.2d 701 (Del. 1983). For a useful analysis of this decision, see Elliott J. Weiss, *The Law of Take Out Mergers:* Weinberger v. UOP, Inc. *Ushers in Phase Six*, 4 CARDOZO L. REV. 245 (1983).

635. *Weinberger*, 457 A.2d at 715.

636. Courts in other jurisdictions applied the *Singer* doctrine prior to the decision in *Weinberger*. *See* Dower v. Mosser Indus., Inc., 648 F.2d 183, 188-89 (3d Cir. 1981) (applying the business purpose test but holding that facilitation of financing constituted a valid purpose); Perl v. IU Int'l Corp., 607 P.2d 1036, 1045-46 (Haw. 1980) (embracing the *Singer* business purpose doctrine in a case involving a reverse triangular merger).

And some courts applied the *Singer* doctrine after (and notwithstanding) *Weinberger*. *See* Coggins v. New England Patriots Football Club, 492 N.E.2d 1112, 1116-17 (Mass. 1986) (holding that a cash-out merger must meet the business purpose test as well as the test of fairness); Alpert v. 28 Williams St. Corp., 473 N.E.2d 19, 28-29 (N.Y. 1984)

duty/entire fairness test as the proper basis for evaluating a cash-out merger. In the fiduciary duty part of that test, it stressed the duty of loyalty;[637] and, in the entire fairness part of the test, it stressed fair dealing as well as fair price.[638]

(c) Some Unfinished Business

The *Weinberger* court came down on solid ground when it made the fiduciary duty of loyalty and the requirement of entire fairness the focal points in dealing with cash-out mergers. However, the Delaware Supreme Court has yet to address squarely two points that appear to deserve attention.

The result of a cash-out merger (as noted above) is that the controlling party winds up with the wherewithal to continue the business of the controlled corporation, while the minority shareholders wind up with nothing but cash. Such a result (if achieved without resort to a negotiating committee capable of engaging in arm's length bargaining or to an informed vote of a majority of the minority) would seem to violate two of the principal ingredients of the duty of loyalty: the controlling shareholder (or cohesive group) has used its fiduciary position to benefit itself to the detriment of the minority,[639] and there has been disparate treatment of the majority and minority shareholders.[640] With respect to entire fairness or lack thereof, the controlling shareholder has made a unilateral decision as to when and on what terms the minority shareholders are to sell their stock in the enterprise.[641] Upon revisiting the concepts of the fiduciary duty of loyalty and the

(holding that, in an equitable action challenging a freeze-out merger, a court should consider, among other things, "whether there exists any independent corporate purpose for the merger," but holding also that the need of the business to attract additional capital constituted "a bona fide business purpose"). *But see* Persinger v. Carmazzi, 441 S.E.2d 646, 654 (W. Va. 1994) (expressing agreement with *Weinberger*'s rejection of the *Singer* business purpose requirement "so long as the terms tendered to the minority stockholders [in a cash-out merger] accurately reflect the fair market value of the minority interest").

637. *See Weinberger*, 457 A.2d at 710-11.

638. *See id.* at 711-12.

639. *See supra* note 427 and accompanying text, and notes 447-48 and accompanying text.

640. *See supra* notes 428-29 and accompanying text.

641. *See* Borden, *supra* note 606, at 1015 ("The chief objection of minority public shareholders to going-private transactions is that public policy should not permit the controlling shareholders to fix the price at which they will use the assets of the corporation to buy out the remaining shareholders."); Vorenberg, *supra* note 4, at 1202 ("[T]he nub of the problem is that an absolute freeze-out right would mean that those in control rather than the stockholder himself would decide when he shall sell his stock.").

requirement of entire fairness, the Delaware Supreme Court may yet have occasion to qualify its statement—made in a 1984 cash-out merger case—that "[i]t is ... settled under Delaware law that minority stock interests may be eliminated by merger."[642]

The other point that deserves attention involves the question whether the elimination of minority shareholders by way of merger should be confined to stock mergers. While recognizing that there may be good reasons why the management of a parent corporation might want to eliminate the minority interest in a majority-owned subsidiary, it should be understood that this objective can be accomplished, not only by a cash merger, but also by a stock merger.[643] In the classic case of *Sterling v. Mayflower Hotel Corp.*,[644] the minority interest in the subsidiary (Mayflower) was eliminated by way of a long-form merger of Mayflower into its parent (Hilton) using common stock of Hilton as the merger consideration, so that minority shareholders of Mayflower (excluding any who may have elected to exercise their appraisal rights) became shareholders of Hilton.[645] Similarly, in *Tanzer*,[646] the minority interest in Kliklock

642. Rothschild Int'l Corp. v. Liggett Group, Inc., 474 A.2d 133, 136 (Del. 1984) (involving an unsuccessful challenge by preferred shareholders of a cash-out merger, following a tender offer, at a price substantially below the preferred's liquidation preference).

Only seven years earlier, in *Tanzer v. International General Industries, Inc.*, 379 A.2d 1121 (Del. 1977), the same court had said: "In *Singer* ..., we held that a merger of a Delaware corporation caused by a majority stockholder solely for the purpose of cashing-out minority stockholders is a violation of a fiduciary duty owed by the former to the latter." *Id.* at 1122. Other courts, as well, have said that a cash-out merger constitutes a breach of fiduciary duty. *See* Umstead v. Durham Hosiery Mills, Inc., 578 F. Supp. 342, 345 (M.D.N.C. 1984) ("[P]laintiffs' allegation, taken as true, that defendants intended to freeze out the minority shareholders adequately states a breach of fiduciary duty claim."); Perl v. IU Int'l Corp., 607 P.2d 1036, 1046 (Haw. 1980) ("We agree that a merger effected for the sole purpose of freezing out the minority interest is a violation of fiduciary principles governing the relationship between controlling and minority shareholders."). *But see* Rosenstein v. CMC Real Estate Corp., 522 N.E.2d 221, 223-24 (Ill. App. Ct. 1988) (holding that a reverse triangular cash-out merger, engineered by a parent corporation, did not entail any breach of fiduciary duty).

643. The transaction might take the form of a merger of a subsidiary into its parent, with stock of the parent used as the merger consideration. With authorization given for the use of stock of another corporation as merger consideration, *see supra* text accompanying notes 595-605, the transaction might take the form of a merger of the subsidiary with a newly created subsidiary of the parent using stock of the parent as the merger consideration.

644. 93 A.2d 107 (Del. 1952).

645. Before the merger, the minority shareholders held approximately 17.4% of Mayflower's outstanding common stock. *See id.* at 108. After the merger, if no one had exercised the right of appraisal, the former minority shareholders of Mayflower would have wound up owning approximately 4.1% of Hilton's outstanding common stock. *See*

could have been eliminated by way of a merger using IGI stock; and, in *Weinberger*,[647] the minority interest in UOP could have been eliminated by way of a merger utilizing Signal stock. Given the benefits—a continuing equity interest with tax free treatment[648]—that would accrue to minority shareholders from use of parent company stock as the merger consideration, the question that arises is whether the use of cash to eliminate the minority interest is consistent with the duty of entire fairness owed by the controlling shareholder to the minority.[649] During the period from 1977 to 1983, when the Delaware Supreme Court was examining the question whether there was a valid business purpose to sustain a take-out merger, perhaps it should have been examining the question whether there was a valid business purpose for using cash rather than parent company stock in effecting the elimination of the subsidiary's minority shareholders.[650] A requirement that parent company stock be used in effecting a merger of a subsidiary into its parent (or into a newly created subsidiary of the parent) would ensure that minority shareholders of the subsidiary could retain a continuing equity interest in the total post-merger enterprise (parent or parent plus new subsidiary) comparable to their interest in the total pre-merger enterprise (parent plus former subsidiary), thereby conforming more nearly with the mandates of the fiduciary duty of loyalty and the requirement of entire fairness.[651]

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id. at 108-09.

646. *See supra* text accompanying notes 629-30.

647. *See supra* text accompanying notes 634-38.

648. *See supra* text accompanying notes 325-26 and 613-14.

649. In *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983), the court said: "The requirement of fairness is unflinching in its demand that where one stands on both sides of a transaction, he has the burden of establishing its entire fairness, sufficient to pass the test of careful scrutiny by the courts." *Id.* at 710. This statement was repeated in *Rosenblatt v. Getty Oil Co.*, 493 A.2d 929, 937 (Del. 1985).

650. In *In re Delaware Racing Ass'n*, 213 A.2d 203 (Del. 1965), Delaware Park, a charitable corporation, owning more than 90% of the stock of Steeplechase, transferred that stock to its wholly owned subsidiary, Racing, and then caused Steeplechase to be merged into Racing by way of a cash-out short-form merger. *See id.* at 207-09. Because the parent was a charitable corporation, and as such did not issue stock, there was a compelling reason to use cash in effecting the merger.

Borden draws a distinction between requiring the use of stock in the case of a public operating parent eliminating the minority interest in a public subsidiary and permitting the use of cash in the case of a non-public operating parent eliminating such a minority interest. *See* Borden, *supra* note 606, at 1018-19.

651. It may not be too great a stretch to view the parent's shareholders and the subsidiary's minority holders as two groups of shareholders in one combined enterprise and to say that, in a take-out merger, both groups should be treated evenly. *See* Brudney & Chirelstein, *supra* note 606, at 1375 ("The effect then [of using parent company stock in a take-out merger] is to allow management to unite its stockholder groups without

Some observations are in order concerning the suggestion that a parent corporation be required (absent a valid reason for doing otherwise) to use shares of its stock rather than cash in eliminating minority shareholders from a controlled corporation.[652] First, such a requirement would preclude a transaction in which individuals, owning a controlling stock interest in a corporation, transfer such stock to a newly created shell corporation and then bring about a cash merger between the controlled corporation and the shell corporation for the purpose of eliminating the minority interest.[653] Second, in order to preserve the right of appraisal for dissenting shareholders of a Delaware subsidiary whose shares are marketable (in the sense of being listed on a national securities exchange or designated as a national market system security or being held of record by more than 2000 holders), it would be necessary to amend the flawed provisions of the Delaware appraisal statute (discussed below) that deny appraisal rights to such shareholders if their corporation disappears in a long-form merger and if, under the agreement of merger, they are to receive shares of the surviving corporation or marketable shares (similarly defined) of another corporation.[654] Third, the suggested requirement that parent

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preferring one group to the other.").

652. This suggested requirement does not overlook the fact that, if minority shareholders are cashed out of a subsidiary of a publicly traded parent, such shareholders could use the cash received by them in the merger to purchase shares of the parent's stock in the open market. The problem, of course, is that brokerage commissions would, and capital gains taxes might, reduce the number of parent company shares that could be purchased with the cash proceeds from the merger.

Brudney and Chirelstein suggest that, in mergers between publicly held parents and their subsidiaries, the subsidiaries' shareholders should receive common stock of the parent or enough cash "to enable them to reacquire the same proportionate interest in the parent that they would have possessed had the consideration received been common stock alone." *Id.* at 1372-73. One difficulty with this suggested cash alternative lies in the fact that different shareholders of the subsidiary will have different tax bases and therefore different capital gains (or losses) on their respective holdings of the subsidiary's stock.

653. Transactions of this kind have been invalidated in a number of cases. *See, e.g.*, Bryan v. Brock & Blevins Co., Inc., 490 F.2d 563, 570-71 (5th Cir. 1974); Albright v. Bergendahl, 391 F. Supp. 754, 756-57 (D. Utah 1974); Gabhart v. Gabhart, 370 N.E.2d 345, 353-56 (Ind. 1977); Berkowitz v. Power/Mate Corp., 342 A.2d 566, 570-74 (N.J. Super. Ct. Ch. Div. 1975); *see also* People v. Concord Fabrics, Inc., 371 N.Y.S.2d 550, 554 (Sup. Ct. 1975) (enjoining a cash-out merger, utilizing a shell corporation of the controlling family, in a suit brought not by complaining minority shareholders but by the state attorney general), *aff'd per curiam*, 377 N.Y.S.2d 84 (App. Div. 1975).

Such transactions also have been frowned upon by commentators. *See* Brudney & Chirelstein, *supra* note 606, at 1365-70; Greene, *supra* note 606, at 512-13.

654. This problem was alluded to when the *Tanzer* case was considered on remand. *See* Tanzer v. International Gen. Indus., Inc., 402 A.2d 382, 390-91 (Del. Ch. 1979)

company stock be used in effecting a merger of a subsidiary into its parent (or into a newly created subsidiary) need not be applied in a case in which the merger has been consummated following arm's length negotiation of its terms nor in a case in which the merger terms have been approved by an informed vote of a majority of the minority shares—that is, in cases in which the parent is acting with some appropriate level of approval.[655]

(2) Triangular Merger[656]

The triangular merger is another mode of corporate combination made possible by the newer forms of permissible merger consideration. As implied by its name, it involves three corporations: the prime mover in effecting the combination (acquiring corporation), the corporation being acquired (acquired corporation), and the acquiring corporation's wholly owned subsidiary (subsidiary)—often newly created for purposes of the transaction. In a straight triangular merger, the acquired corporation is merged into the subsidiary, with shareholders of the acquired corporation receiving either cash or stock of the acquiring corporation, and the latter corporation (through its stock ownership of the subsidiary) attaining control of the acquired corporation's business. In a reverse triangular merger, the subsidiary is merged into the acquired corporation, with shareholders of the latter corporation receiving the same kind of merger consideration as in a straight triangular merger, and the acquiring corporation receiving (in exchange for its stock interest in the disappearing subsidiary) new voting stock of the acquired corporation which makes that corporation a wholly owned subsidiary of the acquiring corporation.

An important consequence of the triangular merger lies in the

("[N]or are [appraisal rights] available for shares of stock which are listed on a national securities exchange, and which are exchanged upon a merger for shares of stock listed on a national securities exchange."), *on remand from* 379 A.2d 1121 (Del. 1977), *overruled in part by* Weinberger v. UOP, Inc., 457 A.2d 701, 715 (Del. 1983). The pertinent provision of the Delaware appraisal statute, *see* DEL. CODE ANN. tit. 8, § 262(b)(1)-(2) (Supp. 1996) (quoted *infra* in note 753), is criticized *infra* in text accompanying notes 773-76.

The problem would be eliminated if the Delaware appraisal statute were to be modified (as the appraisal provision of the Model Business Corporation Act has been) by removing the denial of appraisal rights for shares that are marketable. *See infra* notes 775-76 and accompanying text.

655. This approach is in harmony with the philosophy embodied in interested director statutes. *See, e.g.*, DEL. CODE ANN. tit. 8, § 144 (1991).

656. The subject is discussed in Gerald Raskin, *Triangular Mergers: A Useful Technique*, 12 COLO. LAW. 1630 (1983), and Note, *Three-Party Mergers: The Fourth Form of Corporate Acquisition*, 57 VA. L. REV. 1242 (1971).

fact that, after the transaction is completed, the acquired corporation's assets and liabilities are those of a subsidiary of the acquiring corporation rather than assets and liabilities of the acquiring corporation (as would be the case, by operation of law, had the acquired corporation been merged into the acquiring corporation). This means that the acquiring corporation enjoys the benefit of limited liability so that its assets are not exposed to claims of the acquired corporation's creditors.[657] Moreover, in a reverse triangular merger, with the acquired corporation's separate existence continuing, the survival of that separate existence protects franchises and licenses of the acquired corporation that are not freely transferable and could obviate the need for consents from governmental authorities when the acquired corporation is in a regulated industry.

A triangular merger can, of course, be effected when cash is used as the merger consideration.[658] However, it is in the context of a large-scale acquisition utilizing stock of the acquiring corporation[659]

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657. This could be a matter of considerable importance when the acquired corporation has exposure to mass market product liability of the kind involved in *Brotherton v. Celotex Corp.*, 493 A.2d 1337, 1339 (N.J. Super. Ct. Law Div. 1985) (holding that, when a corporation engaged in the asbestos business was merged into a corporation not previously engaged in that business, the surviving corporation "became statutorily bound to absorb all the liabilities of [the disappearing corporation] including any potential claims for punitive damages").

658. One context in which the triangular form of merger has been attempted (with a view toward eliminating the minority shareholders of the acquired corporation) is that in which the acquiring corporation is an alien corporation and the statute of the acquired corporation's domicile does not permit mergers with alien corporations. *See* Braasch v. Goldschmidt, 199 A.2d 760, 763 (Del. Ch. 1964) (involving a short-form cash-out merger).

659. If a Delaware parent corporation ("A") owns 90% or more of the stock of a subsidiary corporation ("B") and creates a new wholly owned subsidiary ("C") to which A not only transfers its stock in B but also issues A shares to be used by C as the consideration for a merger of B into C, it may be that the simplified procedure of a short-form merger could not be utilized. The Delaware short-form merger statute specifies the consideration for such a merger as "the securities, cash, property, or rights to be issued, paid, delivered or granted by the surviving corporation." DEL. CODE ANN. tit. 8, § 253(a) (Supp. 1996) (quoted *supra* in note 457). If this provision were to be interpreted as requiring a linking of each of the four verbs to each of the four nouns in their respective order, then it would seem to preclude a triangular short-form merger using A's stock as the merger consideration because such stock is not "issued" by the surviving corporation.

This problem of interpretation does not arise under North Carolina's short-form merger statute, which provides for merger consideration in the form of "shares, obligations, or other securities of the surviving or any other corporation." N.C. GEN. STAT. § 55-11-04(b)(2) (1990), *as amended by* Act of Aug. 26, 1997, ch. 485, § 29 (effective Oct. 1, 1997) (quoted *supra* in note 496). Nor does it arise under New Jersey's short-form merger statute, whose specification of merger consideration is virtually the same as North Carolina's. *See* N.J. STAT. ANN. § 14A:10-1(2)(c) (West Supp. 1997) (quoted *supra* in text accompanying notes 485-86).

that the triangular merger has become the device of choice.[660] An important reason for this is the triangular stock merger's effect upon voting and appraisal rights that might otherwise accrue to shareholders of the acquiring corporation in a non-triangular merger. If the acquired corporation were to be merged into the acquiring corporation with the merger consideration consisting of common stock of the acquiring corporation in an amount exceeding 20% (40% in New Jersey) of its previously outstanding common, a key requirement for a small-scale merger[661] would not be met, and both voting and appraisal rights would be accorded to the acquiring corporation's shareholders. When the merger is effected in triangular form, the acquiring corporation is not literally a party to the merger—even though the merger consideration may consist of its common stock in an amount exceeding 20% (40% in New Jersey) of that previously outstanding. One could take the view that, while the acquiring corporation may not be formally a party to the merger, it is the true party in interest and, accordingly, its shareholders should have voting and appraisal rights with respect to such a transaction.[662] However, it has come to be recognized that the acquiring corporation's shareholders do not enjoy voting or appraisal rights in a triangular merger.[663]

This is an anomaly that should be corrected. The small-scale merger statutes were intended to provide greater flexibility in effecting mergers by eliminating voting and appraisal rights for shareholders of the surviving corporation, but one of the conditions imposed for utilization of those statutes in effecting a stock merger was that the survivor's outstanding common stock not be thereby

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660. This was the device initially proposed (but later abandoned) whereby Time Incorporated was to acquire Warner Communication utilizing common stock of Time in an amount that would have more than doubled the number of shares of Time stock outstanding. *See* Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140, 1146 (Del. 1990). The proposed transaction was misdescribed by the court as follows: "The agreement called for Warner to be merged into a wholly-owned Time subsidiary with Warner becoming the surviving corporation." *Id.*

661. *See supra* text accompanying notes 522-52.

662. *See* EISENBERG, *supra* note 116, at 305-06.

663. *See* Terry v. Penn Central Corp., 668 F.2d 188, 192-93 (3d Cir. 1981); *Paramount Communications*, 571 A.2d at 1146 ("The [abandoned merger] agreement called for Warner to be merged into a wholly-owned Time subsidiary .... Delaware law did not require any vote by Time stockholders."); Horizon House-Microwave, Inc. v. Bazzy, 486 N.E.2d 70, 75 (Mass. App. Ct. 1985) ("There is no ignoring that the triangular merger device permits an acquiring corporation to outflank the requirement of stockholder approval which attends a straight merger ...."); Stephen H. Schulman & Alan Schenk, *Shareholders' Voting and Appraisal Rights in Corporate Acquisition Transactions*, 38 BUS. LAW. 1529, 1536-38 (1983); Note, *supra* note 656, at 1244-45.

increased by more than 20% (40% in New Jersey). To allow the policy underlying that condition to be thwarted by a resort to the triangular merger device seems wrong. If it makes sense for the statutes to accord voting and appraisal rights to shareholders of the corporation surviving a long-form merger whenever that corporation's outstanding common stock is thereby increased by more than 20% (40% in New Jersey), it makes equally good sense to accord those rights to shareholders of the acquiring corporation whenever the same potential for dilution is present—regardless of the form of the transaction, whether it be a triangular merger, a purchase of assets, or a stock acquisition (by way of a share exchange or otherwise). The legislatures of California and Ohio have taken this unified approach with respect to both voting and appraisal rights,[664] and so has the New York Stock Exchange with respect to voting rights.[665]

4. Changes in Right of Appraisal

a. Valuation Standard

(1) Statutory Provisions

Under the Delaware appraisal statute, as it read in 1950, the standard for valuing a dissenter's shares was stated to be "the value of his stock on the date of the recording of [the merger agreement], exclusive of any element of value arising from the expectation or accomplishment" of the merger.[666] When the Delaware statute was rewritten in 1967,[667] the standard remained essentially the same.[668] An amendment to the statute, made in 1976,[669] introduced the concept of "fair" value, and it retained the concept of excluding "any element of value arising from the accomplishment or expectation of the merger." As rewritten in 1981,[670] the pertinent provision of the

664. *See* CAL. CORP. CODE §§ 181, 1200-1203, 1300 (West 1990 & Supp. 1997); OHIO REV. CODE ANN. §§ 1701.01, 1701.83-.85 (Anderson 1992 & Supp. 1996).

665. *See* NEW YORK STOCK EXCHANGE LISTED COMPANY MANUAL ¶¶ 312.03(c), 312.05 (1995) (quoted *supra* in note 549).

666. Former DEL. CODE ANN. tit. 8, § 262(b) (1953); *see supra* text accompanying note 336.

667. *See* Act of July 3, 1967, ch. 50, 56 Del. Laws 151; *supra* note 251 (second paragraph).

668. *See* former DEL. CODE ANN. tit. 8, § 262(b) (Cum. Supp. 1968).

669. *See* Act of Apr. 24, 1976, ch. 371, § 7, 60 Del. Laws 1070, 1077.

670. *See* Act of June 6, 1981, ch. 25, § 14, 63 Del. Laws 36, 38-40.

Delaware appraisal statute[671] contains a new sentence requiring the court to "take into account all relevant factors."[672]

The valuation standard in the New Jersey statute, in 1950, was "the full market value of his stock, without regard to any depreciation or appreciation thereof in consequence" of the merger.[673] When the New Jersey Business Corporation Act was rewritten in 1968,[674] the standard of "full market value" was changed to "fair value,"[675] and a provision was added concerning the determination of such "fair value."[676]

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671. The Delaware appraisal statute provides in part as follows: "[T]he Court [of Chancery] shall appraise the shares, determining their fair value exclusive of any element of value arising from the accomplishment or expectation of the merger or consolidation .... In determining such fair value, the Court shall take into account all relevant factors." DEL. CODE ANN. tit. 8, § 262(h) (1991).

672. *Id.* For a commentary on the recent part of this statutory evolution, see *Weinberger v. UOP, Inc.*, 457 A.2d 701, 713-14 (Del. 1983).

673. Former N.J. STAT. ANN. §§ 14:12-6 to -7 (West 1939); *see supra* text accompanying notes 333-34.

674. *See* Act of Nov. 21, 1968, ch. 350, 1968 N.J. Laws 1011 (effective Jan. 1, 1969); *supra* note 250 (second paragraph).

675. *See* N.J. STAT. ANN. § 14A:11-3(2) (West 1969). The Commissioners' Comment—1968 included the following:

> The Commission abandoned the more restrictive standard of "full market value" used in Title 14, in favor of the broader and more flexible test of "fair value" found in the Model Act. In most cases the shares to be appraised will not be readily marketable.

Id. § 14A:11-3 commentary at 99.

676. *See* former N.J. STAT. ANN. § 14A:11-3(3) (West 1969). As amended by Act of Jan. 7, 1974, ch. 366, § 62, 1973 N.J. Laws 964, 1032-33 (effective May 1, 1974), and Act of Aug. 4, 1988, ch. 94, § 66, 1988 N.J. Laws 676, 748-49 (effective Dec. 1, 1988), it provides as follows:

> (3) "Fair value" as used in this Chapter shall be determined
>
> (a) As of the day prior to the day of the meeting of shareholders at which the proposed action was approved or as of the day prior to the day specified by the corporation for the tabulation of consents to such action if no meeting of shareholders was held; or
>
> (b) In the case of a merger pursuant to section 14A:10-5.1 or subsection 14A:10-7(4) in which shareholder approval is not required, as of the day prior to the day on which the board of directors approved the plan of merger; or
>
> (c) In the case of an acquisition of all the shares or all the shares of a class or series by another corporation pursuant to section 14A:10-9, as of the day prior to the day on which the board of directors of the acquiring corporation authorized the acquisition, or, if a shareholder vote was taken pursuant to section 14A:10-12, as of the day provided in paragraph 14A:11-3(3)(a).
>
> In all cases, "fair value" shall exclude any appreciation or depreciation resulting from the proposed action.

N.J. STAT. ANN. § 14A:11-3(3) (West Supp. 1997).

The 1950 valuation standard in North Carolina was "the fair value of his stock without regard to any depreciation or appreciation thereof in consequence" of the merger.[677] Under that state's 1955 Business Corporation Act,[678] the standard was "the fair value of his shares, as of the day prior to the date on which the vote was taken."[679] When that Act was rewritten in 1989,[680] the standard was stated as "the fair value of his shares,"[681] and "fair value" was defined to mean "the value of the shares immediately before the effectuation of the corporate action to which the dissenter objects, excluding any appreciation or depreciation in anticipation of the corporate action unless exclusion would be inequitable."[682] This standard and the definition were taken from the 1984 Model Business Corporation Act.[683]

677. Former N.C. GEN. STAT. § 55-167 (1950); *see supra* text accompanying note 338.

678. Act of May 26, 1955, ch. 1371, 1955 N.C. Sess. Laws 1432 (effective July 1, 1957); *see supra* note 252 (second paragraph).

679. Former N.C. GEN. STAT. § 55-113(b) (1982).

680. *See* Act of June 8, 1989, ch. 265, 1989 N.C. Sess. Laws 566 (effective July 1, 1990); *supra* note 252 (third paragraph).

681. N.C. GEN. STAT. § 55-13-02(a) (Supp. 1996).

682. N.C. GEN. STAT. § 55-13-01(3) (1990).

683. *See* MODEL BUS. CORP. ACT ANN. §§ 13.02(a), 13.01(3) (1996). The Official Comment with respect to the definition states:

> The definition of "fair value" in section 13.01(3) . . . leaves untouched the accumulated case law about market value, value based on prior sales, capitalized earnings value, and asset value. It specifically preserves the former language excluding appreciation and depreciation in anticipation of the proposed corporate action, but permits an exception for equitable considerations. The purpose of this exception ("unless exclusion would be inequitable") is to permit consideration of factors similar to those approved by the Supreme Court of Delaware in *Weinberger v. UOP, Inc.*, a case in which the court found that the transaction did not involve fair dealing or fair price: "In our view this includes the elements of rescissory damages if the Chancellor considers them susceptible of proof and a remedy appropriate to all the issues of fairness before him." Consideration of appreciation or depreciation which might result from other corporate actions is permitted; these effects in the past have often been reflected either in market value or capitalized earnings value.
>
> "Fair value" is to be determined immediately before the effectuation of the corporate action, instead of the date of the shareholder's vote, as is the case under most state statutes that address the issue. This comports with the plan of this chapter to preserve the dissenter's prior rights as a shareholder until the effective date of the corporate action, rather than leaving him in a twilight zone where he has lost his former rights, but has not yet gained his new ones.

Id. § 13.01 commentary at 13-6 to -7 (citation omitted) (quoting Weinberger v. UOP, Inc., 457 A.2d 701, 714 (Del. 1983)).

(2) Cases and Commentary

(Before examining the valuation standard applicable to the exercise of appraisal rights, it will be helpful to eliminate a complicating factor. The factor to be eliminated is the valuation, in the appraisal context, of shares of preferred stock. While this is a matter of large importance (especially to preferred shareholders), it is also one of much difficulty. Moreover, any effort to address that matter herein would unduly complicate an exposition of the points that are to be covered. Accordingly, the discussion that follows assumes the existence of common stock only.)

The right of appraisal is much less important as a safeguard for shareholders in the case of a merger of two previously unrelated corporations than in the case of an interested-party merger.[684] In the former context, with no self-dealing involved, the management of each of the merging corporations is likely to strike a fair deal for its shareholders or terminate negotiations. Moreover, in a merger of unrelated corporations, the shareholders of both corporations (other than those of the survivor in a small-scale merger[685]) must approve such a merger, and the required vote may not be forthcoming unless the terms of the merger are perceived to be fair. On the other hand, in the case of an interested-party merger—when there is no arm's length bargaining and no prospect of a shareholder veto—the appraisal right is of great importance. Accordingly, the correctness of the valuation standard applied in appraisal proceedings is best examined in the context of interested-party mergers.[686]

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684. In *Alpert v. 28 Williams Street Corp.*, 473 N.E.2d 19 (N.Y. 1984), the court said:

> When the directors and majority shareholders of each corporation are independent and negotiate at arm's length, it is more likely that the negotiations will reflect the full exertion of each party's bargaining power and the final terms of the transaction will be the best attainable. When, however, there is a common directorship or majority ownership, the inherent conflict of interest and the potential for self-dealing requires careful scrutiny of the transaction.

Id. at 26 (citations omitted).

685. *See supra* text accompanying notes 522-47.

686. Schaefer states:

> By their terms, appraisal statutes apply to all mergers, but, in practice, most appraisal cases which have been litigated through the appellate court level involve conflicts of interests; the outside shareholders have been frozen out on terms dictated by insiders. For this reason, there is a compelling need for a remedy which produces accurate valuations in appraisal proceedings.

Elmer J. Schaefer, *The Fallacy of Weighting Asset Value and Earnings Value in the Appraisal of Corporate Stock*, 55 S. CAL. L. REV. 1031, 1032 (1982) (footnote omitted). *See generally* Robert B. Thompson, *Exit, Liquidity, and Majority Rule: Appraisal's Role in Corporate Law*, 84 GEO. L.J. 1 (1995) (noting that the right of appraisal is most significant in the context of interested-party transactions).

Today, the appraisal statutes of the three subject states prescribe "fair value" as the valuation standard. It is necessary, therefore, to consider what meaning has been, and should be, given to "fair value" in the appraisal context.[687]

(a) Market Value Versus Entity Value

The analysis begins with the question whether the valuation standard for appraisal should be market value or what has sometimes been called intrinsic value. While there is no answer in North Carolina statutory[688] or case law,[689] it is clear that New Jersey and Delaware have rejected market value as the sole valuation standard for appraisal. From 1896 until 1969, New Jersey specified "full market value" as the valuation standard for appraisal;[690] however, when New Jersey rewrote its Business Corporation Act in 1968,[691] the standard was changed to "fair value."[692] Delaware's appraisal statute has never specified market value as the valuation standard, and the

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687. Articles and notes concerning appraisal valuation include the following: Richard A. Booth, *The New Law of Freeze-out Mergers*, 49 MO. L. REV. 517 (1984); Victor Brudney & Marvin A. Chirelstein, *Fair Shares in Corporate Mergers and Takeovers*, 88 HARV. L. REV. 297 (1974); Joseph Evan Calio, *New Appraisals of Old Problems: Reflections on the Delaware Appraisal Proceeding*, 32 AM. BUS. L.J. 1 (1994); Daniel R. Fischel, *The Appraisal Remedy in Corporate Law*, 1983 AM. B. FOUND. RES. J. 875; Hideki Kanda & Saul Levmore, *The Appraisal Remedy and the Goals of Corporate Law*, 32 UCLA L. REV. 429 (1985); Simon M. Lorne, *A Reappraisal of Fair Shares in Controlled Mergers*, 126 U. PA. L. REV. 955 (1978); Schaefer, *supra* note 686; Joel Seligman, *Reappraising the Appraisal Remedy*, 52 GEO. WASH. L. REV. 829 (1984); David Cohen, Comment, *Valuation in the Context of Share Appraisal*, 34 EMORY L.J. 117 (1985); Joseph M. Coleman, Comment, *The Appraisal Remedy in Corporate Freeze-Outs: Questions of Valuation and Exclusivity*, 38 SW. L.J. 775 (1984); Robert B. Heglar, Note, *Rejecting the Minority Discount*, 1989 DUKE L.J. 258; Donald E. Schlyer, Note, *"Fair Value" Determination in Corporate "Freeze-outs," and in Security and Exchange Act Suits:* Weinberger, *Other, and Better Methods*, 19 VAL. U. L. REV. 521 (1985); Michael R. Schwenk, Note, *Valuation Problems in the Appraisal Remedy*, 16 CARDOZO L. REV. 649 (1994); Note, *Valuation of Dissenters' Stock Under Appraisal Statutes*, 79 HARV. L. REV. 1453 (1966); and Ferdinand S. Tinio, Annotation, *Valuation of Stock of Dissenting Stockholders in Case of Consolidation or Merger of Corporation, Sale of Its Assets, or the Like*, 48 A.L.R.3D 430 (1973).

688. *See supra* text accompanying notes 680-82.

689. *See supra* note 341.

690. For pre-1950 New Jersey decisions on this point, see *supra* note 342. After 1950, it continued to be the New Jersey rule (based on the pre-1969 language of that state's statute) that appraisers should look to market value and not asset value. *See In re* Paterson & Hudson River R.R. Co., 94 A.2d 657, 660 (N.J. 1953).

691. *See* Act of Nov. 21, 1968, ch. 350, 1968 N.J. Laws 1011 (effective Jan. 1, 1969); *supra* note 250 (second paragraph).

692. *See supra* note 675 and accompanying text. The first reported opinion on this new valuation standard was *Dermody v. Sticco*, 465 A.2d 948 (N.J. Super. Ct. Ch. Div. 1983).

case law of that state makes it clear that market value is not the sole standard to be applied in appraisal.[693]

Despite its simplistic appeal,[694] there were several reasons for rejecting market value as the measure of "fair value" for appraisal purposes.[695] One of those reasons lay in the vagaries of stock market prices—a point colorfully stated in a 1934 Delaware opinion[696] and

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693. For Delaware decisions in 1934 and 1950, see *supra* notes 343-44 and accompanying text. In *In re Delaware Racing Ass'n*, 213 A.2d 203 (Del. 1965), the court said:

> It is, of course, axiomatic that if there is an established market for shares of a corporation the market value of such shares must be taken into consideration in an appraisal of their intrinsic value.... It is, of course, equally axiomatic that market value, either actual or constructed, is not the sole element to be taken into consideration in the appraisal of stock.

Id. at 211.

694. In *Beerly v. Department of the Treasury*, 768 F.2d 942 (7th Cir. 1985), the court said: "[I]f a stock has a 'thick' market, not only is market value the only rational measure of value, but appraisal rights are unnecessary since the dissenting shareholder can fully protect his interests by selling his shares." *Id.* at 946. (This was a rare case involving an appraisal by the Comptroller of the Currency following a bank merger.)

695. The unfortunate consequence that can flow from a slavish adherence to a market value standard of valuation is illustrated by the case of *Armstrong v. Marathon Oil Co.*, 513 N.E.2d 776 (Ohio 1987). In this appraisal case, U.S. Steel (through a subsidiary) had acquired all of Marathon's common stock (other than that owned by shareholders who perfected their appraisal rights) in a two-step transaction, consisting of a tender offer at $125 per share for 51% and a second-step merger whereby each remaining share was converted into a $100 note whose estimated value was $86 at the time of the tender offer and $76 at the time of the merger. *See id.* at 779, 791. The court, believing itself bound by the provisions of the state appraisal statute to value the dissenters' stock at the market value on the day preceding the vote on the merger, set the appraisal value at the closing price on that day of $75.75 even though Marathon's investment banker had estimated the "blended value" of the U.S. Steel package at $106 per share. *See id.* at 779, 790. In reaching this unfortunate result, the court rejected the lower court's view that:

> "[W]hat is to be valued [in appraisal] is not the value of a single share if it were to be sold in an isolated sale, but instead the value per share of all the shares of the corporation, which can be determined only upon the basis of a hypothetical market or sale of all the shares of the corporation."

Id. at 789 (quoting lower court opinion).

A quite different—and more sensible—result was reached in *BNE Massachusetts Corp. v. Sims*, 588 N.E.2d 14 (Mass. App. Ct. 1992). Following a "controlled auction" by its investment bankers, 100% of Charterbank was acquired by Conifer in a negotiated merger: $101 per share in cash for 35% of Charterbank's stock plus shares of Conifer stock worth $92.25 for each remaining share of Charterbank, representing a "blended value" of $95.35. *See id.* at 16. On the premise that the transaction represented an arm's length negotiation for sale of the entire enterprise, the court suggested that, on remand, the "fair value" for appraisal purposes be set at the blended value that had been agreed to by the corporation's management. *See id.* at 20-21.

696. In *Chicago Corp. v. Munds*, 172 A. 452 (Del. Ch. 1934), the court said:

> When it is said that the appraisal which the market puts upon the value of the stock of an active corporation as evidenced by its daily quotations, is an accurate, fair reflection of its intrinsic value, no more than a moment's reflection

graphically illustrated by comparing the market prices of selected common stocks on three dates in the fall of 1987.[697] Other reasons lay in the fact that there might well be material information not yet disclosed to traders in the market;[698] and, in the case of a controlled corporation, the presence of a controlling shareholder could itself have a dampening effect on the market price of the company's stock, and the timing of a take-out merger might well coincide with a

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> is needed to refute it. There are too many accidental circumstances entering into the making of market prices to admit them as sure and exclusive reflectors of fair value. The experience of recent years is enough to convince the most casual observer that the market in its appraisal of values must have been woefully wrong in its estimates at one time or another within the interval of a space of time so brief that fundamental conditions could not possibly have become so altered as to affect true worth. Markets are known to gyrate in a single day. The numerous causes that contribute to their nervous leaps from dejected melancholy to exhilarated enthusiasm and then back again from joy to grief, need not be reviewed. It would be most unfortunate indeed either for the consolidated corporation or for the objecting stockholder if, on the particular date named by the statute for the valuation of the dissenter's stock, viz., the date of the consolidation, the market should be in one of its extreme moods and the stock had to be paid for at the price fixed by the quotations of that day. Even when conditions are normal and no economic forces are at work unduly to exalt or depress the financial hopes of man, market quotations are not safe to accept as unerring expressions of value. The relation of supply to demand on a given day as truly affects the market value of a stock as it does of a commodity; and temporary supply and demand are in turn affected by numerous circumstances which are wholly disconnected from considerations having to do with the stock's inherent worth.

Id. at 455.

697. Closing prices of the common stock of selected companies, as reported on the days following the dates indicated, were as follows:

	10/5/87	10/19/87	11/2/87
Du Pont	122 3/4	80 1/2	93 1/4
Exxon	49 3/4	33 1/2	43 5/8
General Electric	62 5/8	41 7/8	47 1/8
IBM	156 1/2	103 1/4	124 1/2
Merck	208	160	180 1/2
Phillip Morris	117 1/2	88 1/8	93
Sears	51 3/8	31	37

See WALL ST. J., Oct. 6, 1987, at 67-68; WALL ST. J., Oct. 20, 1987, at 75-76; WALL ST. J., Nov. 3, 1987, at 69-70.

698. *See In re* Libby, McNeill & Libby, 406 A.2d 54, 64 (Me. 1979). Among other things, if there had been an undisclosed misappropriation of corporate funds, giving rise to a potential derivative suit against management, the potential recovery would not be reflected in the market price of the company's stock but, if discovered during the course of appraisal proceedings, could be included in net asset valuation. *See* Cole v. Wells, 113 N.E. 189, 191 (Mass. 1916).

depressed price for the company's stock.[699]

Of greater importance is the fact that, in the absence of special circumstances, the product of multiplying the number of a corporation's outstanding shares by the market price of the small fraction of those shares traded on a given day is likely to be less than the value of the total enterprise.[700] And, if that lesser value were to govern in an appraisal valuation, the dissenter would not receive "his proportionate interest in a going concern."[701] Accordingly, it has come to be recognized that the first step in appraisal valuation—and the one of overall importance—is to determine the value of the corporate entity.[702] The second step involves nothing more than

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699. These points are made in Brudney & Chirelstein, *supra* note 687, at 305-06.

700. The "Legislative declaration" accompanying New York's 1982 revision of its appraisal statute stated in part:

> The case law interpretation of fair value has not always reflected the reality of corporate business combinations. These transactions involve the sale of the corporation as a whole, and the corporation's value as an entirety may be substantially in excess of the actual or hypothetical market price for shares trading among investors.

Act of June 15, 1982, ch. 202, § 1, 1982 N.Y. Laws 1718, 1718 (effective Sept. 1, 1982).

Weiss, commenting on valuation in the context of fairness in take-out mergers, states:

> Many recent transactions demonstrate that the value of a corporation's shares, when someone desires to purchase the entire corporation, is often much greater than the value suggested by the prices at which the corporation's shares usually trade. It is the value of the minority's shares as a proportion of the corporation being purchased as a whole, not the public trading price of those shares, that should be the measure of fairness in take out mergers.

Weiss, *supra* note 4, at 678 (footnote omitted).

701. *Tri-Continental Corp. v. Battye*, 74 A.2d 71, 72 (Del. 1950), is the case most frequently cited for the proposition that a dissenting shareholder is entitled to be paid for "his proportionate interest in a going concern." *See supra* note 348 (second paragraph). The point has been reiterated in subsequent cases. *See, e.g.*, Rapid-American Corp. v. Harris, 603 A.2d 796, 802, 805 (Del. 1992); Cavalier Oil Corp. v. Harnett, 564 A.2d 1137, 1144 (Del. 1989); Weinberger v. UOP, Inc., 457 A.2d 701, 713 (Del. 1983); *In re* McLoon Oil Co., 565 A.2d 997, 1003 (Me. 1989).

702. In *In re Shell Oil Co.*, 607 A.2d 1213 (Del. 1992), the court said:

> Fair value, in an appraisal context, measures "that which has been taken from [the shareholder], *viz.*, his proportionate interest in a going concern." In the appraisal process the corporation is valued "as an entity," not merely as a collection of assets, or by the sum of the market price of each share of its stock.

Id. at 1218 (citations omitted) (quoting *Tri-Continental Corp.*, 74 A.2d at 72, and *Cavalier Oil Corp.*, 564 A.2d at 1144).

In *Cavalier Oil Corp.*, the court said:

> [T]he Court of Chancery's task here was to value what has been taken from the shareholder: "viz. his proportionate interest in a going concern." To this end the company must be first valued as an operating entity by application of traditional value factors, weighted as required, but without regard to post-merger events or other possible business combinations.

Cavalier Oil Corp., 564 A.2d at 1144 (citation omitted) (quoting *Tri-Continental Corp.*, 74

determining the portion of that entity value equivalent to the dissenter's proportionate interest in the outstanding shares of the corporation's stock.[703]

Notwithstanding the view that the proper approach in valuing a dissenter's stock is to determine his proportionate share of the value of the total enterprise,[704] the question has been raised as to whether the resulting determination should be discounted by applying either a minority discount or a marketability discount.[705] Discounting has long been accepted in the context of valuation for tax purposes,[706] and some courts have applied discounts in other contexts as well.[707] Only

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A.2d at 72).

In *McLoon Oil Co.*, the court said:

> In the statutory appraisal proceeding, the involuntary change of ownership caused by a merger requires as a matter of fairness that a dissenting shareholder be compensated for the loss of his proportionate interest in the business as an entity. The valuation focus under the appraisal statute is not the stock as a commodity, but rather the stock only as it represents a proportionate part of the enterprise as a whole. The question for the court becomes simple and direct: What is the best price a single buyer could reasonably be expected to pay for the firm as an entirety? The court then prorates that value for the whole firm equally among all shares of its common stock. The result is that all of those shares have the same fair value.

McLoon Oil Co., 565 A.2d at 1004.

See Weiss, *supra* note 634, at 252 (suggesting that the value of the company as a whole is the most important factor in valuation).

703. In *In re Radiology Associates, Inc. Litigation*, 611 A.2d 485 (Del. Ch. 1991), the court said:

> In determining the fair value of a shareholder's shares, the Court first must determine the company's fair value as a whole. *See Cavalier Oil Corp. v. Hartnett.* In the second step, the Court determines plaintiff's share by merely using his proportionate interest (*i.e.*, the number of shares plaintiff owns divided by the number of shares outstanding).

Id. at 494 (citation omitted).

704. The concept was stated in *Valuation of Dissenters' Stock Under Appraisal Statutes* as follows:

> One aim of the appraisal remedy is to give the dissenter his "fair share" of the value of the corporation. Clearly he will receive this if he goes along with the corporate change, since he will share proportionately with all the other stockholders. If he chooses instead to terminate his interest, it would be unjust to give him less than his proportionate share of the business.

Note, *supra* note 687, at 1456.

705. *See* Harry J. Haynsworth IV, *Valuation of Business Interests*, 33 MERCER L. REV. 457, 488-96 (1982); Heglar, *supra* note 687, at 260-61.

706. *See* William P. Lyons & Martin J. Whitman, *Valuing Closely Held Corporations and Publicly Traded Securities with Limited Marketability: Approaches to Allowable Discounts from Gross Values*, 33 BUS. LAW. 2213, 2215-18 (1978).

707. In *Blake v. Blake Agency, Inc.*, 486 N.Y.S.2d 341 (App. Div. 1985), in which the need to determine the "fair value" of a one-fourth stock interest in a corporation arose not under an appraisal statute but under a statute allowing a buy-out as an alternative to a

in fairly recent years has this question been addressed in the appraisal context,[708] and a number of courts—both federal and

minority shareholder's petition for dissolution, a valuation was made combining a determination of petitioner's share of the intangible value (goodwill) of the corporation and a determination of his share of net tangible value (based on book value of assets less liabilities), and then the court applied a 25% discount to petitioner's share of the intangible value but not to his share of the net tangible value. *See id.* at 345-49. However, the court drew a distinction between allowing a discount based on shares' lack of marketability and denying a discount based on the fact that shares represent only a minority interest. *See id.* at 349. Similarly, in *In re Fleischer*, 486 N.Y.S.2d 272 (App. Div. 1985), when the need to determine the fair value of a one-third stock interest in a corporation arose not under an appraisal statute but under a buy-out arrangement allowed as an alternative to dissolution, the court accepted a determination of total enterprise value on the basis of an adjusted capitalization of earnings but approved the application of "a 25% lack of marketability or illiquidity discount" while disclaiming that this was "a minority interest discount." *Id.* at 274-75. In the same context, in *Raskin v. Walter Karl, Inc.*, 514 N.Y.S.2d 120 (App. Div. 1987), the court allowed a 10% discount for lack of marketability but held that a minority discount (based on a minority shareholder's lack of control) would be improper. *See id.* at 122. In a similar context, in *McCauley v. Tom McCauley & Son, Inc.*, 724 P.2d 232 (N.M. Ct. App. 1986), the court upheld the trial court's application of a 25% discount, without drawing a clear distinction between minority discount and marketability discount. *See id.* at 243-45.

However, in the context of a purchase at "fair value" in lieu of dissolution, the court in *Charland v. Country View Golf Club, Inc.*, 588 A.2d 609 (R.I. 1991), refused to apply either a minority discount or a marketability discount. *See id.* at 612-13; *accord* Brown v. Corrugated Box Co., 154 Cal. Rptr. 170, 176 (Ct. App. 1979). And, in *Woodward v. Quigley*, 133 N.W.2d 38, *modified on reh'g*, 136 N.W.2d 280 (Iowa 1965), the court refused to allow a minority discount in applying a statute requiring majority shareholders to purchase "at its real value" the stock voted against an extension of corporate existence. *See id.* at 39-40. *But cf.* McCann Ranch, Inc. v. Quigley-McCann, 915 P.2d 239 (Mont. 1996) (upholding the application of a 25% minority discount in a declaratory judgment action seeking to establish the value of a shareholder's one-fourth interest in the stock of a close corporation).

For a criticism of decisions allowing discounting in the context of a buy-out in lieu of dissolution, see Charles W. Murdock, *The Evolution of Effective Remedies for Minority Shareholders and Its Impact upon Valuation of Minority Shares*, 65 NOTRE DAME L. REV. 425, 478-89 (1990).

708. Prior to the 1989 decision in *Cavalier Oil Corp. v. Harnett*, 564 A.2d 1137 (Del. 1989), *see infra* note 711 (first paragraph) (discussing *Cavalier Oil Corp.*), the Delaware courts had addressed this matter only superficially.

In *Felder v. Anderson, Clayton & Co.*, 159 A.2d 278 (Del. Ch. 1960), the chancery court said:

> After finding the average multiplier, the appraiser then discounted it 10% for certain reasons, such as the lack of marketability of the stock, etc. I have reviewed the pertinent evidence and arguments and I am satisfied that his ultimate choice of 8.4 (based upon a fair comparison and discount) is within the range of reason. It will not be disturbed.

Id. at 285.

However, in *Bell v. Kirby Lumber Corp.*, 413 A.2d 137 (Del. 1980), involving an appraisal proceeding following a short-form cash-out merger, the supreme court said:

> Kirby [the surviving corporation] would have the earnings value determined by the Appraiser and the Vice-Chancellor, adjusted for lack of a

state—have condoned discounting even in this context.[709] Such discounting, however, would seem to contravene the widely held view that a dissenter is entitled to receive, in an appraisal proceeding, "his proportionate interest in a going concern."[710] Accordingly, in a

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> market. The Appraiser stated that he was aware of no Delaware authority for discounting earnings and declined to do so. We agree.

Id. at 147; *accord* Richardson v. Palmer Broad. Co., 353 N.W.2d 374, 379 (Iowa 1984).

709. In *Perlman v. Permonite Manufacturing Co.*, 568 F. Supp. 222 (N.D. Ind. 1983), *aff'd*, 734 F.2d 1283 (7th Cir. 1984), when minority shareholders (owning 48 of 145 outstanding shares) dissented from a merger of their corporation into its parent and sought an appraisal of their shares, the court first determined the net asset value of the total enterprise (using fair market value of the assets rather than book value based on cost) and computed the dissenters' proportionate share (33.1%) of that value, but then the court applied a 35% discount—15% to reflect the fact that the dissenters' shares represented a minority interest, 15% to reflect the fact that there was virtually no market for the dissenters' shares, and 5% to reflect the particular risk associated with holding those shares because of the company's size and lack of diversity. *See id.* at 223-26, 230-32. (Interestingly, this resulted in an appraised value of $2849.85 per share or just under 83% of the $3435.00 per share that had been offered by the parent corporation to the dissenters on the day after the merger was effected.) In *Hernando Bank v. Huff*, 609 F. Supp. 1124 (N.D. Miss. 1985), *aff'd*, 796 F.2d 803 (5th Cir. 1986), it was said, in an appraisal proceeding following a merger, that it was proper to apply a minority discount in determining the fair value of the dissenters' stock. *See id.* at 1126; *accord* Atlantic States Constr., Inc. v. Beavers, 314 S.E.2d 245, 251 (Ga. Ct. App. 1984) (holding that the trial court, in an appraisal proceeding following a merger, should have given consideration to both a minority discount and a discount for lack of marketability); Stanton v. Republic Bank, 581 N.E.2d 678, 681-82 (Ill. 1991) (refusing, in an appraisal proceeding following a merger, to overturn a trial court's determination that minority and marketability discounts of 5% each should be applied); Moore v. New Ammest, Inc., 630 P.2d 167, 177 (Kan. Ct. App. 1981) (allowing, with little discussion, the application of a 20% minority discount in an appraisal proceeding following an interested-party merger); Ford v. Courier-Journal Job Printing Co., 639 S.W.2d 553, 555-57 (Ky. Ct. App. 1982) (holding, in an appraisal proceeding following a sale-of-assets transaction, that the appraisers had not erred in applying a 25% marketability discount to their determination of net asset value); King v. F.T.J., Inc., 765 S.W.2d 301, 304-06 (Mo. Ct. App. 1988) (upholding the trial court's denial of a marketability discount, in an appraisal proceeding following a merger, but concurring in its application of a minority discount); Friedman v. Beway Realty Corp., 661 N.E.2d 972, 977-78 (N.Y. 1995) (rejecting a minority discount, in an appraisal proceeding following a sale of the assets of several close corporations, but accepting a discount based on lack of marketability); Columbia Management Co. v. Wyss, 765 P.2d 207, 209, 213-14 (Or. Ct. App. 1988) (holding, in an appraisal proceeding following a charter amendment, that it was proper for the appraisers to apply a 33.3% marketability discount to the minority shareholder's proportionate interest in the corporation's total enterprise value but that it was improper for them to apply a minority discount); *cf.* Walter S. Cheesman Realty Co. v. Moore, 770 P.2d 1308, 1312-13 (Colo. Ct. App. 1988) (holding that minority and marketability discounts should not be applied, in an appraisal proceeding, when the dissenter's objection concerned a plan of dissolution and liquidation).

710. *See* Friedman v. Beway Realty Corp., 661 N.E.2d 972, 977 (N.Y. 1995) ("A minority discount would necessarily deprive minority shareholders of their proportionate interest in a going concern ...."); *see also supra* note 701 (citing cases voicing the proposition that a dissenter is entitled to be paid his "proportionate interest in a going

recent line of cases—with the Delaware decision in *Cavalier Oil Corp. v. Harnett*[711] at the forefront—such discounting has been rejected.[712] These latter cases are based on a salutary recognition of

concern").

711. 564 A.2d 1137 (Del. 1989). This case involved an appraisal proceeding following a cash-out short-form merger of a closely held corporation. *See id.* at 1139. The court sustained the lower court's refusal to apply a minority or marketability discount, saying:

> In rejecting a minority or marketability discount, the Vice Chancellor concluded that the objective of a section 262 appraisal is "to value the *corporation* itself, as distinguished from a specific fraction of its *shares* as they may exist in the hands of a particular shareholder" [emphasis in original]. We believe this to be a valid distinction.
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> . . . The dissenting shareholder's proportionate interest is determined only after the company as an entity has been valued. In that determination the Court of Chancery is not required to apply further weighting factors at the shareholder level, such as discounts to minority shares for asserted lack of marketability.

Id. at 1144 (quoting the lower court); *see also* Rapid-American Corp. v. Harris, 603 A.2d 796, 804-07 (Del. 1992) (distinguishing the proper allowance of a control premium at the corporate level from the improper application of a minority discount at the shareholder level).

712. *In re McLoon Oil Co.*, 565 A.2d 997 (Me. 1989), involved an appraisal proceeding following a merger of closely held corporations. Relying heavily on *Cavalier Oil Corp.*, the court affirmed the lower court's acceptance of a referee's report rejecting the application of a minority or marketability discount. The court said:

> In sum, the referee held that the fair value of each Dissenter's stock was his proportionate share of the full value of each company, as determined from the expert appraisal testimony presented by the parties. The referee expressly rejected Lido's contention that he should discount the full value of each company because of the minority status and lack of marketability of the Dissenters' stock. On appeal Lido's only serious challenge to the referee's finding of fair value is directed at the referee's recognition of the Dissenters' full proportionate interest in the whole value of each company, free of any minority or nonmarketability discount. We find Lido's arguments for such discounts unpersuasive. In our view application of those discounts would run directly counter to our appraisal statute's purpose of protecting dissenting shareholders.

Id. at 1003.

In *Hunter v. Mitek Industries, Inc.*, 721 F. Supp. 1102 (E.D. Mo. 1989), a diversity case applying Missouri law in an appraisal proceeding following a merger, the court said: "The Court declines to apply the minority and marketability discounts, and notes that such efforts to discount a dissenting shareholder's stock have been expressly rejected by a number of courts." *Id.* at 1107 (citing *Cavalier Oil Corp.*).

In *MT Properties, Inc. v. CMC Real Estate Corp.*, 481 N.W.2d 383 (Minn. Ct. App. 1992), which involved an appraisal proceeding following a merger, the court (while reserving judgment as to marketability discounts) refused to apply a minority discount, saying that "because the legislature has enacted the [appraisal] statute with the evident aim to protect the dissenting shareholder, we must prohibit application of minority discounts when determining 'fair value' in statutory dissenter's rights cases." *Id.* at 388.

In *Rigel Corp. v. Cutchall*, 511 N.W.2d 519 (Neb. 1994), involving appraisal following a merger, the court, after reviewing a number of cases (including *Cavalier Oil Corp.*), rejected the application of discounts, saying:

> We are persuaded, however, that in the event of a merger, neither a minority discount nor a deduction for lack of marketability is to be given in determining

the fact that to discount the dissenters' shares would be to assign to the majority more than its proportionate interest in the total enterprise and that such a windfall would constitute an undesirable inducement for the majority to initiate freeze-outs at inadequate prices.[713]

(b) Valuation Factors

The implicit objective of the decades-old "Delaware Block" approach to appraisal valuation—involving a weighting of market value, earnings value, and net asset value[714]—was to arrive at a valuation of the total enterprise. However, as is well known, in *Weinberger v. UOP, Inc.*[715] the Delaware Supreme Court said that this approach "shall no longer exclusively control [appraisal and other valuation] proceedings" and that "a more liberal approach must include proof of value by any techniques or methods which are generally considered acceptable in the financial community and otherwise admissible in court."[716] While this pronouncement by the

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> the fair value of a dissenter's shares under the provisions of [the appraisal statute]. Only by not doing so can the statutory policy of fully compensating a dissenting minority shareholder be achieved.

Id. at 526.

713. In *Cavalier Oil Corp.*, the court said: "[T]o fail to accord to a minority shareholder the full proportionate value of his shares imposes a penalty for lack of control, and unfairly enriches the majority shareholders who may reap a windfall from the appraisal process by cashing out a dissenting shareholder, a clearly undesirable result." *Cavalier Oil Corp.*, 564 A.2d at 1145; *accord Rigel Corp.*, 511 N.W.2d at 525; *Friedman*, 661 N.E.2d at 977.

In *In re McLoon Oil Co.*, the court said: "Any rule of law that gave the shareholders less than their proportionate share of the whole firm's fair value would produce a transfer of wealth from the minority shareholders to the shareholders in control. Such a rule would inevitably encourage corporate squeeze-outs." *In re McLoon Oil Co.*, 565 A.2d at 1005.

714. *See* Bell v. Kirby Lumber Corp., 413 A.2d 137, 145-46 (Del. 1980); Poole v. N.V. Deli Maatschappij, 243 A.2d 67, 73 (Del. 1968) (involving valuation in a context other than appraisal); *In re* Delaware Racing Ass'n, 213 A.2d 203, 214 (Del. 1965); Levin v. Midland-Ross Corp., 194 A.2d 50, 53 (Del. Ch. 1963); *In re* Libby, McNeill & Libby, 406 A.2d 54, 59, 67 (Me. 1979); Piemonte v. New Boston Garden Corp., 387 N.E.2d 1145, 1148 (Mass. 1979); Endicott Johnson Corp. v. Bade, 338 N.E.2d 614, 616 (N.Y. 1975); FOLK, *supra* note 459, at 380-86.

There have been other approaches to valuation. One is the award of rescissory damages. *See* Lynch v. Vickers Energy Corp., 429 A.2d 497, 501-03 (Del. 1981). Another involves allocation of the synergistic benefits of a merger. *See* Mills v. Electric Auto-Lite Co., 552 F.2d 1239, 1248 (7th Cir. 1977).

715. 457 A.2d 701 (Del. 1983).

716. The court said:

> In this breach of fiduciary duty case, the Chancellor perceived that the approach to valuation was the same as that in an appraisal proceeding.... This

Delaware court made it predictable that future appraisal proceedings would entail a battle of financial experts,[717] it did not mark an end to the use of the former valuation factors.[718] Market value, earnings value, and net asset value will continue to be used in entity valuation,[719] but probably with some differences in approach.

Because of problems inherent in the weighting of different values,[720] use of this "mechanistic procedure" (as previously practiced

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> means that the so-called "Delaware block" or weighted average method was employed wherein the elements of value, i.e., assets, market price, earnings, etc., were assigned a particular weight and the resulting amounts added to determine the value per share. This procedure has been in use for decades. However, to the extent it excludes other generally accepted techniques used in the financial community and the courts, it is now clearly outmoded. It is time we recognize this in appraisal and other stock valuation proceedings and bring our law current on the subject.
>
> ... Accordingly, the standard "Delaware block" or weighted average method of valuation, formerly employed in appraisal and other stock valuation cases, shall no longer exclusively control such proceedings. We believe that a more liberal approach must include proof of value by any techniques or methods which are generally considered acceptable in the financial community and otherwise admissible in court, subject only to our interpretation of [the Delaware appraisal statute]. This will obviate the very structured and mechanistic procedure that has heretofore governed such matters.

Id. at 712-13 (citations omitted).

717. In *Kahn v. Household Acquisition Corp.*, 591 A.2d 166 (Del. 1991), the court said: "As is often the case in disputed appraisal proceedings, the dispute over the value of Wien shares at the time of the merger became a battle of experts, each espousing a particular technique which purported to demonstrate the fairness of their respective positions." *Id.* at 175.

At the end of its opinion in *In re Shell Oil Co.*, 607 A.2d 1213 (Del. 1992), the court took "the occasion to comment upon a recurring theme in recent appraisal cases—the clash of contrary, and often antagonistic, expert opinions on value." *Id.* at 1222. To compensate for the handicap of having "to pick and choose from a limited record without the benefit of objective analysis and opinion," the court suggested that the chancery court "should consider, in a proper case, appointing its own expert witness." *Id.* at 1222-23.

718. *See* Rosenblatt v. Getty Oil Co., 493 A.2d 929, 940 (Del. 1985) ("*Weinberger* did not abolish the block formula, only its exclusivity as a tool of valuation."); *In re* Radiology Assocs., Inc. Litig., 611 A.2d 485, 496 (Del. Ch. 1991) ("Even though the Delaware courts have used the Delaware Block Method infrequently since *Weinberger*, the Delaware courts still consider it an acceptable procedure for valuing a company.").

719. *See In re* McLoon Oil Co., 565 A.2d 997, 1003 (Me. 1989) ("We note that since *Weinberger* a number of jurisdictions have continued to rely primarily upon the three-factor analysis . . . ."); Oakridge Energy, Inc. v. Clifton, 937 P.2d 130, 132 (Utah 1997) ("We will discuss market value, investment value, and asset value in that order.").

720. In *Rosenblatt*, the court said: "[U]nder Delaware law assets are often given greatest weight." *Rosenblatt*, 493 A.2d at 941. On the other hand, in *Radiology Associates*, the court said: "[E]xcept for corporations with significant natural resource assets or with significant non-operating assets, the Delaware courts generally have refrained from weighing the asset prong heavily in applying the Delaware Block Method when the earnings valuation method appears reliable." *Radiology Assocs.*, 611 A.2d at

under the Delaware Block approach) is likely to diminish.[721] Moreover, for reasons stated above,[722] market value is likely to play a smaller role than in the past. The most prominent factor in the valuation process is likely to be earnings value, but with less emphasis on historic earnings[723] and more attention given to current and prospective earnings and cash flows.[724]

The future of net asset value—at least in Delaware—is less clear. If a corporation is profitable, implying that it should continue in business, earnings value should be the dominant valuation factor for appraisal purposes.[725] On the other hand, if the corporation is unprofitable and its prospects are bleak, it may well have a liquidation value in excess of its earnings value. In the latter circumstance, implying that the corporation should be liquidated, logic would seem to require the conclusion that net asset value (or liquidation value) should be the dominant valuation factor for appraisal purposes.[726] Otherwise, in the controlled corporation context, the majority could effect a take-out merger, basing the merger consideration on market value or earnings value, and thereafter proceed to liquidate the corporation—with the result that the majority would stand to reap the benefit of the higher liquidation value.[727] However, the Delaware courts have adhered for years to the

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Moreover, courts and appraisers can sometimes differ, and sometimes agree, on the weights to be assigned to market value, earnings value, and net asset value. *See* Levin v. Midland-Ross Corp., 194 A.2d 50, 57-58 (Del. Ch. 1963); *In re* Libby, McNeill & Libby, 406 A.2d 54, 63-67 (Me. 1979).

721. *See* Schaefer, *supra* note 686, at 1095-96.

722. *See supra* notes 690-703 and accompanying text.

723. One of the problems with the determination of earnings value under the Delaware Block approach, as it came to be applied, lay in the fact that it used average annual earnings over the preceding five years. However, future prospects as well as the trend of past earnings could be considered in selecting the multiplier used to capitalize the earnings average. *See* Universal City Studios, Inc. v. Francis I. duPont & Co., 334 A.2d 216, 218 (Del. 1975).

724. In *Radiology Associates*, the court said:

> I find it intrinsically more appealing to rely on the future prospects of a company, where reliable projections are available, than the historical earnings of the company because the theoretically more correct measure of the entity's value, under an earnings valuation approach, is the present value of its future cash flows or earnings.

Radiology Assocs., 611 A.2d at 497-98.

725. *See* Schaefer, *supra* note 686, at 1038-39.

726. *See id. But see* Seligman, *supra* note 687, at 848 (suggesting that to award the dissenter a fair value based on liquidation value would be an "undeserved windfall").

727. A reason sometimes advanced for denying dissenters an appraisal valuation based on liquidation value is that minority shareholders have no right or power to cause the

proposition that value is to be determined on a going-concern basis rather than a liquidation basis[728]—an approach of real merit when earnings value exceeds liquidation value but one of dubious validity when the reverse is true.[729] In *In re General Realty & Utilities*

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corporation to be liquidated. *See, e.g., In re* Behrens, 61 N.Y.S.2d 179, 183 (Sup. Ct. 1946) ("Assuming ... that the company could be liquidated to produce the valuations for the preferred and common stocks attributed to them by the appraisers, the fact remains that this company was not to be liquidated; that petitioners [dissenting shareholders] had no expectation or right to have it liquidated or considered on a liquidating basis."), *aff'd without opinion*, 69 N.Y.S.2d 910 (App. Div. 1947). However, this is beside the point; the question is not about the dissenters' powers, it is about the fair value of their stock. Moreover, to say that a lack of power to compel liquidation deprives dissenting shareholders of a right to an appraisal valuation based on liquidation value, even when liquidation offers the best hope of maximizing shareholder wealth, is to say that dissenters are necessarily restricted to an appraisal valuation generated by the course of action (or inaction) chosen by the corporation's management even though that course might be self-serving to the management and contrary to the best interests of the shareholders.

728. *See In re* Shell Oil Co., 607 A.2d 1213, 1221 (Del. 1992) ("Liquidation value is one factor relevant to a fair value inquiry and an acceptable technique, with others, upon which the Court of Chancery can rely. Liquidation value cannot, however, be viewed as a substitute for, or interchangeable with, fair value." (citation omitted)); Rosenblatt v. Getty Oil Co., 493 A.2d 929, 942 (Del. 1985) ("In Delaware a company is valued as a going concern, not on what can be obtained by its liquidation."); Bell v. Kirby Lumber Corp., 413 A.2d 137, 142 (Del. 1980) (referring to "the traditional going concern standard under established Delaware law"); Universal City Studios, Inc. v. Francis I. duPont & Co., 334 A.2d 216, 218 (Del. 1975) ("It is well settled that in an appraisal proceeding ... the shares must be valued on a going concern basis."); *In re* Delaware Racing Ass'n, 213 A.2d 203, 209 (Del. 1965) ("[T]hese [dissenting] stockholders are entitled to be paid the intrinsic value of their shares determined on a going concern basis, which excludes a valuation based solely upon the liquidating value ...."); Tri-Continental Corp. v. Battye, 74 A.2d 71, 72 (Del. 1950) ("[S]ince value is to be fixed on a going-concern basis, the liquidating value of the stock may not be accepted as the sole measure."); *Radiology Associates*, 611 A.2d at 496 ("The use of liquidation value rather than going-concern value is inappropriate."); Sporborg v. City Specialty Stores, Inc., 123 A.2d 121, 123 (Del. Ch. 1956) ("[I]t is well established that in an appraisal proceeding under our statute the shares must be valued on a going concern basis.").

729. *Sterling v. Mayflower Hotel Corp.*, 93 A.2d 107 (Del. 1952), is a classic illustration of the injustice that can result from a court's refusal to test the fairness of the consideration received by minority shareholders in an interested-party merger against the liquidation value of the corporation. In this case, Hilton, owning 321,883 of Mayflower's 389,738 outstanding shares of common stock, effected a share-for-share merger of Mayflower into Hilton. *See id.* at 108-09. The court appears to have accepted the fact that Mayflower had a liquidation value of $10,500,000 or about $27 for each of Mayflower's outstanding shares. *See id.* at 111. Yet it permitted Hilton, in effect, to acquire the 67,855 minority shares of Mayflower—each of which would have received about $27 had Mayflower been liquidated—in exchange for a like number of Hilton shares having a market value of only about $15 per share. *See id.* at 109-11. (Ironically, this is the case most frequently cited for the proposition that a controlling shareholder standing on both sides of a transaction must bear the burden of proving its entire fairness. *See supra* note 450.)

Corp.,[730] the appraiser's report advanced the proposition that the intrinsic value of a shareholder's interest could never be less than its liquidation value,[731] but the court rejected this view as being contrary to the legal requirement that appraisal valuation be on a going-concern basis.[732]

Mention needs to be made of a closely related point concerning appraisal valuation. It has been suggested that the best of all measures of entity value is the amount that a willing buyer would pay for the total enterprise.[733] However, this suggested approach has

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730. 52 A.2d 6 (Del. Ch. 1947).

731. The conclusion of the appraiser's report, as set forth by the court, included the following:

> "[T]he *liquidating* value of the stock is not the *sole* basis for an appraisal of its intrinsic worth, if we assume that the Company is justified in staying in business. By holding the component parts of the Corporation together, it is presumed that they will be worth more, because of the income which together they produce, than could be realized from them in liquidation. But, it certainly cannot be said that the intrinsic value of any shareholder's interest in a going Corporation at a given time is *less* than he could realize for it upon a liquidation of the Corporation's assets at that time. If that be the situation in any Corporation, surely its time for liquidation has arrived."

Id. at 10 (quoting the appraiser's report).

732. The *General Realty* court said:

> It appears that, contrary to the governing law, the Appraiser did in fact approach the problem somewhat as though a liquidation were involved. This court indicated in Chicago Corporation v. Munds that such is not the test in cases arising under our appraisal statute. Moreover, asset value, while a factor, must not be overemphasized in arriving at a determination of appraised value, because other factors such as the value based on prospective earnings are vitally important.
>
> As stated, the Appraiser indicated that the "intrinsic value" of a stockholder's shares in a going concern should always be more than their then liquidating value, and if the situation is otherwise, he suggests that the Corporation is a proper subject for liquidation. I cannot believe the Appraiser intended to convey the thought that the appraised value of shares under our statute should never be less than their hypothetical liquidating value because such is not the law.

Id. at 15 (citation omitted).

733. In *In re McLoon Oil Co.*, 565 A.2d 997 (Me. 1989), the court said:

> Especially in fixing the appraisal remedy in a close corporation, the relevant inquiry is what is the highest price a single buyer would reasonably pay for the whole enterprise, not what a willing buyer and a willing seller would bargain out as the sales price of a dissenting shareholder's shares in a hypothetical market transaction.

Id. at 1005.

Dreiseszun v. FLM Industries, Inc., 577 S.W.2d 902 (Mo. Ct. App. 1979), involved an appraisal proceeding following a sale-of-assets transaction negotiated at arm's length by the family in control of the selling corporation. The selling corporation was to remain in existence as a holding or investment company, and minority shareholders were offered $23 for each of their shares although (if this offer were to be accepted by all of the

been perceived as raising the question whether dissenters should be entitled to share in a control premium. The Massachusetts courts have answered this question in the affirmative,[734] but the Delaware

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minority holders) the controlling family would be left with shares having a book value of $55 per share. *See id.* at 904-05. The court rejected the trial court's reasoning that $23 per share represented "fair value" mainly because most of the minority shareholders had accepted that amount; and it held, instead, that the dissenters should receive their proportionate share of the worth of the total package of consideration paid by the purchasing corporation. *See id.* at 906-08. The court said:

> The terms of the Garfinckel contract represented the price for which a willing seller (Harzfeld's) would sell, and a willing buyer (Garfinckel) would pay, for the business as a going concern representing the result of arm's length, fair and knowledgeable negotiations.
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> ....
>
> In light of the sale of Harzfeld's, at a price conceded by all the parties involved, including the parties herein, to be a fair and reasonable price, the usual criteria, otherwise useful in evaluating the fair value of the stock, including Harzfeld's business difficulties, capital situation, inventories, dividend history, book value and market value of its stock and store locations and condition fade into relative insignificance. The overriding, compelling and decisive factors vital here to the ascertainment of "fair value" for the dissenters' stock are the terms of the Garfinckel sale considered as a whole and reduced to cash value as of [the valuation date] of the considerations flowing therefrom.

Id. at 907-08.

For a discussion of the fairness of third-party sale value in various contexts, see Leonard Chazen, *Fairness from a Financial Point of View in Acquisitions of Public Companies: Is "Third-Party Sale Value" the Appropriate Standard?*, 36 BUS. LAW. 1439 (1981).

734. In *Sarrouf v. New England Patriots Football Club, Inc.*, 492 N.E.2d 1122 (Mass. 1986), all of the 100,000 shares of voting common were owned by a single holder, while 139,800 shares of non-voting common were publicly owned. *See id.* at 1125. The latter stock was eliminated by a cash-out merger with a newly created shell corporation, leading dissenters to seek appraisal. *See id.* at 1124. The court sustained the trial judge's appraisal valuation, *see id.* at 1130, which consisted essentially of two steps: (i) determining what amount would be paid for the entire enterprise by one of those extremely wealthy individuals desiring to become members of the exclusive club of NFL franchise-owners, and (ii) assigning to each outstanding share, whether voting or nonvoting, an equal portion of the amount determined in the first step—noting that the two classes of stock were identical except for the right to vote, but not bothering to consider that a purchaser would surely have paid a higher per-share price for all of the voting stock than for all of the non-voting stock, *see id.* at 1125-26.

In *BNE Massachusetts Corp. v. Sims*, 588 N.E.2d 14 (Mass. App. Ct. 1992), the court said:

> We accept the possibility that there may be a difference between the valuation of the enterprise as an entirety and the value the market might assign to shares which do not represent control of the enterprise; but it is that difference to which the dissenting stockholder may be entitled under § 92 [the appraisal statute]. The task assigned to the court by § 92 is not to reconstruct an "intrinsic value" of each share of the enterprise but, rather, to determine what a willing buyer realistically would pay for the enterprise as a whole on the statutory valuation date.... Only in this fashion can minority stockholders be assured that insiders in control of a company, burdened by conflicting interests, may not purchase the

courts have answered it in the negative. In *Bell v. Kirby Lumber Corp.*,[735] which involved a cash-out short-form merger of a subsidiary owning valuable natural resources, dissenting minority shareholders contended that the subsidiary's stock should be valued on the basis of what all of the shareholders (including the parent) would have received per share in a transaction negotiated at arm's length with a third party,[736] but the court rejected this contention because of "the traditional going concern standard under established Delaware law."[737] *In re Radiology Associates, Inc. Litigation*[738] contains a similar rejection of the view that dissenters are entitled to a proportionate share of the amount for which the entire enterprise could be sold.[739]

The right of appraisal can be thought of as the ultimate remedy of dissenting shareholders. If it is to serve this function properly, dissenters should receive in appraisal their proportionate share of the value demonstrably available from applying the resources of the corporation to their most highly valued use—whether that be the earnings value from continuing in business, the net asset value realizable from liquidation, or the amount that could be obtained

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> enterprise at a price less than that obtainable in the marketplace of qualified buyers and avoid paying a full and fair price to the minority.

Id. at 19.

735. 413 A.2d 137 (Del. 1980); *see* Shlomo Cohen, Comment, Bell v. Kirby Lumber Corp.*: Ascertaining "Fair Value" Under the Delaware Appraisal Statute*, 81 COLUM. L. REV. 426 (1981).

736. The court said:

> The [dissenting] stockholders contend that the entire fairness, close judicial scrutiny rule in this parent/subsidiary merger requires the Court to assess damages on the basis of a per share value of the stock as negotiated in a hypothetical third party arms length transaction in which the vast natural resource assets of Kirby would control.

Bell, 413 A.2d at 140.

737. *Id.* at 142.

738. 611 A.2d 485 (Del. Ch. 1991).

739. The *Radiology Associates* court said:

> The [discounted cash flow] calculation arguably may have left out a premium that normally accrues when shareholders sell a company. However, "the appraisal process is not intended to reconstruct a pro forma sale but to assume that the shareholder was willing to maintain his investment position, however slight, had the merger not occurred." Plaintiff is not entitled to the proportionate sales value of Radiology. Plaintiff is entitled to the proportionate value of Radiology as a *continuing shareholder.*

Id. at 494 (citation omitted) (quoting Cavalier Oil Corp. v. Harnett, 564 A.2d 1137, 1145 (Del. 1989)); *see also* Armstrong v. Marathon Oil Co., 513 N.E.2d 776, 789 (Ohio 1987) ("The view that fair cash value must be determined by calculating a pro-rata share of a constructed or hypothetical purchase price for the entire corporation where there is an actual market for the stock of the company . . . is simply incorrect.").

from a sale of the corporate enterprise to a new owner.

b. Entitlement and Exceptions

(1) Statutory Provisions

In the three subject states up to 1950 (as discussed above), dissenting shareholders of both corporations involved in a merger (other than a parent-subsidiary merger, permitted then only in Delaware[740]) were entitled to appraisal rights. Among the most significant statutory changes made in the merger law of the subject states after 1950 were those involving new exceptions to the right of appraisal for dissenting shareholders. One kind of exception relates to the nature of the merger transaction, another involves attributes of the shares held by dissenters, and the third involves the type of consideration used to effect the merger.

(a) Exceptions Based on Nature of Transaction

Under the current statutes of the three subject states, there is only one kind of merger transaction (in only two of the three states) in which shareholders of the *disappearing* corporation are denied the right of appraisal because of the nature of the transaction. In Delaware and North Carolina, shareholders of a parent corporation that disappears in a downstream short-form merger—although required to give their voting approval of such a transaction—are denied the right of appraisal.[741]

However, under the current statutes of the three states, there are several kinds of merger transactions in which shareholders of the *surviving* corporation are denied appraisal rights. In all three states, the appraisal right is denied to shareholders of the surviving corporation in a small-scale merger[742]—assuming, of course, that all the conditions of the respective small-scale merger statutes are met. The statutes of the three states (with limited exceptions in New

740. *See supra* notes 380-84 and accompanying text.

741. *See* DEL. CODE ANN. tit. 8, § 253(c)-(d) (1991) (discussed *supra* in note 468 and accompanying text); N.C. GEN. STAT. § 55-13-02(a)(1) (Supp. 1996) (discussed *supra* in notes 501-02 and accompanying text). New Jersey's short-form merger statute permits downstream mergers, *see* N.J. STAT. ANN. § 14A:10-5.1(1) (West Supp. 1997); *supra* note 482 and text accompanying note 487; however, its appraisal statute accords appraisal rights to shareholders of the disappearing corporation, *see* N.J. STAT. ANN. § 14A:11-1(1)(a) (West Supp. 1997); *supra* note 489 and text accompanying notes 489-90.

742. For Delaware, see *supra* text accompanying notes 527-28. For New Jersey, see *supra* text accompanying notes 537-38. For North Carolina, see *supra* note 547 (first paragraph) and accompanying text.

Jersey) also deny appraisal rights to shareholders of a parent corporation surviving an upstream short-form merger.[743] New Jersey—alone among the three states—denies the right of appraisal (except in limited circumstances) to shareholders of the subsidiary that survives in a downstream short-form merger.[744] Of course, shareholders of the true acquiring corporation do not get appraisal rights in the case of a triangular merger; however, this is not because they are shareholders of a surviving corporation, but because their corporation is not a party to the merger.[745]

What this means, so far as the nature of the transaction is concerned, is that, under the current statutes of the three subject states, the right of appraisal is accorded to shareholders of both corporations in a long-form merger, to shareholders of the disappearing corporation in a small-scale merger, and to shareholders of the disappearing subsidiary in an upstream short-form merger. With respect to downstream short-form mergers, New Jersey (but not Delaware or North Carolina) accords appraisal rights to shareholders of the disappearing parent, while Delaware and North Carolina (but not New Jersey) accord such rights to shareholders of the surviving subsidiary. Moreover, the statutory right of appraisal—if granted at all—is granted with respect to non-voting as well as voting shares.[746]

As to the last point, the Model Business Corporation Act takes a different approach. It provides that, except in the case of shareholders of a subsidiary involved in a short-form merger, a shareholder is not entitled to appraisal rights with respect to a merger if that shareholder is not entitled to vote on the merger.[747]

743. For Delaware, see *supra* note 468 and accompanying text. For New Jersey, see *supra* text accompanying note 491. For North Carolina, see *supra* notes 501-02 and accompanying text.

744. For Delaware, see *supra* notes 469-70 and accompanying text. For North Carolina, see *supra* note 503 and accompanying text. For New Jersey, see *supra* note 491 and accompanying text, note 488 and accompanying text, and text accompanying note 517.

745. *See supra* text accompanying notes 662-63.

746. *See* DEL. CODE ANN. tit. 8, § 262(a) (Supp. 1996); N.J. STAT. ANN. § 14A:11-1(1)(a) (West Supp. 1997); N.C. GEN. STAT. § 55-13-02(a)(1) (Supp. 1996).

747. *See* MODEL BUS. CORP. ACT ANN. § 13.02(a)(1) (1996) (quoted *supra* in note 509). The Official Comment includes the following:

> Generally, only shareholders who are entitled to vote on the transaction are entitled to assert dissenters' rights with respect to the transaction.... One exception to this principle is the merger of a subsidiary into its parent under section 11.04 in which minority shareholders of the subsidiary have the right to assert dissenters' rights even though they have no right to vote.

Id. § 13.02 commentary at 13-16.

(b) Exceptions Based on Attributes of the Dissenter's Shares

A major change involving the denial of appraisal rights occurred in the 1967 rewrite of the Delaware General Corporation Law.[748] It was followed by New Jersey in the 1968 rewrite of its Business Corporation Act[749] and by North Carolina when its 1989 Business Corporation Act was amended in 1997.[750] In general (and subject to certain exceptions), it took away appraisal rights with respect to marketable shares.

The Delaware change added a new provision to that state's appraisal statute;[751] and, notwithstanding several amendments,[752] its basic thrust remains the same.[753] One part of the statute provides

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While the 1989 North Carolina Business Corporation Act is based (for the most part) on the 1984 Model Business Corporation Act, it does not follow the Model Act in this respect. *See supra* note 547. The Amended North Carolina Commentary states:

> Subdivisions (a)(1), (a)(2), and (a)(3) [of § 55-13-02] give a right of dissent for all shares, whether voting or nonvoting, in the case of a merger or sale or exchange of assets; the corresponding provisions in the Model Act give the right of dissent only to voting shareholders.

N.C. GEN. STAT. § 55-13-02 commentary at 171 (Supp. 1996).

748. *See* Act of July 3, 1967, ch. 50, sec. 1, § 262(k), 56 Del. Laws 151, 222; *supra* note 251 (second paragraph).

749. *See* Act of Nov. 21, 1968, ch. 350, § 14A:11-1(1)(a), 1968 N.J. Laws 1011, 1106-07 (effective Jan. 1, 1969); *supra* note 250 (second paragraph).

750. *See* Act of June 9, 1997, ch. 202, § 1 (effective Oct. 1, 1997) (to be codified at N.C. GEN. STAT. § 55-13-02(c)).

751. The new provision read as follows:

> This section shall not apply to the shares of any class of stock which, at the record date fixed to determine the stockholders entitled to receive notice of and to vote at the meeting of stockholders at which the agreement of merger or consolidation is to be acted on, were either (1) registered on a national securities exchange, or (2) held of record by not less than 2,000 stockholders, unless the certificate of incorporation of the corporation issuing such stock shall otherwise provide;.... This subsection shall not be applicable to stockholders of a corporation whose stock in a constituent corporation was not converted by the merger or consolidation solely into stock of the corporation resulting from or surviving a merger pursuant to sections 251 or 252 of this title.

Former DEL. CODE ANN. tit. 8, § 262(k) (Cum. Supp. 1968).

752. *See* Act of June 23, 1969, ch. 148, § 29, 57 Del. Laws 433, 449 (effective July 15, 1969); Act of June 25, 1973, ch. 106, § 12, 59 Del. Laws 209, 214-15 (effective July 1, 1973); Act of Apr. 24, 1976, ch. 371, §§ 11-12, 60 Del. Laws 1070, 1079-80 (effective July 1, 1976); Act of June 6, 1981, ch. 25, § 14, 63 Del. Laws 36, 38-40; Act of July 14, 1981, ch. 152, 63 Del. Laws 290; Act of July 9, 1987, ch. 136, §§ 30-32, 66 Del. Laws 335, 339; Act of July 12, 1988, ch. 352, § 9, 66 Del. Laws 755, 756; Act of July 8, 1992, ch. 337, §§ 3-4, 68 Del. Laws 1159, 1159 (effective July 1, 1992); Act of July 1, 1993, ch. 61, § 10, 69 Del. Laws 54, 54-55; Act of June 27, 1994, ch. 262, §§ 1-9, 69 Del. Laws 523, 523 (effective July 1, 1994); Act of June 23, 1995, ch. 79, § 16, 70 Del. Laws 118, 121 (effective July 1, 1995); Act of Feb 1, 1996, ch. 299, §§ 2-3, 70 Del. Laws 711, 711.

753. The Delaware statute provides as follows:

that appraisal rights do not apply with respect to a class of marketable shares—in the sense of shares that are "either (i) listed on a national securities exchange or designated as a national market system security ... or (ii) held of record by more than 2,000 holders."[754] However, another part of the statute provides that appraisal rights do apply with respect to such a class of marketable shares if the holders thereof are required by terms of the merger agreement to accept in exchange therefor anything (leaving aside cash in lieu of fractional shares) other than shares of the surviving

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> (b) Appraisal rights shall be available for the shares of any class or series of stock of a constituent corporation in a merger or consolidation to be effected pursuant to § 251 [relating to merger or consolidation of domestic corporations] ..., § 252 [relating to merger or consolidation of domestic and foreign corporations] ... of this title:
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> (1) Provided, however, that no appraisal rights under this section shall be available for the shares of any class or series of stock, which stock, ... at the record date ..., were either (i) listed on a national securities exchange or designated as a national market system security on an interdealer quotation system by the National Association of Securities Dealers, Inc. or (ii) held of record by more than 2,000 holders; ....
>
> (2) Notwithstanding paragraph (1) of this subsection, appraisal rights under this section shall be available for the shares of any class or series of stock of a constituent corporation if the holders thereof are required by the terms of an agreement of merger or consolidation pursuant to §§ 251, 252 ... of this title to accept for such stock anything except:
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> a. Shares of stock of the corporation surviving or resulting from such merger or consolidation ...;
>
> b. Shares of stock of any other corporation ..., which shares of stock ... at the effective date of the merger or consolidation will be either listed on a national securities exchange or designated as a national market system security on an interdealer quotation system by the National Association of Securities Dealers, Inc. or held of record by more than 2,000 holders;
>
> c. Cash in lieu of fractional shares ... described in the foregoing subparagraphs a. and b. of this paragraph; or
>
> d. Any combination of the shares of stock ... and cash in lieu of fractional shares ... described in the foregoing subparagraphs a., b. and c. of this paragraph.
>
> ....

DEL. CODE ANN. tit. 8, § 262(b) (Supp. 1996).

754. *Id.* § 262(b)(1). The marketable shares exception does not apply to minority shares of a Delaware subsidiary involved in a short-form merger, even if those shares are listed on a national securities exchange or held of record by more than 2000 holders. This is because section 262(b)(1)-(2) does not apply with respect to mergers effected under section 253 (the short-form merger statute) and, further, because section 262(b)(3) provides as follows: "In the event all of the stock of a subsidiary Delaware corporation party to a merger effected under section 253 of this title is not owned by the parent corporation immediately prior to the merger, appraisal rights shall be available for the shares of the subsidiary Delaware corporation." DEL. CODE ANN. tit. 8, § 262(b) (1991 & Supp. 1996).

corporation or marketable shares, similarly defined, of another corporation. Thus, if a shareholder is cashed out by a merger, he does not lose his appraisal right simply because his pre-merger shares were marketable.

The New Jersey statute, as rewritten in 1968, followed the Delaware approach to a large degree.[755] However, as subsequently amended,[756] the New Jersey statute departs from the Delaware approach in one significant respect.[757] The current New Jersey

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755. The New Jersey statute, as enacted in 1968, provided as follows:

> (1) Any shareholder of a domestic corporation shall have the right to dissent from any of the following corporate actions
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> (a) any plan of merger or consolidation to which the corporation is a party, provided that
>
> (i) a shareholder shall not have right to dissent from any plan of merger or consolidation with respect to shares
>
> (A) which are listed on a national securities exchange or are regularly quoted in an over-the-counter market ... on the record date ... ; and
>
> (B) for which, pursuant to the plan of merger or consolidation such shareholders are required to accept only shares or shares and cash in lieu of fractional shares of the corporation surviving or resulting from such merger or consolidation;
>
> ....

Former N.J. STAT. ANN. § 14A:11-1(1) (West 1969).

The Commissioners' Comment—1968 was as follows:

> Subparagraph 14A:11-1(1)(a)(i) departs from both Title 14 and the Model Act and follows subsection 262(k) of the Delaware Act by withholding the right of appraisal in the instances specified. However, the Commission did not adopt the 2,000 shareholder provision of the Delaware Act. Further, whereas the Delaware Act limits the withholding of appraisal rights only with regard to shares registered on a national securities exchange, division 14A:11-1(1)(a)(i)(A) also withholds the right of appraisal with regard to shares regularly quoted on an over-the-counter market....

Id. § 14A:11-1 commentary at 87.

756. *See* Act of Jan. 7, 1974, ch. 366, § 60, 1973 N.J. Laws 964, 1029-30 (effective May 1, 1974).

757. The amended New Jersey statutes provides as follows:

> (1) Any shareholder of a domestic corporation shall have the right to dissent from any of the following corporate actions
>
> (a) Any plan of merger or consolidation to which the corporation is a party, provided that, unless the certificate of incorporation otherwise provides
>
> (i) a shareholder shall not have the right to dissent from any plan of merger or consolidation with respect to shares
>
> (A) of a class or series which is listed on a national securities exchange or is held of record by not less than 1,000 holders on the record date ... ; or
>
> (B) for which, pursuant to the plan of merger or consolidation, he will receive (x) cash, (y) shares, obligations or other securities which, upon consummation of the merger or

statute (in the absence of a contrary charter provision) contains an outright denial of appraisal rights to dissenters whose shares are marketable (using a test of ownership by 1000 rather than 2000 shareholders to imply a market for shares), with no provision whereby that denial is subject to nullification on the basis of the kind of merger consideration received. Thus, if a shareholder is cashed out by a merger, that fact does not (as in Delaware) negate a denial of appraisal rights based on the marketability of his pre-merger shares.

As enacted in 1989 (effective July 1, 1990), North Carolina's Business Corporation Act did not deny appraisal rights to dissenters because of the marketability of their shares, but that Act did (and continues to) deny such rights to a shareholder dissenting from a merger if his shares are "then redeemable by the corporation at a price not greater than the cash to be received in exchange for such shares."[758] In 1997, North Carolina amended its 1989 Act to

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> consolidation, will either be listed on a national securities exchange or held of record by not less than 1,000 holders, or (z) cash and such securities;
>
> ....

N.J. STAT. ANN. § 14A:11-1(1) (West Supp. 1997).

The Commissioners' Comment—1972 Amendments contained the following:

> The amendment of subsection 14A:11-1(1) modifies the previous statute by withholding the right of appraisal (unless the certificate of incorporation otherwise provides) on a merger, consolidation, or sale of all or substantially all the assets of a corporation if a shareholder holds prior to the transaction, or will acquire as a result of the transaction, readily marketable securities. Under subsection 14A:11-1(1), as amended, there is no appraisal right with respect to shares held prior to a merger, consolidation, or sale of assets which are of a class or series listed on a national securities exchange or held of record by not less than 1,000 holders. Similarly, there is no appraisal right for a shareholder who will receive upon consummation of any such transaction cash, securities which are either listed on a national securities exchange or held of record by not less than 1,000 holders, or a combination of cash and securities.
>
> The Commission concluded that the standard of record ownership by not less than 1,000 holders was preferable to the standard of regular quotation in an over-the-counter market. Although the Delaware Act uses a 2,000 holder test, the commission felt that a 1,000 holder requirement would adequately assure the marketability of securities so held.

Id. § 14A:11-1 commentary at 44.

758. The North Carolina statute provides as follows:

> (a) In addition to any rights granted under Article 9 [the North Carolina Shareholder Protection Act], a shareholder is entitled to dissent from, and obtain payment of the fair value of his shares in the event of, any of the following corporate actions:
>
> (1) Consummation of a plan of merger to which the corporation (other than a parent corporation in a [short-form] merger under G.S. 55-11-04) is a party unless (i) ... (ii) such shares are then redeemable by the

provide—for the first time—that shareholders will have no right of dissent and appraisal if their shares are marketable (in the sense of being listed on a national securities exchange or held by at least 2000 record holders).[759] Unlike the comparable Delaware statute,[760] this

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> corporation at a price not greater than the cash to be received in exchange for such shares;
>
> ....

N.C. GEN. STAT. § 55-13-02(a) (Supp. 1996). While the new North Carolina Act is based, generally, on the 1984 Model Business Corporation Act, the provision of the North Carolina Act relating to redeemable shares does not appear in the Model Act.

The theory of the redeemable shares provision is that, if a corporation has outstanding shares that are redeemable at the corporation's option, and if the corporation proposes to enter into a merger pursuant to a plan that contemplates a cash-out of those redeemable shares for an amount of cash that is not less than their redemption price, then, a holder of such shares can be no worse off than if the redemption option had been exercised, and thus there is no occasion to give him appraisal rights for the protection of his interests.

759. The North Carolina statute provides as follows:

> Notwithstanding any other provision of this Article [relating to Dissenters' Rights], there shall be no right of dissent in favor of holders of shares of any class or series which, at the record date fixed to determine the shareholders entitled to receive notice of and to vote at the meeting at which the plan of merger or share exchange or the sale or exchange of property is to be acted on, were (i) listed on a national securities exchange or (ii) held by at least 2,000 record shareholders, unless in either case:
>
> (1) The articles of incorporation of the corporation issuing the shares provide otherwise;
>
> (2) In the case of a plan of merger or share exchange, the holders of the class or series are required under the plan of merger or share exchange to accept for the shares anything except:
>
> a. Cash;
>
> b. Shares, or shares and cash in lieu of fractional shares of the surviving or acquiring corporation, or of any other corporation which, at the record date fixed to determine the shareholders entitled to receive notice of and vote at the meeting at which the plan of merger or share exchange is to be acted on, were either listed subject to notice of issuance on a national securities exchange or held of record by at least 2,000 record shareholders; or
>
> c. A combination of cash and shares as set forth in subsubdivisions a. and b. of this subdivision.

Act of June 9, 1997, ch. 202, § 1 (effective Oct. 1, 1997) (to be codified at N.C. GEN. STAT. § 55-13-02(c)).

The provisions of this statute do not apply to subsidiary corporations that are parties to short-form mergers. *See* N.C. GEN. STAT. § 55-11-04(f) (1990), *as amended by* Act of Aug. 26, 1997, ch. 485, § 29 (effective Oct. 1, 1997) (quoted *supra* in note 496).

It is difficult to determine, under subsubdivision (2)b of this statute, whether or not a shareholder's right of dissent is denied if he holds marketable shares and is required under a plan of merger or share exchange to accept (in exchange therefor) shares of the acquiring corporation which (at the record date) are not marketable. Compare the provisions of this statute with those of section 262(b)(1)-(2) of the Delaware Code. *See* DEL. CODE ANN. tit. 8, § 262(b)(1)-(2) (Supp. 1996) (quoted *supra* in note 753).

new North Carolina statute denies appraisal rights to holders of marketable shares (unless otherwise provided in the corporate charter) even when the consideration received by them in a merger consists of nothing but cash.

(c) Exceptions Based on Type of Merger Consideration

New Jersey—alone among the three subject states—denies the right of appraisal (without regard to any other circumstance) simply on the basis of the shareholder's receiving either of two specified types of merger consideration: cash or marketable securities.[761] The New Jersey statute states that, unless otherwise provided in the corporate charter, "a shareholder shall not have the right to dissent from any plan of merger ... with respect to shares ... for which ... he will receive (x) cash, (y) shares, obligations or other securities which, upon consummation of the merger ..., will either be listed on a national securities exchange or held of record by not less than 1,000 holders, or (z) cash and such securities."[762]

(d) Voluntary Appraisal Provisions

In 1974,[763] New Jersey added a new subsection to its appraisal statute, authorizing a corporation to provide in its charter for appraisal rights in connection with specified transactions.[764]

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760. *See supra* text accompanying note 754.

761. This concept was introduced into the New Jersey appraisal statute by Act of Jan. 7, 1974, ch. 366, § 60, 1973 N.J. Laws 964, 1029-30 (effective May 1, 1974). For the Commissioners' Comments—1972 Amendments, see *supra* note 757 (second paragraph).

762. N.J. STAT. ANN. § 14A:11-1(1)(a)(i)(B) (West Supp. 1997) (quoted *supra* in note 757 (first paragraph)).

763. *See* Act of Jan. 7, 1974, ch. 366, § 60, 1973 N.J. Laws 964, 1031.

764. The New Jersey statute provides as follows:

> A corporation may provide in its certificate of incorporation that holders of all its shares, or of a particular class or series thereof, shall have the right to dissent from specified corporate actions in addition to those enumerated in subsection 14A:11-1(1), in which case the exercise of such right of dissent shall be governed by the provisions of this Chapter.

N.J. STAT. ANN. § 14A:11-1(4) (West Supp. 1997). The Commissioners' Comment—1972 Amendments includes the following:

> A new subsection 14A:11-1(4) has been added to permit a corporation to provide in its Certificate of Incorporation that shareholders are entitled to the right of dissent from specified corporate actions in addition to those corporate actions as to which the right to dissent is required by this Act. This, in effect, enables a corporation to "volunteer" an appraisal right in particular situations where the right is not required by the statute.

Id. § 14A:11-1 commentary at 44.

Delaware followed, in 1981,[765] adding a comparable provision to its appraisal statute.[766] North Carolina's 1989 Business Corporation Act[767] goes a step further; it authorizes appraisal rights to be volunteered by a corporation, not only if so permitted by provisions of the corporate charter or bylaws, but also if so provided in a resolution of the board of directors.[768]

(2) Cases and Commentary

The denial of appraisal rights to shareholders of the parent corporation in an upstream short-form merger makes good sense,

765. *See* Act of June 6, 1981, ch. 25, § 14, 63 Del. Laws 36, 38 (effective July 6, 1981).

766. The Delaware statute provides as follows:

> Any corporation may provide in its certificate of incorporation that appraisal rights under this section shall be available for the shares of any class or series of its stock as a result of an amendment to its certificate of incorporation, any merger or consolidation in which the corporation is a constituent corporation or the sale of all or substantially all of the assets of the corporation. If the certificate of incorporation contains such a provision, the procedures of this section . . . shall apply as nearly as is practicable.

DEL. CODE ANN. tit. 8, § 262(c) (1991).

767. Act of June 8, 1989, ch. 265, 1989 N.C. Sess. Laws 566 (effective July 1, 1990); *see supra* note 252 (third paragraph).

768. The North Carolina statute provides as follows:

> (a) In addition to any rights granted under Article 9 [the North Carolina Shareholder Protection Act], a shareholder is entitled to dissent from, and obtain payment of the fair value of his shares in the event of, any of the following corporate actions:
>
> . . . .
>
> (5) Any corporate action taken pursuant to a shareholder vote to the extent the articles of incorporation, bylaws, or a resolution of the board of directors provides that voting or nonvoting shareholders are entitled to dissent and obtain payment for their shares.

N.C. GEN. STAT. § 55-13-02(a) (Supp. 1996). This provision is taken from the 1984 Model Business Corporation Act, as to which the Official Comment states:

> Corporations may wish to grant on a voluntary basis dissenters' rights in connection with important transactions (e.g., those submitted for shareholder approval). The grant may be to nonvoting shareholders in connection with transactions that give rise to dissenters' rights with respect to voting shareholders. The grant of dissenters' rights may add to the attractiveness of preferred shares, and may satisfy shareholders who would, in the absence of dissenters' rights, sue to enjoin the transaction. Also, in situations where the existence of dissenters' rights may otherwise be disputed, the voluntary offer of those rights under this section will avoid a dispute.

MODEL BUS. CORP. ACT ANN. § 13.02 commentary at 13-15 (1996).

One can wonder whether (although probably unintended) the introductory language of section 55-13-02(c) of the North Carolina General Statutes (quoted *supra* in note 759) has the effect of precluding a volunteering of appraisal rights (otherwise than by terms of the corporate charter) with respect to shares that are marketable as specified in that 1997 addition to North Carolina's appraisal statute.

having in mind the limitations (discussed above) on use of this form of merger. The same cannot be said for Delaware's or North Carolina's denial of appraisal rights to the parent's shareholders in a downstream short-form merger,[769] nor for New Jersey's denial of appraisal rights to the subsidiary's shareholders in a downstream short-form merger.[770] There should always be appraisal rights for dissenting shareholders of a corporation that disappears in a merger and for shareholders dissenting from a merger of their controlled corporation even when it is made the survivor.[771]

The denial of appraisal rights to shareholders of the surviving corporation in a small-scale merger makes good sense, given the requirements that have to be met for such a merger. On the other hand, statutes are deficient when they permit, by resort to the triangular merger device, a stock merger that increases the acquiring company's outstanding common stock by more than 20% (40% in New Jersey) without any right of appraisal for dissenters.[772]

Some aspects of the post-1950 appraisal statutes in the three subject states seem patently wrong. One, now applicable in all three states, is the denial of appraisal rights to shareholders whose shares are marketable. The other, applicable only in New Jersey, is the denial of appraisal rights to dissenting shareholders who receive cash or marketable securities for their stock.

The premise underlying the denial of appraisal rights with respect to marketable shares is (to say the least) difficult to accept.[773] It would appear to be based on the notion that the price at which a dissenting shareholder can sell his shares (i.e., the market value of those shares) is the same as his entitlement in appraisal (i.e., the "fair value" of such shares). Yet, as pointed out above, this notion has come to be widely discredited;[774] and it is significant that a provision

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769. For a problem that could arise with respect to a Delaware corporation, see *supra* text accompanying notes 519-21.

770. *See supra* text accompanying notes 517 and 744.

771. For an example of a case, outside New Jersey, in which steps were taken to make the subsidiary corporation the survivor in a short-form merger, see *Temple v. Combined Properties Corp.*, 410 A.2d 1375 (Del. Ch. 1979).

772. *See supra* text accompanying notes 663-65.

773. That premise has been stated as follows: "In short, the theory is that, if the appraisal remedy provides a judicially created market for dissenting stockholders, such a device is unnecessary where there is already a substantial trading market, either through a securities exchange or the over-the-counter market." FOLK, *supra* note 459, at 391; *see also* Willard P. Scott, *Changes in the Model Business Corporation Act*, 24 BUS. LAW. 291, 302-03 (1968) (stating that the right of dissent and appraisal, while useful in limited market situations, is not needed when an established market exists).

774. *See supra* notes 690-701 and accompanying text. For criticism of the denial of

comparable to Delaware's, having been added to the Model Business Corporation Act in 1969,[775] was deleted from the Model Act in 1978.[776]

The New Jersey statute—unlike that of Delaware or North Carolina—denies appraisal rights in the context in which it is probably needed most. It contains an outright denial of such rights to any shareholder (whether of the surviving or the disappearing corporation) if his shares are converted, in a merger, into cash.[777] This leaves a cashed out shareholder with no means of checking the adequacy of the consideration proffered for his shares—short of a suit for equitable relief.

Consider the implications of this in the following case. A private corporation is taken public with about 30% of its stock sold to

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appraisal rights for holders of marketable shares, see EISENBERG, *supra* note 116, at 79-84, and Note, *A Reconsideration of the Stock Market Exception to the Dissenting Shareholder's Right of Appraisal*, 74 MICH. L. REV. 1023, 1036-60 (1976).

775. That provision read as follows:

> This [right of dissent] section shall not . . . apply to the holders of shares of any class or series if the shares of such class or series were registered on a national securities exchange on the [record date for the shareholders' meeting] at which a plan of merger ... is to be acted upon unless the articles of incorporation of the corporation shall otherwise provide.

MODEL BUS. CORP. ACT ANN. § 80 (1971).

776. The reasons for this deletion, as stated in Alfred F. Conard, *Amendments of Model Business Corporation Act Affecting Dissenters' Rights (Sections 73, 74, 80, and 81)*, 33 BUS. LAW. 2587 (1978), were in part as follows:

> The former exception for shares listed on stock exchanges has been eliminated in the light of facts which have become more visible since the stock market exception was added to the Model Act in 1969. The 1970s have demonstrated again the possibility of a demoralized market in which fair prices are not available, and in which many companies publicly offer to buy their own shares because the market grossly undervalues them. Under these circumstances, access to market value is not a reasonable alternative for a dissenting shareholder. Moreover, a shareholder may be disqualified by state or federal securities laws from using the market because his shares are "restricted," because he is an "insider" who has acquired shares within six months, or because he possesses "inside information." Even if the dissenter is free to use the market, he may find it impractical to do so because his holdings are large and the market is thin. In any event, the market cannot reflect the value of the shares "excluding any appreciation or depreciation in anticipation" of the corporate change which gives rise to the dissenters' rights.

Id. at 2595-96.

777. *See supra* note 757 and text accompanying notes 761-62. Appraisal rights are denied also if the shareholder's stock is converted into marketable securities. *See* N.J. STAT. ANN. § 14A:11-1(1)(a)(i)(B) (West Supp. 1997) (quoted *supra* in note 757 (first paragraph)); *see also* John R. MacKay II, *The 1974 Corporation Law Amendments*, 97 N.J. L.J. 337, 347 (1974) ("In sum, if a shareholder's shares are publicly traded or if he is to receive, in exchange for his shares, shares which are publicly traded, or cash, or both, he will not be entitled to dissent from a transaction.").

outsiders at $5 per share; and later, when the market price of the stock drops, its two controlling shareholders (owning about 70% of its stock) arrange a cash-out merger. They organize a new shell corporation, receive all of its stock in exchange for their 70% of the stock of the operating company, and then arrange a merger of the operating company into the shell corporation with the public shareholders to receive $2 per share in cash. With the two individuals dominating both boards, there is no arm's length bargaining; with their control of 70% of the operating company's stock, the outcome of the shareholder vote is a foregone conclusion; and with the merger consideration consisting of cash, the minority shareholders are frozen out of the on-going enterprise. These facts cry out for a statutory right of appraisal, but under the New Jersey statute (as amended in 1974) there is none.[778]

c. Exclusivity of Appraisal[779]

(1) Statutory Provisions

The Delaware appraisal statute[780] continues (as in the past) to be silent on the question whether appraisal is the dissenting shareholder's exclusive remedy.

Prior to 1969, the New Jersey corporation statute also was silent on the question. However, that state's 1968 Business Corporation Act[781] makes the right of appraisal exclusive except when the "corporate action will be or is ultra vires, unlawful or fraudulent as to such dissenting shareholder."[782]

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778. The facts are essentially those in *Berkowitz v. Power/Mate Corp.*, 342 A.2d 566 (N.J. Super. Ct. Ch. Div. 1975). The court granted a preliminary injunction against consummation of the merger, noting in the course of its opinion that "[w]here, as here, the stockholders of the corporation which is a party to the merger are to be paid in cash, the stockholder does not have the right to dissent to the terms of the merger." *Id.* at 571.

779. The matter of appraisal exclusivity is discussed in the following: Vorenberg, *supra* note 4; Coleman, *supra* note 687, at 790-98; Steven D. Gardner, Note, *A Step Forward: Exclusivity of the Statutory Appraisal Remedy for Minority Shareholders Dissenting from Going-Private Merger Transactions*, 53 OHIO ST. L.J. 239 (1992); and Julie Gwyn Hudson, Comment, *The Exclusivity of the Appraisal Remedy Under the New North Carolina Business Corporation Act: Deciding the Standard of Review for Cash-Out Mergers*, 69 N.C. L. REV. 501 (1991). For a California case in which the court split four to three on the question of appraisal exclusivity, see *Steinberg v. Amplica, Inc.*, 729 P.2d 683 (Cal. 1987) (en banc).

780. *See* DEL. CODE ANN. tit. 8, § 262 (1991 & Supp. 1996).

781. Act of Nov. 21, 1968, ch. 350, 1968 N.J. Laws 1011 (effective Jan. 1, 1969); *see supra* note 250 (second paragraph).

782. The New Jersey statute, as enacted in 1968 and now in effect, provides as follows:

North Carolina's 1955 Business Corporation Act[783] made the right of appraisal non-exclusive.[784] However, when that Act was rewritten in 1989,[785] appraisal was made exclusive "unless the action is unlawful or fraudulent with respect to the shareholder or the corporation."[786]

> The enforcement by a dissenting shareholder of his right to receive payment for his shares shall exclude the enforcement by such dissenting shareholder of any other right to which he might otherwise be entitled by virtue of share ownership, . . . except that this subsection shall not exclude the right of such dissenting shareholder to bring or maintain an appropriate action to obtain relief on the ground that such corporate action will be or is ultra vires, unlawful or fraudulent as to such dissenting shareholder.

N.J. STAT. ANN. § 14A:11-5(2) (West 1969).

The Commissioners' Comment—1968 states:

> As under existing law, the remedy of dissent and appraisal is not exclusive. See Colgate v. United States Leather Co.; Riker & Son Co. v. United Drug Co. In subsection 14A:11-5(2), the Commission followed closely the language of section 623(k) of the New York Act, limiting the alternate available actions to those where the corporate action is "ultra vires, unlawful or fraudulent." Compare Windhurst v. Central Leather Co. Attention is invited to the last sentence of the first paragraph of section 74 of the Model Act, which apparently makes the right of appraisal exclusive. Of course, the non-dissenting shareholder continues to have the right to resort to courts without regard to the provisions of this Chapter. See Imperial Trust Co. v. Magazine Repeating Razor Co.

Id. § 14A:11-5 commentary at 102-03 (citations omitted).

783. Act of May 26, 1955, ch. 1371, 1955 N.C. Sess. Laws 1432 (effective July 1, 1957); *see supra* note 252 (second paragraph).

784. That statute contained the following provision:

> In addition to any other right he may have in law or equity, a shareholder giving such notice [of dissent] shall be entitled, if and when the amendment, dissolution, merger, consolidation or sale of assets for shares is effected, to be paid by the corporation the fair value of his shares, as of the day prior to the date on which the vote was taken, subject only to the surrender by him of the certificate representing his shares.

Former N.C. GEN. STAT. § 55-113(b) (1982); *see* Austell v. Smith, 634 F. Supp. 326, 329 (W.D.N.C. 1986).

785. *See* Act of June 8, 1989, ch. 265, 1989 N.C. Sess. Laws 566 (effective July 1, 1990); *supra* note 252 (third paragraph).

786. The North Carolina statute now provides as follows:

> A shareholder entitled to dissent and obtain payment for his shares under this Article may not challenge the corporate action creating his entitlement, including without limitation a merger solely or partly in exchange for cash or other property, unless the action is unlawful or fraudulent with respect to the shareholder or the corporation.

N.C. GEN. STAT. § 55-13-02(b) (Supp. 1996).

This provision is based on section 13.02(b) of the Model Business Corporation Act, *see* MODEL BUS. CORP. ACT ANN. § 13.02(b) (1996), except that the Model Act does not contain the portion set off by commas in the North Carolina statute. The matter of appraisal exclusivity had first been addressed in the Model Act in the late 1970s. *See* Conard, *supra* note 776, at 2590-91, 2596; Report, *Changes in the Model Business*

(2) Cases and Commentary

It makes a significant difference whether appraisal is the dissenting shareholder's exclusive remedy. It bears directly on the question whether the dissenter can move to enjoin consummation of the questioned transaction or (if it has been consummated) move for rescission or rescissory damages. If the right of appraisal were held to be a dissenter's exclusive remedy, the result would be to give a controlling shareholder license to cash out a minority interest at any time chosen by such shareholder.[787]

While there are some states in which the appraisal remedy is truly exclusive,[788] most states have a different rule. In the latter states, the rule is generally to the effect that appraisal is exclusive only in the absence of fraud or illegality.[789] Two questions arise

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Corporation Act Affecting Dissenters' Rights, 32 BUS. LAW. 1855, 1859-61, 1863 (1977).

787. *Blumenthal v. Roosevelt Hotel, Inc.*, 115 N.Y.S.2d 52 (Sup. Ct. 1952), involved a proposed sale of assets by the corporation operating the Roosevelt Hotel in New York City to a wholly owned subsidiary of its dominant shareholder, Hilton Hotels Corporation. *See id.* at 53. Alleging (among other things) that the purpose of the proposed transaction was to freeze out the minority shareholders, plaintiffs sought to enjoin its consummation. *See id.* Holding that the right of appraisal constituted an adequate and exclusive remedy, the court denied plaintiffs' motion for a temporary injunction and granted defendant's motion to dismiss the complaint. *See id.* at 55, 58.

The following passages from Manning, *supra* note 115, are pertinent:

> [T]he major effect of these appraisal statutes has been quite different from the function generally attributed to them. Almost certainly the statutes have made their major contribution not in shielding the minority, but in giving greater mobility of action to the majority—that is, to corporate managements speaking in the name of the majority. When a dissenting shareholder seeks to enjoin a transaction, the courts turn him away if he has the appraisal remedy available to him.
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> ....
>
> The early supporters of the appraisal remedy may not have foreseen that its availability would help to free corporate managements (the "majority") from some of the risk of injunction.

Id. at 227, 229.

788. Connecticut is such a state. *See* Yanow v. Teal Indus., Inc., 422 A.2d 311, 320-21 (Conn. 1979), *followed in* Brandt v. Travelers Corp., 665 A.2d 616, 618-19 (Conn. Super. Ct. 1995).

789. *See* Kademian v. Ladish Co., 792 F.2d 614, 628-30 (7th Cir. 1986); Yeager v. Paul Semonin Co., 691 S.W.2d 227, 228 (Ky. Ct. App. 1985); Willcox v. Stern, 219 N.E.2d 401, 405 (N.Y. 1966) ("[I]t has been a judicial principle that equity *will* act—despite the existence of an appraisal remedy—where there is fraud or illegality ...."); Adams v. United States Distrib. Corp., 34 S.E.2d 244, 250 (Va. 1945) ("Suffice it to say, that the weight of authority is to the effect that unless the corporate merger be tainted with fraud or illegality ... the dissenting stockholder must pursue the remedy prescribed by the appraisal statute.").

In *Twenty Seven Trust v. Realty Growth Investors*, 533 F. Supp. 1028 (D. Md. 1982), the court said:

under such a rule. The first is whether a breach of fiduciary duty amounts to illegality so that appraisal is not exclusive. The second is whether, notwithstanding illegality based on breach of fiduciary duty, appraisal will be held to be exclusive when a minority shareholder complains of nothing more than inadequacy of the proffered merger consideration.

(a) Delaware Case Law on Question

The interplay of concepts of fiduciary duty, entire fairness, business purpose, and exclusivity of appraisal, in the Delaware cash-out merger cases decided between 1959 and 1983, has been covered above.[790] Those decisions culminated in *Weinberger v. UOP, Inc.*[791] in which, on the subject of exclusivity of the appraisal remedy, the court said the following:

> In considering the nature of the remedy available under our law to minority shareholders in a cash-out merger, we believe that it is, and hereafter should be, an appraisal under [the Delaware appraisal statute] as hereinafter construed.[792]

The court stated further:

> [Except with respect to certain pending matters] the provisions of [the Delaware appraisal statute], as herein construed, . . . shall govern the financial remedy available to minority shareholders in a cash-out merger.[793]

However, the court also stated:

> While a plaintiff's monetary remedy ordinarily should be confined to the more liberalized appraisal proceeding herein established, we do not intend any limitation on the historic powers of the Chancellor to grant such other relief as the facts of a particular case may dictate. The appraisal remedy we approve may not be adequate in certain cases,

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> The prevailing view among state courts in states having similar appraisal statutes, in the absence of statutory language making such appraisal the dissenting shareholders' exclusive remedy, is that the statutory appraisal proceeding is not the dissenters' exclusive remedy in cases of fraud, illegal purpose or other wrongful conduct by the majority or controlling shareholder. In other words, upon proof of such wrongful conduct, a court of equity will provide appropriate relief apart from that set out in the appraisal statute.

Id. at 1036 (footnote omitted).

790. *See supra* text accompanying notes 618-38.

791. 457 A.2d 701 (Del. 1983).

792. *Id.* at 703.

793. *Id.* at 715.

> particularly where fraud, misrepresentation, self-dealing, deliberate waste of corporate assets, or gross and palpable overreaching are involved.[794]

The following observations can be made on the basis of the words employed in these passages. First, when the court refers to "financial" and "monetary" remedy, it seems to be saying that appraisal should be the exclusive remedy in any case in which a minority shareholder seeks nothing more than a larger amount of consideration than that proffered in the merger. Second, the court makes it clear that relief other than appraisal may be in order in cases involving "fraud, misrepresentation, self-dealing, deliberate waste of corporate assets, or gross and palpable overreaching." Moreover, because most cash-out mergers entail "self-dealing,"[795] the court's inclusion of that term seems to mean that a minority shareholder can properly seek equitable relief with respect to such a merger in all cases except when the controlling shareholder has eschewed self-dealing either (i) by having the terms of the merger negotiated by outside directors of the controlled corporation, as suggested in a footnote to the *Weinberger* opinion,[796] or (ii) by conditioning consummation of the merger on the favorable vote of a majority of the minority, as was done (though unsuccessfully) in *Weinberger*.

There is support in other jurisdictions for the proposition that appraisal is the exclusive remedy when a dissenter's only quarrel is with the amount of the payment tendered in a cash-out merger.[797]

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794. *Id.* at 714.

795. *See supra* text accompanying notes 615-16.

796. *See Weinberger*, 457 A.2d at 709 n.7.

797. In *Walter J. Schloss Associates v. Arkwin Industries, Inc.*, 460 N.E.2d 1090 (N.Y. 1984), while the New York appraisal statute embodied the often-stated proposition that appraisal is the exclusive remedy except when the dissenter seeks by appropriate action to obtain relief on the ground that the transaction is unlawful or fraudulent as to him, and even though the complainant alleged fraud and breach of fiduciary duty on the part of the majority shareholder in engineering a cash-out merger, appraisal was held to be the exclusive remedy because the complainant sought only monetary relief as distinguished from equitable relief. *See id.* at 1091 (adopting the reasoning of the dissent to the lower court's opinion, *Walter J. Schloss Associates v. Arkwin Industries, Inc.*, 455 N.Y.S.2d 844, 847-52 (App. Div. 1982) (Mangano, J., dissenting), *rev'd*, 460 N.E.2d 1090 (N.Y. 1984)). In *Walter J. Schloss Associates v. Chesapeake & Ohio Railway*, 536 A.2d 147 (Md. Ct. Spec. App. 1988), with the appraisal statute silent on the matter of exclusivity, the court was of the view that "the availability of the statutory appraisal procedure is not exclusive, at least to the point of foreclosing injunctive relief, in freeze-out situations." *Id.* at 154. But, because plaintiffs in this case sought essentially monetary relief, the court concluded that "the statutory appraisal right is a wholly adequate remedy." *Id.* at 158. In *Stepak v. Schey*, 553 N.E.2d 1072 (Ohio 1990), the court, while recognizing that the appraisal remedy did not preclude an action for breach of fiduciary duty in connection with a cash-out merger, held that "remedy beyond the statutory [appraisal] procedure is not available

However, subsequent decisions in Delaware make it clear that unfair dealing involving a breach of fiduciary duty in a cash-out merger may justify relief other than appraisal.[798]

(b) Statutory Treatment of Question in New Jersey and North Carolina

As noted above, the New Jersey statute (since January 1, 1969) makes appraisal the exclusive remedy except when the "corporate action will be or is ultra vires, unlawful or fraudulent as to such dissenting shareholder," and the North Carolina statute (since July 1, 1990) makes appraisal exclusive "unless the action is unlawful or fraudulent with respect to the shareholder or the corporation."[799] The principal question that arises under these statutes relates to the meaning that should be given to the word "unlawful" in this context.[800] Some will say that it means nothing more than failure to comply with the statute (e.g., that director action was taken without a proper quorum or that a shareholders' meeting was held without

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where the shareholder's objection is essentially a complaint regarding the price which he received for his shares." *Id.* at 1075. In *IRA ex rel. Oppenheimer v. Brenner Cos.*, 107 N.C. App. 16, 419 S.E.2d 354 (1992), a cash-out merger case decided under North Carolina's former appraisal statute which was expressly non-exclusive, the court sustained a summary judgment in favor of defendant directors and majority shareholders on the ground that, while plaintiffs' complaint asked for compensatory and punitive damages on the theory of unfairness of the merger, breach of fiduciary duty, and actual or constructive fraud, they failed to present facts to support any of their theories for recovery other than that of a challenge to the stock value which "would be more appropriately resolved in a statutory appraisal proceeding." *Id.* at 25, 419 S.E.2d at 360.

798. *See* Cede & Co. v. Technicolor, Inc., 542 A.2d 1182, 1187-89 (Del. 1988) (upholding the right of a minority shareholder, who had dissented from a cash-out merger and commenced an appraisal proceeding, to assert and pursue a later-discovered claim of fraud in the merger through an action for rescissory damages against the participants for breach of fiduciary duty to the shareholder); Rabkin v. Philip A. Hunt Chem. Corp., 498 A.2d 1099, 1100, 1104-05 (Del. 1985) (holding that availability of the appraisal remedy did not preclude a suit challenging a cash-out merger on the basis of unfair dealing in the form of a breach of fiduciary duty); Sealy Mattress Co. v. Sealy, Inc., 532 A.2d 1324, 1342 (Del. Ch. 1987) (granting a temporary injunction to preclude consummation by a controlling shareholder of a cash-out merger when "misrepresentation, self-dealing, and gross and palpable overreaching [were] alleged and preliminarily established"); *accord* Mullen v. Academy Life Ins. Co., 705 F.2d 971, 974 (8th Cir. 1983) (holding, in a diversity action involving a short-form cash-out merger under a New Jersey statute authorizing mergers of insurance companies and providing that "the dissenting shareholder shall cease to have any rights of a shareholder, except the right to be paid the fair value of his shares," that the availability of an appraisal remedy did not preclude a suit challenging the merger on the ground of breach of fiduciary duty by the parent corporation).

799. *See supra* note 782 (first paragraph) and accompanying text, and note 786 (first paragraph) and accompanying text.

800. *See* Hudson, *supra* note 779, at 502.

proper notice). Others will contend that unlawful action includes also action taken in breach of a fiduciary duty.

It is a matter of considerable importance that the latter position be the one adopted, and it appears that the courts have already taken this view of the matter. In *Alpert v. 28 Williams Street Corp.*,[801] involving a cash-out merger, the court said: "When a breach of fiduciary duty occurs, that action will be considered unlawful and the aggrieved shareholder may be entitled to equitable relief . . . ."[802] Similarly, in *Coggins v. New England Patriots Football Club, Inc.*,[803] also involving a cash-out merger, the court said: "Judicial inquiry into a freeze-out merger in technical compliance with the statute may be appropriate, and the dissenting stockholders are not limited to the statutory remedy of judicial appraisal where violations of fiduciary duties are found."[804] Moreover, the Official Comment on section

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801. 473 N.E.2d 19 (N.Y. 1984).

802. *Id.* at 26. The court also said the following:

> The pursuit of an appraisal proceeding generally constitutes the dissenting stockholder's exclusive remedy. An exception exists, however, when the merger is unlawful or fraudulent as to that shareholder, in which event an action for equitable relief is authorized. Thus, technical compliance with the Business Corporation Law's requirements alone will not necessarily exempt a merger from further judicial review.

Id. at 25 (citations omitted).

Perl v. IU International Corp., 607 P.2d 1036 (Haw. 1980), involved a reverse triangular merger in which the minority interest in a subsidiary was to be eliminated in exchange for shares of redeemable convertible preferred stock of the controlling corporation. *See id.* at 1043-44. The applicable statute made appraisal exclusive except for " 'suits or actions to test the sufficiency or regularity of the votes of the stockholders authorizing or approving the proposed action.' " *Id.* at 1045 (quoting section 417-29 of the Hawaii Revised Statutes, as then in effect). Nonetheless, the court held that the merger could be attacked on the ground of an alleged breach of fiduciary duty, saying:

> We agree that a merger effected for the sole purpose of freezing out the minority interest is a violation of fiduciary principles governing the relationship between controlling and minority shareholders. We conclude that appraisal is not the exclusive remedy available to [the complaining shareholder] if the above violation is established.

Id. at 1046.

803. 492 N.E.2d 1112 (Mass. 1986).

804. *Id.* at 1118. The court also stated that "[t]he defendants argue that judicial review of a merger cannot be invoked by disgruntled stockholders, absent illegal or fraudulent conduct," *id.* at 1117, and noted that the defendants relied on a statute making appraisal the exclusive remedy except when " 'corporate action will be or is illegal or fraudulent as to [a shareholder],' " *id.* at 1117 n.12 (quoting MASS. GEN. LAWS ch. 156B, § 98 (1984)). The court concluded, nonetheless, that it was "justified in exercising its equitable power when a violation of fiduciary duty is claimed." *Id.* at 1117. For a somewhat similar holding in Massachusetts, see *Pupecki v. James Madison Corp.*, 382 N.E.2d 1030, 1033 (Mass. 1978).

A different result was reached in *Sifferle v. Micom Corp.*, 384 N.W.2d 503 (Minn. Ct.

13.02(b) of the 1984 Model Business Corporation Act, which makes appraisal the shareholder's exclusive remedy "unless the action is unlawful or fraudulent with respect to the shareholder or the corporation," includes the following:

> If the corporation attempts an action in violation of the corporation law on voting, in violation of clauses in articles of incorporation prohibiting it, by deception of shareholders, or in violation of a fiduciary duty—to take some examples—the court's freedom to intervene should be unaffected by the presence or absence of dissenters' rights under this chapter.[805]

Nevertheless, in a case challenging a cash-out merger on the ground of breach of fiduciary duty, a court—notwithstanding the "unlawful or fraudulent" exception to the exclusivity of appraisal—can fall into the trap of limiting complaining shareholders to the appraisal remedy if the court concludes that the disagreement is solely one as to the value of the shares. Notwithstanding a vigorous dissent, this was the result reached in *Stringer v. Car Data Systems, Inc.*[806] One premise for this result was the observation that "this

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App. 1986), which involved a short-form cash-out merger engineered by the controlling shareholder following a tender offer that left the controlling shareholder with more than 90% of the outstanding stock. *See id.* at 505. However, that result was based on language of the appraisal statute that provided for an exception to appraisal exclusivity only when the corporate action was "fraudulent" and thus made no exception for "unlawful" action. *See id.* at 507-09.

In *Fleming v. International Pizza Supply Corp.*, 640 N.E.2d 1077 (Ind. Ct. App. 1994), when a 75% shareholder sought to oust a 25% shareholder by engineering a sale of corporate assets to a new corporation owned by the 75% holder and a third party and by attempting to relegate the 25% holder to appraisal at the munificent amount of $10 (for stock that had been valued at $300,000 in a buy-sell agreement less than two years earlier), it was held that availability of the appraisal remedy did not preclude a recovery of compensatory damage for a breach of fiduciary duty or fraud. *See id.* at 1078-79, 1080-81. This decision is noteworthy because, two years before the original corporation had been organized (in 1988), Indiana had adopted a new business corporation law based on the 1984 Model Business Corporation Act but had consciously omitted from its provision concerning the exclusivity of appraisal rights the Model Act's language, *see* MODEL BUS. CORP. ACT ANN. § 13.02(b) (1996); *supra* note 786, to the effect that such rights are exclusive unless the action is unlawful or fraudulent with respect to the shareholder or the corporation. *See Fleming*, 640 N.E.2d at 1079.

805. MODEL BUS. CORP. ACT ANN. § 13.02 commentary at 13-16 to -17 (1996).

806. 841 P.2d 1183 (Or. 1992) (en banc). This case was decided under the Oregon Business Corporation Act of 1987, which drew upon the Model Business Corporation Act and contained the Model Act's provision that a shareholder entitled to appraisal " 'may not challenge the corporate action creating the shareholder's entitlement unless the action is unlawful or fraudulent with respect to the shareholder or the corporation.' " *Id.* at 1186 (quoting OR. REV. STAT. § 60.554(2) (1991)). Plaintiffs were minority shareholders of CDS who had been cashed out by way of a merger of CDS with a newly

court may not question the wisdom of the Legislative Assembly in enacting the Oregon Business Corporation Act [which] drew upon the Model Business Corporation Act and contains procedures for majority shareholders to 'squeeze out' minority shareholders."[807] This pronouncement may be thought to reflect sound policy in the form of corporate flexibility, but it hardly encourages investors to take minority positions in Oregon corporations.[808]

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created shell corporation formed by the directors and majority shareholders, and plaintiffs sought compensatory damages (actually, rescissory damages based on the stock value at the time of trial) and punitive damages on the ground that defendants had breached their fiduciary duty and acted unlawfully. *See id.* at 1184, 1186-87. Because the complaint had been dismissed by the trial court and that dismissal had been confirmed below, the question on appeal was whether the complaint stated a cause of action. *See id.* at 1187. The gravamen of the complaint was that CDS's profitability was increasing, that defendants decided to cash out the minority shareholders (owning 43% of the stock) at a price below the fair market value of the stock so that defendants alone could benefit from the anticipated increase in the value of CDS stock, and that defendants had even voted to reject a third party's offer to purchase substantially all of CDS's assets at a price that would have yielded substantially more per share than the price per share paid to the minority in the cash-out merger. *See id.* at 1186-88. The court recognized that the dispositive question was whether plaintiffs had alleged facts that would establish that defendants' conduct was unlawful or fraudulent. *See id.* at 1188. Notwithstanding plaintiffs' allegation that defendants had engineered a merger with a shell corporation to reap for themselves (to the exclusion of the minority) the fruits of the corporation's increasing profitability, the court said:

> Plaintiff's complaint clearly alleges a disagreement as to valuation, and we also can infer payment by Car Data of an unreasonably low price. Where the allegations show only a disagreement as to price, however, with no allegations that permit any inference of self-dealing, fraud, deliberate waste of corporate assets, misrepresentation, or other unlawful conduct, the remedy afforded by [the appraisal statute] is exclusive.

Id. at 1190. The dissenting opinion, after noting the statute's "unlawful or fraudulent" exception to appraisal exclusivity, *see id.* at 1192 (Unis, J., concurring in part and dissenting in part), said (among other things) the following:

> With respect to the minority shareholders of CDS ..., the allegations of the complaint are, in my view, sufficient to permit an inference of self-dealing and gross, palpable, overreaching conduct—a violation of the fiduciary duty owed to plaintiffs by CDS directors and majority shareholders. As such, the case should not have been dismissed at the pleading stage for failure to state a claim.
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> ....
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> ... Surely the majority does not mean to hold that it is lawful for the directors of a corporation to plot unlawfully against some of the corporation's shareholders as long as those shareholders can subsequently defeat the unlawful plot through judicial action to determine the fair value of the company's stock. Yet that is the effect of the majority's holding.

Id. at 1194 (Unis, J., concurring in part and dissenting in part) (footnote omitted).

807. *Id.* at 1188.

808. In *Amanda Acquisition Corp. v. Universal Foods Corp.*, 877 F.2d 496 (7th Cir. 1989), the court said:

> States compete to offer corporate codes attractive to firms. Managers who want to raise money incorporate their firms in the states that offer the combination of

II. PURCHASE/SALE OF ASSETS[809]

The Delaware, North Carolina, and New Jersey sale-of-assets statutes are of relatively recent vintage. They were not enacted until the twentieth century.

A. *Statutory Provisions*

1. Delaware

It was not until 1917 that Delaware first enacted a statute[810] authorizing a corporation to effect a sale-of-assets transaction.[811] That statute, as subsequently amended,[812] now appears as section 271

> rules investors prefer. Laws that in the short run injure investors and protect managers will in the longer run make the state less attractive to firms that need to raise new capital.

Id. at 507 (citations omitted).

809. For articles contrasting mergers and sale-of-assets transactions, see the following: SECURITIES AND EXCHANGE COMMISSION, *supra* note 253, app. B, pts. II-III, at 526-89; and George S. Hills, *Consolidation of Corporations by Sale of Assets and Distribution of Shares*, 19 CAL. L. REV. 349 (1931).

810. *See* Act of Mar. 20, 1917, ch. 113, § 17, 29 Del. Laws 320, 332-33. It has been said that enactment of this statute was prompted by the dictum in *Butler v. New Keystone Copper Co.*, 93 A. 380, 383 (Del. Ch. 1915) (quoted *supra* in note 11 (first paragraph)). *See* FOLK, *supra* note 459, at 399 n.1.

811. The 1917 statute provided as follows:

> Every corporation organized under the provisions of this Chapter, may at any meeting of its Board of Directors, sell, lease or exchange all of its property and assets, including its good will and its corporate franchises, upon such terms and conditions as its Board of Directors deem expedient and for the best interests of the corporation, when and as authorized by the affirmative vote of the holders of a majority of the stock issued and outstanding having voting power given at a stockholders' meeting duly called for that purpose, or when authorized by the written consent of a majority of the holders of the voting stock issued and outstanding, provided, however, that the certificate of incorporation may require the vote or written consent of a larger proportion of the stockholders.

Act of Mar. 20, 1917, ch. 113, § 17, 29 Del. Laws 320, 332-33. By Act of Apr. 2, 1925, ch. 112, § 13, 34 Del. Laws 272, 286-87, the mistaken reference to "the written consent of a majority of the holders" was changed to read "the written consent of the holders of a majority."

812. Two of those amendments addressed the matter of the kind of consideration that could be received in a sale-of-assets transaction. A 1929 amendment, *see* Act of Mar. 22, 1929, ch. 135, § 19, 36 Del. Laws 366, 397, provided that such consideration could be "in whole or in part shares of stock in, and/or other securities of, any other corporation or corporations." The 1967 rewrite of the General Corporation Law, *see* Act of July 3, 1967, ch. 50, sec. 1, § 271(a), 56 Del. Laws 151, 222, inserted the words "money or other property."

The words "or substantially all" first appeared in the sale-of-assets statute in the 1967 rewrite of the General Corporation Law. *See id.*

of the Delaware corporation statute.[813]

Under this statute, the terms and conditions of the sale, including the form of consideration, must be determined by the board of directors.[814] In making this determination, the directors must consider "the best interests of the corporation."[815]

The shareholder vote required to authorize a sale of assets was stated, in the 1917 statute, to be that of "the holders of a majority of the stock issued and outstanding having voting power."[816] This was the requirement notwithstanding the fact that, at that time and until 1969, a merger required a two-thirds shareholder approval.[817] Under the current sale-of-assets statute, the required approval is that of "the holders of a majority of the outstanding stock of the corporation entitled to vote thereon"[818]—the same as that now required for approval of a merger.[819]

As originally enacted in 1917, the statute was silent concerning permissible consideration for a sale of assets.[820] A 1929 amendment authorized the sale of assets to be for stock or securities of "any other corporation";[821] and, in 1967, "money or other property" was added

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Post-1967 amendments of Delaware's sale-of-assets statute were made by the following: Act of June 23, 1969, ch. 148, § 30, 57 Del. Laws 433, 450; Act of July 8, 1983, ch. 112, § 55, 64 Del. Laws 285, 292-93 (effective July 1, 1983); and Act of July 4, 1985, ch. 127, § 9, 65 Del. Laws 224, 225 (effective July 1, 1985).

813. Section 271 provides, in subsection (a), as follows:

> Every corporation may at any meeting of its board of directors ... sell, lease or exchange all or substantially all of its property and assets, including its goodwill and its corporate franchises, upon such terms and conditions and for such consideration, which may consist in whole or in part of money or other property, including shares of stock in, and/or other securities of, any other corporation or corporations, as its board of directors ... deems expedient and for the best interests of the corporation, when and as authorized by a resolution adopted by the holders of a majority of the outstanding stock of the corporation entitled to vote thereon....

DEL. CODE ANN. tit. 8, § 271(a) (1991).

814. *See id.*

815. *Id.*

816. Act of Mar. 20, 1917, ch. 113, § 17, 29 Del. Laws 320, 332-33 (quoted *supra* in note 811).

817. *See supra* text accompanying notes 242 and 553-56.

818. DEL. CODE ANN. tit. 8, § 271(a) (1991) (quoted *supra* in note 813).

819. *See supra* text accompanying note 556.

820. *See supra* note 811.

821. *See supra* note 812 (first paragraph). This meant that a purchasing corporation could operate the business of the selling corporation as a separate subsidiary by having a wholly owned subsidiary of the purchasing corporation act as the nominal purchaser using stock of its parent as the consideration.

as permissible consideration.[822]

The Delaware corporation statute has never given a right of appraisal to shareholders dissenting from a sale of all or substantially all of their corporation's assets. However, the Delaware statute contains a provision whereby a corporation can provide in its charter for appraisal rights in connection with such a transaction.[823]

2. North Carolina

North Carolina's first sale-of-assets statute was enacted in 1925.[824] In that state's 1955 Business Corporation Act, sale-of-assets

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822. *See supra* note 812 (first paragraph).

823. *See supra* note 766.

824. *See* Act of Mar. 10, 1925, ch. 235, § 1, 1925 N.C. Sess. Laws 482, 482. It took the form of an addition to the powers of corporations, providing as follows:

> 9. To sell any part of or all of its corporate property, whenever such sale shall be authorized by a two-thirds vote of the board of directors of such corporation and approved by the vote of the holders of two-thirds of the stock entitled to vote at any stockholders' meeting, notice of which contains notice of the proposed sale: *Provided*, that any corporation hereafter organized may insert a provision in its charter that the powers granted by this subsection nine may be exercised only when such sale shall be approved by the holders of such amount of the stock of the corporation (not less than two-thirds of such stock entitled to vote) or such amount of each class of stock as may be specified in said charter; and *provided further*, that any corporation heretofore organized may by vote of the holders of two-thirds of the stock entitled to vote amend its charter at any stockholders' meeting, notice of which contains notice of the proposed amendment[,] so as to provide the vote of stockholders (not less than two-thirds of the stock entitled to vote) required to enable the corporation to exercise the powers granted by this subsection nine.

Id.

By Act of Mar. 19, 1929, ch. 269, § 1, 1929 N.C. Sess. Laws 312, 312, a new proviso was added, reading as follows: "*Provided* this section shall not be construed to limit or abridge the right or power of any corporation from selling any of its assets in its regular course of business." *Id.*

By Act of Mar. 31, 1939, ch. 279, § 1, 1939 N.C. Sess. Laws 555, 555, subsection 9 was replaced by three subsections, reading as follows:

> 9. To sell, transfer and convey any part of its corporate property in the course of its regular business.
>
> 10. To sell, transfer and convey any part of its corporate real or personal property when authorized so to do by its board of directors.
>
> 11. To sell, transfer and convey all of its corporate property when authorized so to do by its board of directors and approved by a two-thirds vote of the stock entitled to vote at any stockholders meeting, notice of which contains notice of the proposed sale: *Provided*, this Act shall not be construed as authorizing any public utility corporation to sell or convey all of its property otherwise than under the terms prescribed in its charter . . . .

Id.

In 1943, these provisions were re-codified. *See* former N.C. GEN. STAT. § 55-26 (1943).

transactions were covered in section 55-112.[825] The 1989 rewrite of that Act covers such transactions in section 55-12-02.[826]

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825. That statute provided as follows:

> (c) Any other sale (whether for cash or for securities of the purchasing corporation or otherwise), or any other lease or exchange of all or substantially all the property of a corporation requires approval of the shareholders in the following manner:
>
> (1) The board of directors shall adopt a resolution recommending such sale, lease or exchange and directing the submission thereof to a vote at a meeting of shareholders, which may be either an annual or a special meeting.
>
> ....
>
> (3) At such meeting the shareholders may authorize such sale, lease or exchange and may fix, or may authorize the board of directors to fix, any or all of the terms and conditions thereof and the consideration to be received by the corporation therefor. Each outstanding share of the corporation shall be entitled to vote thereon, whether or not otherwise entitled to vote. Such authorization shall require the affirmative vote of at least two thirds of the outstanding shares of the corporation, unless any class of shares is entitled to vote as a class thereon, in which event such authorization shall require the affirmative vote of at least two thirds of the outstanding shares of each class of shares entitled to vote as a class thereon and two thirds of all other outstanding shares. Any class of shares shall be entitled to vote as a class if the sale, lease or exchange is for securities of another corporation, foreign or domestic, and such sale, lease or exchange is part of a plan of distribution of such securities that would effectuate such changes in that class of shares as would entitle those shares to vote as a class if the changes were contained in a proposed amendment to the charter.
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> ....

Former N.C. GEN. STAT. § 55-112(c) (1982).

826. The new Act provides as follows:

> (a) A corporation may sell, lease, exchange, or otherwise dispose of all, or substantially all, of its property, otherwise than in the usual and regular course of business, on the terms and conditions and for the consideration determined by the corporation's board of directors, if the board of directors proposes and its shareholders approve the proposed transaction.
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> (b) For a transaction to be authorized:
>
> (1) The board of directors must recommend the proposed transaction to the shareholders unless the board of directors determines that because of conflict of interest or other special circumstances it should make no recommendation, in which event the board of directors must communicate the basis for its lack of a recommendation to the shareholders with the submission of the proposed transaction; and
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> (2) The shareholders entitled to vote must approve the transaction.
>
> (c) The board of directors may condition its submission of the proposed transaction on any basis.
>
> (d) The corporation shall notify each shareholder, whether or not entitled to vote, of the proposed shareholders' meeting in accordance with G.S. 55-7-05. The notice must also state that the purpose, or one of the purposes, of the meeting is to consider the sale, lease, exchange, or other disposition of all, or substantially all, the property of the corporation and contain or be accompanied by a description of the transaction.

From its enactment in 1925[827] until its amendment in 1939,[828] North Carolina's sale-of-assets statute required such a transaction to be authorized by "a two-thirds vote of the board of directors." As in the case of that state's 1955 Business Corporation Act,[829] the requirement in the 1989 rewrite of that Act is that a sale-of-assets transaction be acted upon by the board of directors (under its established voting rules) before its submission to shareholders.[830]

As enacted in 1925 and amended in 1939,[831] the North Carolina statute required, for shareholder approval of a sale of assets, two-thirds of the stock entitled to vote. North Carolina's 1955 Business Corporation Act (effective July 1, 1957) continued the requirement of a two-thirds vote of shareholders to approve a sale of assets[832] (even though the same Act required only a majority vote to approve a merger[833]), and it also gave the right to vote on such a transaction to all shares whether or not otherwise entitled to vote.[834] Additionally, a class vote was accorded by that Act to any class of stock if the sale of assets was "for securities of another corporation" and was "part of a

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> (e) Unless the articles of incorporation, a bylaw adopted by the shareholders, Article 9 or the board of directors (acting pursuant to subsection (c)) require a greater vote or a vote by voting groups, the transaction to be authorized must be approved by a majority of all the votes entitled to be cast on the transaction.
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> ....

N.C. GEN. STAT. § 55-12-02 (1990).

This statute is based on section 12.02 of the 1984 Model Business Corporation Act, with minor differences: (i) the Model Act includes "(with or without the good will)" after the word "property" in subsection (a); (ii) the Model Act uses the words "and communicates the basis for its determination" in subsection (b)(1) rather than the words "in which event the board of directors must communicate the basis for its lack of a recommendation"; and (iii) the Model Act does not include the words "a bylaw adopted by the shareholders, Article 9" in subsection (e). *See id.*; MODEL BUS. CORP. ACT ANN. § 12.02 (1996).

North Carolina General Statutes section 55-12-02(b)(2) and 1984 Model Business Corporation Act section 12.02(b)(2) are deficient in not concluding with the words "as provided in subsection (e)." *See* N.C. GEN. STAT. § 55-12-02(b)(2) (1990); MODEL BUS. CORP. ACT ANN. § 12.02(b)(2) (1996). The point here is the same as that explained *supra* in note 588.

827. *See supra* note 824 (first paragraph).

828. *See supra* note 824 (third paragraph).

829. Former N.C. GEN. STAT. § 55-112(c)(1) (1982) (quoted *supra* in note 825).

830. *See* N.C. GEN. STAT. § 55-12-02(a) (1990) (quoted *supra* in note 826 (first paragraph)).

831. *See supra* note 824 (first and third paragraphs).

832. *See* former N.C. GEN. STAT. § 55-112(c)(3) (1982) (quoted *supra* in note 825).

833. *See* former N.C. GEN. STAT. § 55-108(b) (1982) (quoted *supra* in text accompanying notes 566-67).

834. *See* former N.C. GEN. STAT. § 55-112(c)(3) (1982) (quoted *supra* in note 825).

plan of distribution of such securities that would effectuate such changes in that class of shares as would entitle those shares to vote as a class if the changes were contained in a proposed amendment to the charter."[835] When that Act was rewritten in 1989 (effective July 1, 1990), the required vote was changed to "a majority of all the votes entitled to be cast on the transaction";[836] however, this is subject to a more demanding vote being required by the charter, a shareholder-adopted bylaw, or a board resolution.

The pre-1955 statutes of North Carolina contained no specification of the consideration that a corporation was permitted to receive upon a sale of all of its assets.[837] The 1955 statute, on the other hand, covered such a sale "whether for cash or for securities of the purchasing corporation or otherwise."[838] The 1989 statute refers simply to "the consideration determined by the [selling] corporation's board of directors."[839]

Until enactment of its 1955 Business Corporation Act, North Carolina gave no right of appraisal to shareholders dissenting from a sale of assets; and, under the 1955 Act, dissenters were accorded the appraisal right only if the sale was "made for, or substantially for, shares of another corporation."[840] Under the 1989 rewrite of that Act, the right of appraisal is given to shareholders dissenting from a sale of assets unless it is "a sale pursuant to court order or a sale pursuant to a plan by which all or substantially all of the net proceeds of the sale will be distributed in cash to the shareholders within one year after the date of sale."[841] However, under a 1997 amendment of

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835. *Id.*

836. N.C. GEN. STAT. § 55-12-02(e) (1990) (quoted *supra* in note 826 (first paragraph)).

837. *See supra* note 824 (first and third paragraphs).

838. Former N.C. GEN. STAT. § 55-112(c) (1982) (quoted *supra* in note 825).

839. N.C. GEN. STAT. § 55-12-02(a) (1990) (quoted *supra* in note 826 (first paragraph)).

840. Former N.C. GEN. STAT. § 55-113(a)(1), (b) (1982).

841. The North Carolina statute provides as follows:

> (a) In addition to any rights granted under Article 9 [the North Carolina Shareholder Protection Act], a shareholder is entitled to dissent from, and obtain payment of the fair value of his shares in the event of, any of the following corporate actions:
>
> ....
>
> (3) Consummation of a sale or exchange of all, or substantially all, of the property of the corporation other than as permitted by G.S. 55-12-01 [relating to sales of assets in the regular course of business and mortgage of assets], including a sale in dissolution, but not including a sale pursuant to court order or a sale pursuant to a plan by which all or substantially all of the net proceeds of the sale will be distributed in cash to the shareholders

the Act, the right of appraisal is denied (unless otherwise provided in the corporate charter) to shareholders whose shares are marketable.[842]

3. New Jersey

It was not until 1931 that New Jersey first enacted a statute authorizing the sale by a corporation of all or substantially all of its assets.[843] That statute, as subsequently amended,[844] now appears as

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> within one year after the date of sale;
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> ....

N.C. GEN. STAT. § 55-13-02(a) (Supp. 1996). The words "as permitted by G.S. 55-12-01" were substituted for the words "in the usual and regular course of business" by Act of July 12, 1991, ch. 645, § 12, 1991 N.C. Sess. Laws 1540, 1544 (effective Oct. 1, 1991).

This statute is based in part on the 1984 Model Business Corporation Act, which provides as follows:

> (a) A shareholder is entitled to dissent from, and obtain payment of the fair value of his shares in the event of, any of the following corporate actions:
>
> ....
>
> (3) consummation of a sale or exchange of all, or substantially all, of the property of the corporation other than in the usual and regular course of business, if the shareholder is entitled to vote on the sale or exchange, including a sale in dissolution, but not including a sale pursuant to court order or a sale for cash pursuant to a plan by which all or substantially all of the net proceeds of the sale will be distributed to the shareholders within one year after the date of sale;
>
> ....

MODEL BUS. CORP. ACT ANN. § 13.02(a) (1996).

A major difference between these two provisions is that the Model Act, unlike the North Carolina statute, accords the appraisal right only to shareholders who are entitled to vote on the sale-of-assets transaction.

842. *See* Act of June 9, 1997, ch. 202, § 1 (effective Oct. 1, 1997) (to be codified at N.C. GEN. STAT. § 55-13-02(c)) (quoted *supra* in note 759 (first paragraph)).

843. Act of Apr. 27, 1931, ch. 288, § 1, 1931 N.J. Laws 721, 721-22, provided as follows:

> Every corporation organized under this act [i.e., the act of 1896], including every corporation organized under "An act concerning corporations" (Revision), approved April seventh, one thousand eight hundred seventy-five, except railroad and canal corporations, may, by action taken at any meeting of its board of directors, sell or exchange all or substantially all of its property and assets, including its good will, upon such terms and conditions and for such considerations, which may be in whole or in part shares of stock in, and/or other securities of, any other corporation or corporations as its board of directors shall deem expedient and for the best interests of the corporation, when and as authorized by the affirmative vote of two-thirds in interest of the holders of each class of stock having voting powers on such proposal given at a stockholders' meeting duly called for that purpose, or when authorized by the written consent of two-thirds in interest of the holders of each class of stock having voting powers on such proposal. Notice of such meeting or of such consent shall be given to all stockholders of record of the corporation, whether or not they shall be entitled to vote on such proposal. If any stockholder shall at such meeting or within twenty days after such meeting or the receipt of notice of such consent,

section 14A:10-11 of the New Jersey statute.[845]

> object to such sale, and demand payment for his shares, such objecting stockholder or the corporation may... apply for an appraisal of such stock....

Id. In 1937, this statute (with minor changes) became section 14:3-5 of the New Jersey Revised Statutes. *See* former N.J. STAT. ANN. § 14:3-5 (West 1939).

Under an 1899 statute, any New Jersey corporation (other than a railroad or canal company) was authorized, with the assent of two-thirds in interest of its shareholders, to lease its property and franchises to another corporation, and every New Jersey corporation was authorized to take such lease or an assignment thereof. *See* Act of Mar. 24, 1899, ch. 150, § 1, 1899 N.J. Laws 334, 334 (quoted *supra* in note 182). In 1937, this statute (with minor changes) became section 14:3-6 of the New Jersey Revised Statutes. *See* former N.J. STAT. ANN. § 14:3-6 (West 1939).

844. The 1968 rewrite of New Jersey's corporation statute, *see* Act of Nov. 21, 1968, ch. 350, 1968 N.J. Laws 1011 (effective Jan. 1, 1969), made several changes. It combined in section 14A:10-11 the concept of sale or exchange of assets, *see supra* note 843 (first paragraph), and the concept of lease of assets, *see supra* note 843 (second paragraph); it included "money or property, real or personal" as permissible consideration for a sale of assets; and, in the words of the Commissioners' Comment—1968, it altered the shareholder voting requirement so as to permit "shareholder approval by a majority rather than a two-thirds vote, to (1) all corporations organized subsequent to the effective date of the Revision, and (2) pre-Revision corporations who adopt an amendment to their certificate of incorporation providing for a majority vote," N.J. STAT. ANN. § 14A:10-11 commentary at 82 (West 1969).

A subsequent amendment, in 1974, changed section 14A:10-11 by making minor revisions in subsection (1)(b) and by adding a new subsection (3). *See* Act of Jan. 7, 1974, ch. 366, § 58, 1973 N.J. Laws 964, 1027-29 (effective May 1, 1974). Another amendment, in 1995, added a new subsection (4). *See* Act of Dec. 15, 1995, ch. 279, § 16, 1995 N.J. Laws 1692, 1710-12.

845. The New Jersey statute now provides as follows:

> (1) A sale, lease, exchange, or other disposition of all, or substantially all, the assets of a corporation, if not in the usual and regular course of its business as conducted by such corporation, may be made upon such terms and conditions and for such consideration, which may consist in whole or in part of money or property, real or personal, including shares, bonds, or other securities of any other corporation, domestic or foreign, as may be authorized in the following manner:
>
> > (a) The board shall recommend such sale, lease, exchange, or other disposition and direct that it be submitted to a vote at a meeting of shareholders.
> >
> > (b) [Covers notice to shareholders]
> >
> > (c) At such meeting the shareholders may approve such sale, lease, exchange, or other disposition and may fix, or may authorize the board to fix, any or all of the terms and conditions thereof and the consideration to be received by the corporation therefor. Such sale, lease, exchange or other disposition shall be approved upon receiving the affirmative vote of a majority of the votes cast by the holders of shares entitled to vote thereon, and, in addition, if any class or series of shares is entitled to vote thereon as a class, the affirmative vote of a majority of the votes cast in each class vote; except that, in the case of a corporation organized prior to January 1, 1969, the sale, lease, exchange, or other disposition shall be approved upon receiving the affirmative vote of two-thirds of the votes so cast.
> >
> > (d) Subject to the provisions of section 14A:5-12, a corporation

The 1931 statute was similar to Delaware's 1917 statute with respect to director action.[846] However, the current New Jersey statute requires that the directors "recommend such sale" and direct its submission to a vote of shareholders.[847]

Under the 1931 statute, shareholder approval of a sale of assets required "the affirmative vote of two-thirds in interest of the holders of each class of stock having voting powers on such proposal."[848] As rewritten in 1968[849] and as now in effect,[850] the statute's shareholder voting requirement varies depending upon whether or not the corporation was organized prior to January 1, 1969. For corporations organized on or after that date, a sale of assets requires for its approval "the affirmative vote of a majority of the votes cast by the holders of shares entitled to vote thereon" and, "if any class or series of shares is entitled to vote thereon as a class, the affirmative vote of a majority of the votes cast in each class vote."[851] For corporations organized prior to January 1, 1969, shareholder approval requires "the affirmative vote of two-thirds of the votes so cast"; however, such a corporation (subject to any supermajority voting provision

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> organized prior to January 1, 1969, may adopt the majority voting requirements prescribed in paragraph 14A:10-11(1)(c) by an amendment of its certificate of incorporation adopted by the affirmative vote of two-thirds of the votes cast by the holders of shares entitled to vote thereon.
>
> ....
>
> (3) The sale, lease, exchange, or other disposition of all, or substantially all, the assets of one or more subsidiaries of a corporation, if not in the usual and regular course of business as conducted by such subsidiary or subsidiaries, shall be treated as a disposition within the meaning of subsection 14A:10-11(1) if the subsidiary or subsidiaries constitute all, or substantially all, the assets of the corporation.
>
> (4) Notwithstanding the provisions of subsection (1) of this section, a parent corporation may, upon such terms and conditions and for such consideration as may be determined by its board, transfer any or all of its assets to any corporation, all of the outstanding shares of which are owned, directly or indirectly, by the parent corporation, and, unless the certificate of incorporation of the parent corporation otherwise requires, no approval or authorization by the shareholders of the parent corporation shall be required.

N.J. STAT. ANN. § 14A:10-11 (West Supp. 1997).

846. *See supra* note 843 (first paragraph) and text accompanying notes 814-15.

847. *See* N.J. STAT. ANN. § 14A:10-11(1)(a) (West Supp. 1997) (quoted *supra* in note 845).

848. Act of Apr. 27, 1931, ch. 288, § 1, 1931 N.J. Laws 721, 722 (quoted *supra* in note 843 (first paragraph)). For the different vote required for shareholder approval of a long-form merger under New Jersey's pre-1969 statute, see *supra* text accompanying notes 557-58.

849. *See supra* note 844 (first paragraph).

850. *See supra* note 845.

851. N.J. STAT. ANN. § 14A:10-11(1)(c) (West Supp. 1997) (quoted *supra* in note 845).

contained in its charter[852]) may adopt the majority voting requirements (quoted in the preceding sentence) "by an amendment of its certificate of incorporation adopted by the affirmative vote of two-thirds of the votes cast by the holders of shares entitled to vote thereon."[853] These voting requirements for approval of a sale of assets are the same as those now required in New Jersey for approval of a long-form merger.[854]

As enacted in 1931, the statute provided that the consideration for a sale of assets "may be in whole or in part shares of stock in, and/or other securities of, any other corporation or corporations."[855] In 1968 (effective January 1, 1969), it was made explicit that permissible consideration for a sale of assets included "money or property, real or personal."[856]

From the enactment of its first sale-of-assets statute in 1931[857] until the present,[858] New Jersey has accorded a statutory right of

852. For the text of section 14A:5-12 of the New Jersey Statutes Annotated, referred to at the beginning of section 14A:10-11(1)(d) (quoted *supra* in note 845), see *supra* note 563.

853. N.J. STAT. ANN. § 14A:10-11(1)(c)-(d) (West Supp. 1997) (quoted *supra* in note 845).

854. *See supra* text accompanying notes 560-64.

855. Act of Apr. 27, 1931, ch. 288, § 1, 1931 N.J. Laws 721, 722 (quoted *supra* in note 843 (first paragraph)).

856. Act of Nov. 21, 1968, ch. 350, § 14A:10-11, 1968 N.J. Laws 1011, 1104 (effective Jan. 1, 1969); *see supra* note 844 (first paragraph).

857. *See supra* note 843 (first paragraph).

858. Following adoption of Act of Nov. 21, 1968, ch. 350, § 14A:11-1(1)(b), 1968 N.J. Laws 1011, 1106-07 (effective Jan. 1, 1969), an amendment by Act of Jan. 7, 1974, ch. 366, § 60, 1973 N.J. Laws 964, 1029-31 (effective May 1, 1974), and a further amendment by Act of Dec. 15, 1995, ch. 279, § 21, 1995 N.J. Laws 1692, 1715-16, New Jersey's appraisal statute provides as follows with respect to a sale-of-assets transaction:

> (1) Any shareholder of a domestic corporation shall have the right to dissent from any of the following corporate actions
>
> ....
>
> (b) Any sale, lease, exchange or other disposition of all or substantially all of the assets of a corporation not in the usual or regular course of business as conducted by such corporation, other than a transfer pursuant to subsection (4) of N.J.S. 14A:10-11, provided that, unless the certificate of incorporation otherwise provides, the shareholder shall not have the right to dissent
>
> (i) with respect to shares of a class or series which, at the record date . . . , is listed on a national securities exchange or is held of record by not less than 1,000 holders; or
>
> (ii) from a transaction pursuant to a plan of dissolution of the corporation which provides for distribution of substantially all of its net assets to shareholders in accordance with their respective interests within one year after the date of such transaction, where such transaction is wholly for

appraisal to shareholders dissenting from a sale-of-assets transaction. However, unless otherwise provided in the corporation's charter, the statute takes away that right with respect to marketable shares (as in the case of dissent from a merger[859]) and with respect to a transaction pursuant to a plan of dissolution providing for a distribution of net assets to shareholders within one year when the transaction is for cash or marketable securities.[860]

Unlike the statutes of Delaware and North Carolina, the New Jersey statute addresses sale-of-assets transactions, not only from the perspective of the selling corporation, but also from the perspective of the purchasing corporation when the purchase price is not payable in cash. As a consequence of a 1960 court decision,[861] the New Jersey legislature, in 1974,[862] enacted a statute[863] providing that, in the event

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> (A) cash; or
>
> (B) shares, obligations or other securities which, upon consummation of the plan of dissolution will either be listed on a national securities exchange or held of record by not less than 1,000 holders; or
>
> (C) cash and such securities; or
>
> (iii) from a sale pursuant to an order of a court having jurisdiction.

N.J. STAT. ANN. § 14A:11-1(1) (West Supp. 1997).

859. *See supra* note 757.

860. *See* N.J. STAT. ANN. § 14A:11-1(1)(b) (West Supp. 1997) (quoted *supra* in note 858).

861. *See* Applestein v. United Board & Carton Corp., 159 A.2d 146 (N.J. Super. Ct. Ch. Div. 1960), *aff'd per curiam*, 161 A.2d 474 (N.J. 1960); *infra* note 902 (second paragraph) (discussing *Applestein*).

862. *See* Act of Jan. 7, 1974, ch. 366, § 59, 1973 N.J. Laws 964, 1029 (effective May 1, 1974).

863. The statute provided as follows:

> Shareholders of a corporation which proposes to acquire, directly or through a subsidiary, in exchange for its shares, obligations or other securities, some or all of the outstanding shares of another corporation, or some or all of the assets of a corporation, . . . shall have the same rights, if any, as they would if they were shareholders of a surviving corporation in a merger
>
> (a) to notice of the proposed acquisition;
>
> (b) to vote on the proposed acquisition; and
>
> (c) to dissent from the proposed acquisition and be paid the fair value of their shares
>
> if (i) the securities to be issued or delivered pursuant to such acquisition are, or may be converted into, shares of the acquiring corporation's common stock and (ii) the number of the acquiring corporation's common shares to be issued or delivered, plus those initially issuable upon conversion or exchange of any other securities to be issued or delivered, will exceed 40 percent of the following: the number of its common shares outstanding immediately prior to the acquisition becoming effective plus the number of its common shares, if any, initially issuable upon conversion or exchange of any other securities then outstanding.

of a corporation's acquiring stock or assets of another corporation in a transaction that actually or potentially (through conversion of convertible securities) increased the acquiring corporation's outstanding common stock by more than 40%, the shareholders of the acquiring corporation would be accorded the same voting and appraisal rights that they would have as shareholders of a surviving corporation in a long-form merger.[864] In 1988, this provision and the New Jersey statute covering small-scale mergers[865] were amended[866] and brought into harmony.[867]

Id. (codified as amended at N.J. STAT. ANN. § 14A:10-12 (West Supp. 1997)).

864. The Commissioners' Comment—1972 Amendments was as follows:

> This section is new. It codifies the de facto merger doctrine articulated in *Applestein v. United Board & Carton Corp.*, by granting to shareholders the same rights they would have in a merger in the event of any acquisition where the corporation will issue common stock exceeding 40 percent of the number of shares of its common stock previously outstanding. The Commission is of the opinion that shareholders should be granted the right to vote and to dissent to the same extent as in a merger in any corporate acquisition, however structured, involving the issuance of such a substantial number of shares. At the same time, the Commission believes that this codification will minimize the substantial uncertainties which *Applestein* created.
>
> The Rhode Island and Ohio acts have similar provisions. Note also the similar requirement for a shareholder vote imposed by the New York Stock Exchange and the American Stock Exchange.
>
> Compare subsection N.J.S. 14A:10-3(4), which eliminates the requirement for a vote of the shareholders of a surviving corporation on a merger if its certificate of incorporation is not amended and the merger involves the issuance of 20 percent or less of the number of shares of its common stock previously outstanding.

N.J. STAT. ANN. § 14A:10-12 commentary (1972) at 29 (West Supp. 1997) (citations omitted).

865. *See supra* text accompanying notes 530-36.

866. *See* Act of Aug. 4, 1988, ch. 94, § 62, 1988 N.J. Laws 676, 742 (effective Dec. 1, 1988).

867. As amended in 1988, the New Jersey statute applies if:

> (i) the number of voting shares outstanding immediately after the transaction, plus the number of voting shares issuable on conversion of other securities or on exercise of rights and warrants issued pursuant to the transaction, will exceed by more than 40% the total number of voting shares of the corporation outstanding immediately before the transaction; or (ii) the number of participating shares outstanding immediately after the transaction, plus the number of participating shares issuable on conversion of other securities or on exercise of rights and warrants issued pursuant to the transaction will exceed by more than 40% the total number of participating shares of the corporation outstanding immediately before the transaction.

N.J. STAT. ANN. § 14A:10-12(1) (West Supp. 1997). The Commissioners' Comment—1988 Amendments stated:

> Section 14A:10-12 has been revised to make its language consistent with the revised language in subsection 14A:10-3(4). Both of these sections specify when shareholders of a corporation have rights on an acquisition where their

4. Model Business Corporation Act

The 1950 Model Business Corporation Act authorized a sale of assets, for any kind of consideration (including money, property, or shares), when recommended by the board of directors and approved by the holders of two-thirds of the outstanding shares (whether or not otherwise entitled to vote) including two-thirds of any class entitled to vote thereon as a class, with provision for a dissenters' right of appraisal.[868] The voting requirement was later changed to a majority of the shares entitled to vote.[869] The sale-of-assets provisions of the 1984 Model Business Corporation Act were the basis for the North Carolina provisions, discussed above.[870]

B. *Cases and Commentary*

1. Perspective of Purchasing Corporation

Looking at sale-of-assets transactions from the perspective of the purchasing corporation, one finds that the statutes of Delaware and North Carolina (as well as provisions of the Model Business Corporation Act) are silent. While this is understandable in the case of cash-for-assets transactions, it is anomalous with respect to stock-for-assets transactions of large scale—that is, those that entail an increase of more than 20% in the purchasing corporation's outstanding common stock. There is the same potential for dilution in the latter case as there is in a long-form stock merger; and, this being so, there is as much reason to accord voting and appraisal rights to shareholders of the purchasing corporation in a large-scale stock-for-assets purchase as there is to mandate such rights for shareholders of the surviving corporation in a long-form stock merger.[871] As previously noted, this concept is recognized in New Jersey's acquisition statutes (even though those statutes provide for a 40% rather than a 20% trigger).[872]

> corporation will be the surviving entity. These two sections have been revised to make them identical in form and substance. As the Comment to Section 14A:10-3 explains, the particular language of the revision was taken from § 11.03 of the Model Business Corporation Act (1984 revision).

Id. § 14A:10-12 commentary (1988) at 29.

868. *See* MODEL BUS. CORP. ACT §§ 73, 74 (1950), *in* 6 BUS. LAW. 1, 60-63 (1950).

869. *See* MODEL BUS. CORP. ACT ANN. § 79 (1971).

870. *See supra* notes 826 and 841.

871. *See supra* text accompanying notes 663-65.

872. *See supra* text accompanying notes 861-67.

2. Perspective of Selling Corporation

a. Evaluation of Current Statutes

In one form or another, the statutes of the three subject states require action by the board of directors on a sale-of-assets transaction,[873] thus bringing into play the concepts of fiduciary duty previously discussed.[874] The statutes of Delaware and North Carolina are sound in requiring that a sale of assets be approved by a majority of the shares entitled to vote;[875] but the New Jersey statute, in allowing approval of a sale of assets by only a majority of the votes cast,[876] is deficient in the same respect as is that state's statute relating to shareholder approval of a long-form merger (previously discussed[877]). Permissible consideration for a sale of assets is broadly stated in all three statutes[878]—leaving only the amount of

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873. In Delaware, the terms and conditions as well as the consideration must be "deem[ed]" by the board "expedient and for the best interests of the corporation." DEL. CODE ANN. tit. 8, § 271(a) (1991) (quoted *supra* in note 813).

In North Carolina, the board must "propose[]" the transaction on terms and conditions and for consideration determined by the board. *See* N.C. GEN. STAT. § 55-12-02(a) (1990) (quoted *supra* in note 826 (first paragraph)).

In New Jersey, the board must "recommend" the transaction. *See* N.J. STAT. ANN. § 14A:10-11(1)(a) (West Supp. 1997) (quoted *supra* in note 845).

874. *See supra* text accompanying notes 397-432.

875. In Delaware, the resolution authorizing the transaction must be adopted by "the holders of a majority of the outstanding stock of the corporation entitled to vote thereon." DEL. CODE ANN. tit. 8, § 271(a) (1991) (quoted *supra* in note 813).

In North Carolina, the transaction must be approved by "a majority of all the votes entitled to be cast" thereon. N.C. GEN. STAT. § 55-12-02(e) (1990) (quoted *supra* in note 826 (first paragraph)).

876. In New Jersey, approval of the transaction, in the case of a corporation organized on or after January 1, 1969, requires "the affirmative vote of a majority of the votes cast by the holders of shares entitled to vote thereon" plus, if a class of shares is entitled to a class vote, "the affirmative vote of a majority of the votes cast in each class vote." N.J. STAT. ANN. § 14A:10-11(1)(c) (West Supp. 1997) (quoted *supra* in note 845). Moreover, a corporation organized prior to January 1, 1969, can adopt such majority voting requirements by an amendment of its charter adopted by "the affirmative vote of two-thirds of the votes cast by the holders of shares entitled to vote thereon." *Id.* § 14A:10-11(1)(d) (quoted *supra* in note 845).

877. *See supra* text accompanying note 579.

878. In Delaware, the consideration "may consist in whole or in part of money or other property, including shares of stock in, and/or other securities of, any other corporation or corporations." DEL. CODE ANN. tit. 8, § 271(a) (1991) (quoted *supra* in note 813).

In North Carolina, it is "the consideration determined by the [selling] corporation's board of directors." N.C. GEN. STAT. § 55-12-02(a) (1990) (quoted *supra* in note 826 (first paragraph)).

In New Jersey, it "may consist in whole or in part of money or property, real or

consideration as a point of contention.[879] Aside from the shareholder voting provision in the New Jersey statute (referred to above), the only significant deficiencies in the sale-of-assets statutes of the three states relate to the right of appraisal.

Of the three subject states, only Delaware accords no right of appraisal to shareholders dissenting from a sale-of-assets transaction. Moreover, as of December 1, 1995, Delaware was one of only five states whose statutes were in that posture.[880] For the Delaware statute to accord appraisal rights to shareholders dissenting from a merger of their corporation into another (except in the case of a downstream short-form merger), but not to shareholders dissenting from a sale of their corporation's assets, seems clearly mistaken—for two reasons. The first reason is that the right of appraisal is needed as a check on the fairness of price in the interested-party context. If a controlling shareholder of a Delaware corporation engineers a sale of the corporation's assets to his or its wholly owned entity for cash, minority shareholders of the selling corporation do not enjoy the protections customarily associated with fundamental corporate changes. And, while the minority may have recourse to the courts for equitable relief, statutes should not be written in such a way that the legislature leaves it to the courts to provide the only safety net for investors. The second reason is that the statutory right of appraisal helps to facilitate desirable corporate combinations. It is well recognized[881] that, when corporate transactions are attacked on grounds of inequity, courts are more likely to validate such transactions if there is a right of appraisal[882] and less likely to sustain

personal, including shares, bonds, or other securities of any other corporation, domestic or foreign." N.J. STAT. ANN. § 14A:10-11(1) (West Supp. 1997) (quoted *supra* in note 845).

879. *See* Cottrell v. Pawcatuck Co., 128 A.2d 225, 229 (Del. 1956) ("We are to determine whether the evidence shows such a gross inadequacy of the price received for the sale of [the] business as to raise an inference of improper motive or reckless indifference to the interest of the minority stockholders."); Baron v. Pressed Metals of Am., Inc., 123 A.2d 848, 855 (Del. 1956) ("When disparity is alleged between the value of the assets sold and the consideration received, plaintiff has the burden of showing such a gross disparity as will raise an inference of improper motives or reckless indifference to or intentional disregard of stockholders' interests."); Schiff v. RKO Pictures Corp., 104 A.2d 267, 271-72 (Del. Ch. 1954); Allaun v. Consolidated Oil Co., 147 A. 257, 260-61 (Del. Ch. 1929).

880. *See* MODEL BUS. CORP. ACT ANN. § 13.02 commentary at 13-22 (1996).

881. *See* Manning, *supra* note 115, at 227, 229 (quoted *supra* in note 787 (second paragraph)).

882. In *Consolidated Film Industries, Inc. v. Johnson*, 197 A. 489 (Del. 1937), it was held that dividend arrearages on preferred stock could not be eliminated by way of a charter amendment. *See id.* at 491-93. Yet, in *Federal United Corp. v. Havender*, 11 A.2d

them if there is no such right.[883]

While the statutes of New Jersey and North Carolina provide a right of appraisal for shareholders dissenting from a sale-of-assets transaction (unless they hold marketable shares), both statutes contain an exception that, as a practical matter, denies such right in the circumstance when it is probably needed most—a sale of assets for cash to an entity owned exclusively by the shareholder in control of the selling corporation. Such a transaction will almost inevitably be pursuant to a plan that calls for dissolution of the selling corporation and distribution of the net proceeds of the sale within a year; and, in that case, the statutes of both states deny appraisal rights to the minority shareholders.[884] The explanation in the Official Comment on this provision in the 1984 Model Business Corporation Act (upon which the North Carolina statute is based) is less than satisfactory.[885]

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331 (Del. 1940), it was held that such arrearages could be eliminated by way of a merger with a wholly owned subsidiary. *See id.* at 342-43. It is now well recognized that part of the explanation lies in the fact that appraisal rights were available for mergers but not for charter amendments. *See infra* notes 1025-26 and accompanying text.

The case of *Homer v. Crown Cork & Seal Co.*, 141 A. 425, 434 (Md. 1928), illustrates the proposition that availability of appraisal rights discourages the granting of injunctive relief. So, too, does the case of *Blumenthal v. Roosevelt Hotel, Inc.*, 115 N.Y.S.2d 52, 55 (Sup. Ct. 1952), discussed *supra* in note 787 (first paragraph).

883. In *Allied Chemical & Dye Corp. v. Steel & Tube Co.*, 120 A. 486 (Del. Ch. 1923), a sale of assets was preliminarily enjoined when challenged on the ground of unfairness of price, the court noting that "[i]f the preliminary injunction is denied, the minority stockholders will be barred of all relief." *Id.* at 496.

In *Kamena v. Janssen Dairy Corp.*, 31 A.2d 200 (N.J. Ch. 1943), the court enjoined a recapitalization to eliminate preferred stock dividend arrearages, because shareholders dissenting from the charter amendment had no right of appraisal. The court said:

> [T]he plan is mandatory and lacks an essential element of justice or equity. The situation here is different from that which involves the merger or consolidation of separate companies. In such cases, dissenting minority stockholders are given the right to have the value of their shares determined by a proceeding in the Circuit Court. There the ends of justice are served and the dissenting minority stockholders receive a fair value in return for that which they surrender at the instance of the majority stockholders. The position of the defendant might have been less assailable if some provision had been made to fairly compensate the minority for their loss under the proposed plan.

Id. at 202 (citation omitted).

884. *See* N.J. STAT. ANN. § 14A:11-1(1)(b)(ii)(A) (West Supp. 1997) (quoted *supra* in note 858); N.C. GEN. STAT. § 55-13-02(a)(3) (Supp. 1996) (quoted *supra* in note 841 (first paragraph)).

885. That Comment contains the following statement:

> An exception [i.e., a denial of appraisal rights] is provided for sales [of assets] for cash pursuant to a plan that provides for distribution within one year. These transactions are unlikely to be unfair to minority shareholders since majority and minority are being treated in precisely the same way and all shareholders will

b. Special Uses of Sale-of-Assets Transactions

The right of appraisal can be especially important to minority shareholders when a sale of assets is resorted to for some ulterior purpose. There have been several such special uses of a sale-of-assets transaction.

For example, if a corporation wished to pay cash for the business of another corporation and the merger statute in effect at that time did not countenance the use of cash as consideration, resort could be had to a sale-of-assets transaction when a minority shareholder was unwilling to join in a sale of 100% of the stock to the purchasing corporation.[886] Similarly, it has been held that a sale of assets to a newly formed corporation, requiring approval by only a majority vote of the selling corporation's shareholders, could be utilized to extend the life of a business, when those in control were unable to muster the two-thirds shareholder vote required to extend the corporation's existence.[887] Also, a sale-of-assets transaction could be utilized to change the domicile of a corporation by having it sell its assets for stock of a newly organized corporation of another state and distributing such stock to shareholders upon dissolution of the selling corporation.[888] Indeed, before mergers with foreign corporations were permitted, the sale-of-assets device was the one resorted to in an effort—not always successful[889]—to change a corporation's

ultimately receive cash for their shares.

MODEL BUS. CORP. ACT ANN. § 13.02 commentary at 13-14 (1996). While this explanation may be valid in the case of a sale of assets negotiated at arm's length between unrelated parties, it misses the point in the context of an interested-party transaction. In the latter case, only the minority shareholders will be hurt by an unduly low price, since the controlling shareholder will simply recoup his or its proportionate share of whatever amount of cash he or it put up to effect the transaction. That is why a right of appraisal is important for the minority shareholders.

886. *See* Smith v. Good Music Station, Inc., 129 A.2d 242, 244-45 (Del. Ch. 1957).

887. *See* Porter v. C.O. Porter Mach. Co., 58 N.W.2d 135, 136-37 (Mich. 1953) (en banc). This was not a freeze-out case; the minority shareholders were offered their proportionate share of the stock of the new corporation. *See id.* at 136. The court denied injunctive relief; having concluded that no fraud or bad faith was involved, it held that appraisal was the exclusive remedy for dissenters. *See id.* at 137; *see also* Hill v. Page & Hill Co., 268 N.W. 705, 705-06 (Minn. 1936) (holding that a Minnesota corporation, whose corporate charter was about to expire (in 1933), could, over the protest of a minority shareholder, sell all of its assets to a Delaware corporation, which had been created (in 1929) by some of the shareholders of the Minnesota corporation, in exchange for stock of the Delaware corporation to be distributed to shareholders of the Minnesota corporation, when the alternative would have been liquidation of the Minnesota corporation's assets at values depressed by the Great Depression).

888. *See* Light v. National Dyeing & Printing Co., 55 A.2d 233, 234-36 (N.J. Ch. 1947).

889. *See* Forrester v. Boston & Montana Consol. Copper & Silver Mining Co., 55 P.

domicile.

Because some of the early sale-of-assets statutes were less demanding—in terms of voting or appraisal rights—than then-existing merger statutes, corporate combinations were sometimes structured as sale-of-assets transactions even though the end result was the same as in a merger.[890] Some courts have treated such a transaction as a de facto merger[891] and, accordingly, have invalidated the transaction either because it did not receive the higher vote of approval required by the merger statute[892] or because shareholders were not given the right of appraisal accorded by the merger statute.[893] Delaware, on the other hand, has been consistent in refusing to apply the de facto merger doctrine,[894] preferring its doctrine of the independent legal significance of different provisions of its corporation statute.[895]

229, 236-37 (Mont. 1898) (enjoining a proposed change of the corporation's domicile from Montana (where its mining operations were conducted) to New York (where its management operations were conducted) by way of a sale of all of the Montana corporation's assets to a newly formed New York corporation in exchange for all of the New York corporation's stock which was to be distributed share-for-share to shareholders of the Montana corporation); William B. Riker & Son Co. v. United Drug Co., 82 A. 930, 930-31 (N.J. 1912) (holding that a sale of assets by a New Jersey corporation to a Massachusetts corporation, in exchange for stock of the purchasing corporation to be distributed to shareholders in dissolution of the selling corporation, amounted to a merger of the two corporations not permitted by New Jersey's merger statute because that statute then authorized mergers only between domestic corporations); People v. Ballard, 32 N.E. 54, 55, 59-60 (N.Y. 1892) (holding that, in the absence of statutory authorization, a corporation could not change its domicile from one state (New York) to another (California) by way of a sale of its assets).

890. *Compare* Argenbright v. Phoenix Fin. Co., 187 A. 124, 125-26 (Del. Ch. 1936) (refusing to treat as a merger or consolidation a transaction in which seven corporations sold all of their assets to an eighth corporation in exchange for securities of the latter and immediately thereafter the selling corporations were dissolved), *with* Marks v. Autocar Co., 153 F. Supp. 768, 769-71 (E.D. Pa. 1954) (holding that, when one corporation sold its assets to another corporation in exchange for the latter's stock and the selling corporation was then dissolved with the stock being distributed to its shareholders, a dissenting shareholder was entitled to recover the value of her shares as though it were a merger).

891. *See* Folk, *supra* note 117, at 1261-62 (discussing the derivation of the de facto merger doctrine); *see also* Good v. Lackawanna Leather Co., 233 A.2d 201, 207-09 (N.J. Super. Ct. Ch. Div. 1967) (collecting some of the cases).

892. *See* Rath v. Rath Packing Co., 136 N.W.2d 410, 415-18 (Iowa 1965) (stock for assets); *cf.* Applestein v. United Board & Carton Corp., 159 A.2d 146, 157 (N.J. Super. Ct. Ch. Div. 1960) (stock for stock), *aff'd per curiam*, 161 A.2d 474 (N.J. 1960).

893. *See* Farris v. Glen Alden Corp., 143 A.2d 25, 27, 31 (Pa. 1958).

894. *See* Orzeck v. Englehart, 195 A.2d 375, 377-78 (Del. 1963) (stock for stock); Hariton v. Arco Elecs., Inc., 188 A.2d 123, 124-25 (Del. 1963) (sale of assets for stock); Heilbrunn v. Sun Chem. Corp., 150 A.2d 755, 757-59 (Del. 1959) (purchase of assets for stock).

895. *See* Rothschild Int'l Corp. v. Liggett Group, Inc., 474 A.2d 133, 136 (Del. 1984)

A significant ulterior purpose for which resort has been had to a sale-of-assets transaction is the cash-out of minority shareholders. Accomplishment of this purpose can be attempted through the device of having the corporation sell its operating assets to its controlling shareholder or to his or its solely owned entity and having the cash paid for such assets (less any amount used to pay liabilities not assumed by the purchaser) distributed to the shareholders upon liquidation of the selling corporation. Such a transaction raises the issue of the controlling shareholder's fiduciary duty[896] and can be successfully attacked by minority shareholders;[897] although, in some cases, such attacks have been unsuccessful because of availability of the appraisal remedy for dissenters.[898]

Freeze-out by way of a sale-of-assets transaction should be governed by the same principles as those applied with respect to the earliest freeze-out device encountered in the reported decisions—namely, a corporate dissolution coupled with a liquidation in which the corporation's operating assets would be acquired by the majority shareholders. When majority shareholders implemented a dissolution statute,[899] not with a view to terminating the corporation's

(referring to "the well-settled principle of Delaware Corporation Law that 'action taken under one section of that law is legally independent, and its validity is not dependent upon, nor to be tested by the requirements of other unrelated sections under which the same final result might be attained by different means' " (quoting *Orzeck*, 195 A.2d at 378)).

896. In *Southern Pacific Co. v. Bogert*, 250 U.S. 483 (1919), the Court said:

> The rule of corporation law and of equity invoked is well settled and has been often applied. The majority has the right to control; but when it does so, it occupies a fiduciary relation toward the minority, as much so as the corporation itself or its officers and directors. If through that control a sale of the corporate property is made and the property acquired by the majority, the minority may not be excluded from a fair participation in the fruits of the sale.

Id. at 487-88.

897. *See* Cathedral Estates, Inc., v. Taft Realty Corp., 157 F. Supp. 895, 897-98 (D. Conn. 1954), *aff'd*, 228 F.2d 85 (2d Cir. 1955); Efron v. Kalmanovitz, 38 Cal. Rptr. 148, 150-51, 154-57 (Dist. Ct. App. 1964); Allaun v. Consolidated Oil Co., 147 A. 257, 260 (Del. Ch. 1929) ("I suppose, however, if the sale is only a 'freezing out' one by which the majority use their power to sell to themselves in another guise and thereby carry on in the business without their former associates of the minority, equity would doubtless restrain it regardless of the fairness of price.").

898. *See* Blumenthal v. Roosevelt Hotel, Inc., 115 N.Y.S.2d 52, 55, 58 (Sup. Ct. 1952) (validating a sale of assets to an entity controlled by the majority shareholder of the selling corporation, because there was a right of appraisal for dissenters); *supra* note 787 (first paragraph) (discussing *Blumenthal*).

899. There was a split of authority as to whether, at common law, unanimous consent of shareholders was required for the dissolution of a corporation. *Compare* Theis v. Spokane Falls Gaslight Co., 74 P. 1004, 1005 (Wash. 1904) ("It is conceded that at common law a corporation had no power to dissolve, excepting by universal consent of

business and distributing its residual assets among all of its shareholders, but for the purpose of acquiring the corporation's operating assets and continuing the enterprise with minority shareholders excluded from the fruits thereof, the courts generally enjoined or otherwise invalidated such a transaction upon application by a minority shareholder.[900] The reason why the courts took this

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stockholders, and that an injunction would be granted upon the application of a single stockholder to prevent such dissolution...."), *with* Treadwell v. Salisbury Mfg. Co., 73 Mass. (7 Gray) 393, 404 (1856) ("But we entertain no doubt of the right of a corporation, established solely for trading and manufacturing purposes, by a vote of the majority of their stockholders, to wind up their affairs and close their business, if in the exercise of a sound discretion they deem it expedient so to do.").

The early statutes in the three subject states resolved the issue. Section 31 of the 1896 New Jersey corporation statute, *see supra* note 250 (first paragraph), provided for the dissolution of a corporation upon (i) the adoption by "a majority of the whole board" of a resolution to the effect that "in the judgment of the board of directors [it is] deemed advisable and most for the benefit of such corporation that it should be dissolved," (ii) the convening upon notice of a meeting of the stockholders "to take action upon the resolution[] so adopted by the board of directors," and (iii) the written consent at such meeting of "two-thirds in interest of all the stockholders" that such dissolution take place, or, "whenever all the stockholders shall consent in writing to a dissolution, no meeting or notice thereof shall be necessary." Act of Apr. 21, 1896, ch. 185, § 31, 1896 N.J. Laws 277, 287-88. (A similar provision, without the clause permitting action by written consent of all the stockholders without a meeting, had been contained in section 34 of the New Jersey corporation statute of 1875, An Act Concerning Corporations (Act of Apr. 7, 1875), *published in* REVISED STATUTES OF NEW JERSEY 3, 13-14 (1875).) Section 34 of both the 1899 Delaware corporation statute, *see* Act of Mar. 10, 1899, ch. 273, § 34, 21 Del. Laws 445, 455-56; *supra* note 251 (first paragraph), and the 1901 North Carolina corporation statute, *see* Act of Mar. 11, 1901, ch. 2, § 34, 1901 N.C. Sess. Laws 13, 22-23 (effective Apr. 1, 1901); *supra* note 252 (first paragraph), authorized the dissolution of a corporation pursuant to procedural steps virtually identical to those specified in section 31 of the 1896 New Jersey statute.

900. In *Theis v. Spokane Falls Gaslight Co.*, 74 P. 1004 (Wash. 1904), the court said:

> The practice is one which is frequently indulged in for the purpose of what is described in vulgar phrase as "freezing out" small stockholders; a compliance with the letter instead of the spirit of the statute; a pernicious practice, which courts of equity cannot too promptly condemn....
>
> ... Vastly more unjust would it be to permit the small stockholder to be deprived of his profitable holdings by the practice upon him by a majority of a sort of legal legerdemain, which, while it ostensibly dissolves the corporation, actually leaves it intact, with his interests eliminated.

Id. at 1006-07. In *In re Paine*, 166 N.W. 1036 (Mich. 1918), the court said:

> [I]f counsel's contention is to prevail, [the minority shareholders] may be driven out by a forced sale of their investment for no better reason than that a larger stockholder desires to acquire it in the interest of economy. It is not conceivable that the Legislature ever intended that the [dissolution] statute should be used for such a purpose. To give the statute this construction would open the way to the majority interest of every corporation in the state to dispose of an offensive minority in the same way if it saw fit. Such a construction would be injurious to the public interest and not beneficial to the stockholders as a whole.

Id. at 1039. In *Kavanaugh v. Kavanaugh Knitting Co.*, 123 N.E. 148 (N.Y. 1919), a

view was that such a transaction entailed a breach of fiduciary duty through the disparate treatment of majority and minority shareholders whereby the majority wound up with the wherewithal to continue the business while the minority wound up with nothing but cash.[901]

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complaint was held to state a cause of action when

> facts are alleged which permit, if they do not compel, the inference that the directors conceived and progressed the scheme of dissolving the corporation, irrespective of the welfare or advantage of the corporation and of any cause or reason related to its condition or future, through the desire and determination to take from the corporation and to secure to themselves the corporate business freed from interference or participation on the part of the [minority shareholder] plaintiff.

Id. at 152. *Cf.* White v. Kincaid, 149 N.C. 415, 418-22, 63 S.E. 109, 110-12 (1908) (allowing a dissolution, authorized by statute, to proceed notwithstanding objection by a minority shareholder, when there was no indication that those in control intended to continue the business for their own benefit).

901. In *In re San Joaquin Light & Power Corp.*, 127 P.2d 29 (Cal. Dist. Ct. App. 1942), in response to the contention that a transaction was fair because "the minority common stockholders would receive the cash value of their shares which is exactly what they would have received had the directors sold all of the assets for money and distributed the proceeds," *id.* at 35, the court said:

> [I]t may be here observed that had all of the assets been sold and the proceeds distributed all of the stockholders would have been treated alike whereas under the plan here attempted the majority stockholder obtains and may continue a going business, whereas the minority stockholders are compelled to take the present value of their respective shares.
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> ....
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> ... [W]e therefore hold that a corporation in the process of voluntary dissolution has not the right to adopt and carry out a plan of distribution whereby its plants and business properties are distributed to a majority stockholder and its minority common stockholders are compelled to take their share of the value of the distributable assets....

Id. at 35-36. In *Zimmermann v. Tide Water Associated Oil Co.*, 143 P.2d 409 (Cal. Dist. Ct. App. 1943), the court said:

> The question as to the desirability of permitting distribution on voluntary dissolution of a corporation by transferring the main assets to certain stockholders and compelling minority stockholders to accept cash for their interests is not only debatable but it is one for the Legislature to decide. This it has done and provisions which authorize such a procedure have been omitted from our statutes. There is good reason to believe that this was intentionally done. We adhere to the views expressed in the San Joaquin case insofar as this issue is concerned.

Id. at 412. In *Kellogg v. Georgia-Pacific Paper Corp.*, 227 F. Supp. 719 (W.D. Ark. 1964), the court said:

> To say that majority stockholders may dissolve a corporation and proceed to take over the business and principal assets for themselves while at the same time forcing the minority to take mere cash for their interests, the payments to be based on a valuation made by the majority, would be to confer upon the majority the power to confiscate the minority interest, thus depriving the minority shareholders of their interest in an existing business with its attendant

III. PURCHASE/SALE OF CONTROLLING STOCK INTEREST

Control of one corporation by another may be acquired through an "upside-down" transaction in which the acquired corporation issues shares of its authorized voting stock to the acquiring corporation in a quantity sufficient to give the acquiring corporation control of the corporation whose stock is so issued.[902] However, the discussion that follows relates to the acquisition by one corporation of stock of another corporation from shareholders of the latter corporation.

A. *Statutory Provisions*

1. General Grants of Power

Statutes authorizing one corporation to acquire and vote stock of another corporation came early in the three subject states.

Section 51 of the 1896 New Jersey corporation statute[903] provided that any corporation could purchase and vote shares of the

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possibilities of growth and appreciation in value, an interest which may be worth much more than the present cash value of the minority shares. Such should not be permitted.

....

... When Georgia-Pacific [the majority shareholder] decided to bring about the dissolution of Crossett rather than to continue its corporate existence and operations, it assumed the obligation to liquidate Crossett in accordance with law. It had a right to distribute the assets in kind or to put them on the block for sale and divide the proceeds, in either case treating all stockholders alike. It had no right to take over [Crossett] as a going business and eliminate plaintiffs' interests in that company by cash payments.

Id. at 724-25.

902. This was the nature of the transaction involved in *Morley Brothers v. Clark*, 361 N.W.2d 763 (Mich. Ct. App. 1984). The court, while disclaiming any need to decide the de facto merger question, held that shareholders of the acquired corporation were entitled to the right of dissent and appraisal. *See id.* at 764.

In *Applestein v. United Board & Carton Corp.*, 159 A.2d 146 (N.J. Super. Ct. Ch. Div.), *aff'd per curiam*, 161 A.2d 474 (N.J. 1960), the court had before it an exchange agreement whereby United would issue its 160,000 previously unissued shares (out of a total of 400,000 authorized) to one Epstein in exchange for his 100% of the shares of Interstate, thereby (along with arrangements for six of eleven directors) giving Epstein "effective control" of United, which would proceed to record the assets and liabilities of Interstate on the books of United and then dissolve Interstate. *See id.* at 148-50, 153-54. The court held that such a transaction would constitute a de facto merger entitling dissenting shareholders of United to the right of appraisal. *See id.* at 157.

See generally Schulman & Schenk, *supra* note 663, at 1551-54 (examining rights available to shareholders in "upside-down" acquisitions).

903. *See supra* note 250 (first paragraph).

capital stock of any other corporation, foreign or domestic.[904] Before Woodrow Wilson ceased to be Governor of New Jersey, this matter became entangled in a spate of state antitrust legislation.[905] However, since the effective date of New Jersey's 1968 Business Corporation Act,[906] the statutory authorization for one corporation to acquire and vote stock of another corporation has been stated in broad terms.[907]

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904. Section 51 of the 1896 statute, Act of Apr. 21, 1896, ch. 185, § 51, 1896 N.J. Laws 277, 294-95, is quoted *supra* in note 236 (first paragraph). It was derived from an 1893 statute, Act of Mar. 14, 1893, ch. 171, § 1, 1893 N.J. Laws 301, 301, quoted *supra* in note 189.

905. By Act of Feb. 19, 1913, ch. 18, § 1, 1913 N.J. Laws 32, 32-33, the grant of authority contained in section 51 of the 1896 statute was rescinded, and that section was restated as follows:

> No corporation heretofore organized or hereafter to be organized under the provisions of [the 1896 act as amended or supplemented], except as otherwise provided therein or thereby, shall hereafter purchase, hold, sell . . . the shares of the corporate stock of any other corporation or corporations of this or any other state, . . . nor as owner of such stock exercise any of the rights, powers and privileges of ownership, including the right to vote thereon.

Id. At the same time, by Act of Feb. 19, 1913, ch. 15, § 1, 1913 N.J. Laws 28, 28-29, section 49 of the 1896 statute (quoted *supra* in note 176 (first paragraph)) was amended so as to narrow its scope. Four years later, by Act of Mar. 28, 1917, ch. 195, 1917 N.J. Laws 566, sections 49 and 51 of the 1896 statute (as amended in 1913) were repealed and replaced by three provisions that, in 1937, became sections 14:3-9, -10, and -11 of former title 14. Section 14:3-9 provided: "Any corporation . . . may purchase . . . property and, subject to the provisions of section 14:3-10 . . . , the stock of any other corporation necessary or desirable for its business . . . ." Former N.J. STAT. ANN. § 14:3-9 (West 1939). Section 14:3-10 provided (in the first paragraph thereof): "No corporation of this state engaged in trade or commerce shall acquire . . . the stock . . . of another corporation also engaged in trade or commerce, where the effect of such acquisition may be to substantially lessen competition . . . or tend to create a monopoly of any line of trade or commerce." *Id.* § 14:3-10. Finally, section 14:3-11 provided:

> Subject to the provisions of sections 14:3-9 and 14:3-10 . . . any corporation of this state may purchase, hold, [or] sell . . . the shares of the capital stock of . . . any other corporation or corporations of this or any other state or any foreign country, and while owner of such stock may exercise all the rights, powers and privileges of ownership, including the right to vote thereon.

Id. § 14-3-11.

906. Act of Nov. 21, 1968, ch. 350, 1968 N.J. Laws 1011 (effective Jan. 1, 1969); *see supra* note 250 (second paragraph).

907. The New Jersey statute provides as follows:

> (1) Each corporation, subject to any limitations provided in this act or any other statute of this State, or in its certificate of incorporation, shall have power
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> . . . .
>
> (f) to purchase, subscribe for, or otherwise acquire, own, hold, vote, use, employ, sell, exchange . . . or otherwise dispose of, and otherwise use and deal in and with, shares or other interests in . . . other domestic or foreign corporations . . . ;
>
> . . . .

N.J. STAT. ANN. § 14A:3-1(1) (West Supp. 1997).

Section 133 of the 1899 Delaware corporation statute authorized a corporation to acquire and vote stock of other corporations.[908] With minor amendments,[909] that authorization continued in effect until the 1967 rewrite of the Delaware statute,[910] when the authorization was amplified to make it virtually unlimited.[911]

In 1903, North Carolina added to its 1901 corporation statute a provision authorizing any corporation to acquire and vote the stock of any other corporation.[912] In 1919,[913] the wording (but not the substance) of this provision was changed, and it continued in effect without further amendment[914] until the effective date of North Carolina's 1955 Business Corporation Act,[915] when the authorization was restated.[916] A similar broad authorization is contained in the

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908. *See* Act of Mar. 10, 1899, ch. 273, § 133, 21 Del. Laws 445, 500-01 (quoted *supra* in note 245).

909. By Act of Mar. 7, 1901, ch. 166, § 39, 22 Del. Laws 255, 283, section 133 was renumbered as section 135, and the words "created under the provisions of this act" were changed to read "organized under the laws of this State." By Act of Mar. 7, 1901, ch. 167, § 135, 22 Del. Laws 286, 352, a mistaken reference to "county" was changed to read "country."

910. *See* Act of July 3, 1967, ch. 50, 56 Del. Laws 151; *supra* note 251 (second paragraph).

911. The Delaware statute provides as follows:

> Any corporation organized under the laws of this State may ... purchase ... or otherwise acquire; own, hold, use or otherwise employ; sell ... or otherwise dispose of; ... or otherwise deal in and with ... shares or other securities or interests in, or issued by, any other domestic or foreign corporation .... A corporation while owner of any such securities may exercise all the rights, powers and privileges of ownership, including the right to vote.

DEL. CODE ANN. tit. 8, § 123 (1991).

912. *See* Act of Mar. 9, 1903, ch. 660, § 3, 1903 N.C. Sess. Laws 1045, 1046. The new provision stated: "Any corporation may purchase, hold, assign ... or otherwise dispose of the shares of the capital stock of ... any other corporation ... of this or any other State, and while owner of such stock may exercise all the rights, powers and privileges of ownership, including the right to vote thereon." *Id.*

913. *See* Act of Mar. 10, 1919, ch. 238, 1919 N.C. Sess. Laws 449 (adopting the Consolidated Statutes); *supra* note 252 (first paragraph).

914. From 1919 until 1957, first as section 1166 of the North Carolina Consolidated Statutes and later as section 55-71 of the North Carolina General Statutes, it provided: "A corporation may purchase stock ... created by any other corporation or corporations of this, or any other state, and while owner of such may exercise all the rights, powers and privileges of ownership." Former N.C. GEN. STAT. § 55-71 (1950).

915. Act of May 26, 1955, ch. 1371, 1955 N.C. Sess. Laws 1432 (effective July 1, 1957); *see supra* note 252 (second paragraph).

916. The 1955 Act provided as follows:

> (b) In connection with carrying out the purposes stated in its charter, and subject to any limitation prescribed by this Chapter or by its charter, every corporation shall also have power:
>
> ....

1989 rewrite of that Act (effective July 1, 1990).[917]

From the time of its first publication in 1950 until its 1984 revision, the Model Business Corporation Act contained (unchanged) authorization for one corporation to acquire and vote stock of another corporation.[918] Such an authorization appears in section 3.02(6) of the 1984 Model Act.[919]

2. Special Share Acquisition or Exchange Provisions

In 1967, New Jersey added to former title 14 a new chapter 12A,[920] which (with some changes) became section 14A:10-9 of the new title 14A enacted in 1968 (effective January 1, 1969).[921] It provides a procedure whereby a New Jersey corporation can acquire, in exchange for shares of its stock, all of the shares (or all of a class of shares) of another New Jersey corporation.[922] The statute requires

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> (5) To acquire, by purchase . . . or otherwise, and to own, hold, vote, use, employ, sell . . . or otherwise dispose of, and otherwise use and deal in and with, shares or other interests in . . . other domestic or foreign corporations . . . .
>
> . . . .

Former N.C. GEN. STAT. § 55-17(b) (1982).

917. The 1989 Act provides as follows:

> (a) Unless its articles of incorporation or this Chapter provide otherwise, every corporation . . . has the same powers as an individual to do all things necessary or convenient to carry out its business and affairs, including without limitation power:
>
> . . . .
>
> (6) To purchase . . . or otherwise acquire; own, hold, vote, use, sell . . . or otherwise dispose of; and deal in and with shares or other interests in . . . any other entity;
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> . . . .

N.C. GEN. STAT. § 55-3-02(a) (Supp. 1996). This provision is the same as that contained in the 1984 Model Business Corporation Act except that the phrase "or this Chapter" does not appear in the Model Act provision. *See* MODEL BUS. CORP. ACT ANN. § 3.02(6) (1996).

918. Section 4(g) provided: "Each corporation shall have power: . . . (g) To purchase . . . or otherwise acquire, own, hold, vote, use, employ, sell . . . or otherwise dispose of, and otherwise use and deal in and with, shares or other interests in . . . other domestic or foreign corporations . . . ." MODEL BUS. CORP. ACT § 4(g) (1950), *in* 6 BUS. LAW. 1, 3-4 (1950); MODEL BUS. CORP. ACT ANN. § 4(g) (1971).

919. *See supra* note 917.

920. *See* Act of June 19, 1967, ch. 116, 1967 N.J. Laws 558 (codified at N.J. STAT. ANN. §§ 14:12A-1 to -5 (West Supp. 1968)).

921. *See* Act of Nov. 21, 1968, ch. 350, 1968 N.J. Laws 1011 (effective Jan. 1, 1969); *supra* note 250 (second paragraph).

922. The New Jersey statute provides as follows:

> Subject to the limitations imposed by any other statute of this State, any domestic corporation may, in the manner provided by this section, acquire, in exchange for its shares, all the shares, or all the shares of any class or series, of

that an offer be made by mail to all holders of the shares to be acquired,[923] and it requires the offeror to complete the acquisition if (within 120 days after such mailing) the offer is accepted by the holders of not less than 90% of the shares to which the offer relates (other than shares already held by or for the offeror).[924] Shareholders who have not accepted the offer must be given written notice of their right either to accept the offer or to dissent and be paid "the fair value of their shares."[925]

North Carolina's Business Corporation Act, as enacted in 1989 (effective July 1, 1990),[926] contains a new provision—based on the 1984 Model Business Corporation Act—authorizing a share exchange.[927] Although the device is referred to in the statute's

any other corporation organized under any statute of this State.

N.J. STAT. ANN. § 14A:10-9(1) (West Supp. 1997).

923. *See id.* § 14A:10-9(2).

924. *See id.* § 14A:10-9(3)-(4).

925. *See id.* § 14A:10-9(3)(b). In the 1967 version of this provision, the valuation standard was "the market value of his shares." Act of June 19, 1967, ch. 116, § 14:12A-3, 1967 N.J. Laws 558, 559.

The basic entitlement to dissent and appraisal is set forth in section 14A:11-1(2), providing as follows: "Any shareholder of a domestic corporation shall have the right to dissent with respect to any shares owned by him which are to be acquired pursuant to section 14A:10-9." N.J. STAT. ANN. § 14A:11-1(2) (West Supp. 1997). However, another section provides as follows:

> Whenever all the shares, or all the shares of a class or series, are to be acquired by another corporation pursuant to section 14A:10-9, a shareholder of the corporation whose shares are to be acquired may, not later than 20 days after the mailing of notice by the acquiring corporation pursuant to paragraph 14A:10-9(3)(b), make written demand on the acquiring corporation for the payment of the fair value of his shares.

Id. § 14A:11-2(5). Though probably not intended, it is possible to read this latter statute (in a multi-class situation) as saying that, not only a holder of shares of the class being acquired in the share exchange, but also any other "shareholder of the corporation whose shares are to be acquired" in the exchange, is entitled to the right of dissent and appraisal.

Minor changes in section 14A:10-9(3)(b), relating to the required notice concerning the right of dissent and appraisal, were made by Act of Jan. 7, 1974, ch. 366, § 57, 1973 N.J. Laws 964, 1025-26 (effective May 1, 1974).

926. *See* Act of June 8, 1989, ch. 265, 1989 N.C. Sess. Laws 566 (effective July 1, 1990); *supra* note 252 (third paragraph).

927. The North Carolina statute provides as follows:

> (a) A corporation may acquire all of the outstanding shares of one or more classes or series of another corporation if the board of directors of each corporation adopts and its shareholders (if required by G.S. 55-11-03) approve the exchange.
>
> (b) The plan of exchange must set forth:
>
> (1) The name of the corporation whose shares will be acquired and the name of the acquiring corporation;
>
> (2) The terms and conditions of the exchange;
>
> (3) The manner and basis of exchanging the shares to be acquired for

caption as a "[s]hare exchange," the consideration paid for the acquired shares can be cash or property and need not (although it may) consist of shares or other securities.[928] The plan of exchange must be adopted by the directors of both corporations;[929] and, while shareholders of the acquiring corporation are not required to approve a plan of exchange, such a plan must be approved by shareholders of the corporation whose shares will be acquired in the exchange.[930] The statutory provisions governing the voting required for such approval are somewhat complicated.[931] The North Carolina statute gives a right of appraisal, not only to dissenting holders of shares of a class being acquired but also (in a multi-class situation) to dissenting holders of a class not being acquired, unless (in either case) the dissenters' shares are part of a class that is marketable as

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> shares, obligations, or other securities of the acquiring or any other corporation or for cash or other property in whole or part.
>
> (c) The plan of exchange may set forth other provisions relating to the exchange.

N.C. GEN. STAT. § 55-11-02(a)-(c) (1990).

This statute is the same as that contained in the 1984 Model Business Corporation Act. *See* MODEL BUS. CORP. ACT ANN. § 11.02(a)-(c) (1996). A share exchange provision first appeared in the Model Act in the 1970s. *See* MODEL BUS. CORP. ACT ANN. 521-23 (Supp. 1977).

928. *See* N.C. GEN. STAT. § 55-11-02(b)(3) (1990) (quoted *supra* in note 927 (first paragraph)).

929. *See id.* § 55-11-02(a) (quoted *supra* in note 927 (first paragraph)).

930. The plan of share exchange must be submitted for shareholder approval only by "the board of directors of the corporation whose shares will be acquired in the share exchange." N.C. GEN. STAT. § 55-11-03(a) (Supp. 1996).

931. The statute provides: "For a plan of . . . share exchange to be approved: . . . (2) The shareholders entitled to vote must approve the plan." *Id.* § 55-11-03(b)(2). The deficiency in this wording has been commented on *supra* in note 588.

Subsection 55-11-03(e), and subsection 55-11-03(f)(2) as amended by Act of July 27, 1990, ch. 1024, § 12.17, 1989 N.C. Sess. Laws 593, 601 (effective July 1, 1990), provide as follows:

> (e) Unless this Chapter, the articles of incorporation, a bylaw adopted by the shareholders or the board of directors (acting pursuant to subsection (c) [authorizing the board to condition its submission of the proposed share exchange to the shareholders]) require a greater vote or a vote by voting groups, the plan of . . . share exchange to be authorized must be approved by each voting group entitled to vote separately on the plan by a majority of all the votes entitled to be cast on the plan by that voting group . . . .
>
> (f) Separate voting by voting groups is required:
>
> . . . ;
>
> (2) On a plan of share exchange by each class or series of shares to be acquired in the exchange, with each class or series constituting a separate voting group.

N.C. GEN. STAT. § 55-11-03(e)-(f) (Supp. 1996).

provided in a 1997 amendment to the statute.[932] This statute permits shares of a North Carolina corporation to be acquired in a share exchange by either a domestic or a foreign corporation, but (standing alone) it does not permit a North Carolina corporation to acquire shares of a foreign corporation by way of a share exchange.[933]

B. Cases and Commentary

Only one comment needs to be made concerning the general power of one corporation to acquire a controlling interest in the stock of another corporation. If the acquiring corporation has a limited-purpose charter, the ultra vires problem could arise if the acquired

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932. The appraisal statute provides as follows:

> (a) In addition to any rights granted under Article 9 [the North Carolina Shareholder Protection Act], a shareholder is entitled to dissent from, and obtain payment of the fair value of his shares in the event of, any of the following corporate actions:
>
> ....
>
> (2) Consummation of a plan of share exchange to which the corporation is a party as the corporation whose shares will be acquired, unless such shares are then redeemable by the corporation at a price not greater than the cash to be received in exchange for such shares;
>
> ....

N.C. GEN. STAT. § 55-13-02(a) (Supp. 1996). By way of contrast, the 1984 Model Business Corporation Act provides as follows:

> (a) A shareholder is entitled to dissent from, and obtain payment of the fair value of his shares in the event of, any of the following corporate actions:
>
> ....
>
> (2) consummation of a plan of share exchange to which the corporation is a party as the corporation whose shares will be acquired, if the shareholder is entitled to vote on the plan;
>
> ....

MODEL BUS. CORP. ACT ANN. § 13.02(a) (1996). The Official Comment to section 11.03 of the 1984 Model Act includes the statement that "[o]nly shareholders who have the right to vote on a ... share exchange under section 11.03 have the right to dissent and obtain payment for their shares under chapter 13." *Id.* § 11.03 commentary at 11-28.

The denial of appraisal rights with respect to marketable shares is covered in a provision of the North Carolina General Statutes added by Act of June 9, 1997, ch. 202, § 1 (effective Oct. 1, 1997) (to be codified at N.C. GEN. STAT. § 55-13-02(c)) (quoted *supra* in note 759).

933. The North Carolina statute provides as follows:

> (a) One or more foreign corporations may merge or enter into a share exchange with one or more domestic corporations if:
>
> ....
>
> (2) In a share exchange, the corporation whose shares will be acquired is a domestic corporation, whether or not a share exchange is permitted by the law of the state or country under whose law the acquiring corporation is incorporated;
>
> ....

N.C. GEN. STAT. § 55-11-07(a) (1990).

corporation is engaged in a different business.[934]

There are significant differences between the share exchange statutes of New Jersey and North Carolina.[935] The New Jersey statute applies only with respect to two domestic corporations, but the North Carolina statute permits shares of a domestic corporation to be acquired in a share exchange by a foreign corporation. Unlike the New Jersey statute, the share exchange provision of the North Carolina statute contemplates a negotiated transaction requiring involvement by directors of the corporation whose shares are to be acquired (as well as directors of the acquiring corporation). Under the New Jersey statute, shareholder approval takes the form of acceptance of a written offer; under the North Carolina statute, such approval takes the form of a shareholder vote.[936] The New Jersey statute applies only when the consideration to be paid consists of shares of the acquiring corporation's stock, whereas the North Carolina statute permits consideration in the form of "shares, obligations, or other securities of the acquiring or any other corporation or . . . cash or other property in whole or part."

Each state's share exchange statute makes it possible for one corporation to acquire control of another corporation while continuing the separate existence of the acquired corporation. In this regard, the share exchange statutes serve the same purpose as the reverse triangular merger,[937] previously discussed.[938]

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934. In *State v. Atlantic City & Shore Railroad Co.*, 72 A. 111 (N.J. 1909), the court said:

> We deem it clear that section 51 [of the 1896 New Jersey corporation statute] is to be construed in subordination to section 2 [of that statute], and that the state thereby grants to one corporation the capacity to hold stock in another corporation only so far as such stock ownership is necessary or convenient to the attainment of the objects set forth in the charter . . . of the holding company.

Id. at 116 (referring to Act of Apr. 21, 1896, ch. 185, §§ 2, 51, 1896 N.J. Laws 277, 278, 294-95).

935. The Delaware General Corporation Law contains no provision comparable to the New Jersey and North Carolina share exchange statutes. *See* N.J. STAT. ANN. § 14A:10-9 (West Supp. 1997); N.C. GEN. STAT. § 55-11-02 (1990).

936. The New Jersey statute states in part: "This section shall not be construed to prevent a corporation from making an offer to purchase the shares of another corporation conditioned upon the acceptance of holders of less than 90% of the shares to which such offer relates." N.J. STAT. ANN. § 14A:10-9(5) (West Supp. 1997). The North Carolina statute states: "This section does not limit the power of a corporation to acquire all or part of the shares of one or more classes or series of another corporation through a voluntary exchange or otherwise." N.C. GEN. STAT. § 55-11-02(d) (1990).

937. The Official Comment to section 11.02 of the 1984 Model Business Corporation Act contains the following:

> It is often desirable to effect a reorganization or combination so that the corporation being acquired does not go out of existence but becomes a

The North Carolina share exchange statute suffers the deficiency, previously discussed,[939] of departing from the policy entailed in the small-scale merger device. It permits an acquiring corporation to increase its outstanding voting or participating stock by more than 20%, in effecting a share exchange, without according voting or appraisal rights to its shareholders.[940] The New Jersey statute, on the other hand, accords those rights to shareholders of the acquiring corporation in a share exchange, but only if its outstanding voting or participating shares are increased by more than 40% in effecting the exchange.[941]

PART THREE: AVAILABILITY OF TWENTIETH-CENTURY LIBERALIZING STATUTES TO CORPORATIONS IN EXISTENCE BEFORE THEIR ENACTMENT

I. RESTATEMENT OF THE PROBLEM

Notwithstanding the twentieth-century liberalization of combination statutes (relaxation of the requirements for mergers, authorization of sale-of-assets transactions, etc.), there remained a problem for older corporations. The problem entailed the question whether the Impairment Clause of the Constitution precluded the

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> subsidiary of the acquiring corporation or holding company, the securities of which are issued as part of the transaction. These objectives often are particularly important in the formation of holding company systems for, or for the acquisition of, insurance companies and banks, but are not limited to these transactions. In the absence of a share exchange procedure, this kind of a transaction often may be accomplished only by the process of a "reverse triangular merger": the formation of a new subsidiary of the acquiring or holding company, followed by a merger of that subsidiary into the corporation to be acquired in which securities of the new subsidiary's parent are exchanged for securities of the corporation to be acquired. Section 11.02 provides a straightforward procedure to accomplish the same end.

MODEL BUS. CORP. ACT ANN. § 11.02 commentary at 11-20 (1996).

938. *See supra* text accompanying note 657.

939. *See supra* text accompanying notes 663-65, 772, and 871-72.

940. The Official Comment to section 11.03 of the 1984 Model Business Corporation Act (on which the North Carolina statute is based) contains the following:

> The requirement that shareholders of the surviving corporation in a statutory merger have a right to vote if the increase in the number of shares exceeds 20 percent may be avoided by arranging the transaction in the form of a merger involving a subsidiary of the acquiring corporation or as a share exchange under section 11.02. This anomaly reflects a compromise among basically conflicting points of view.

MODEL BUS. CORP. ACT ANN. § 11.03 commentary at 11-29 (1996).

941. *See* N.J. STAT. ANN. § 14A:10-12 (West Supp. 1997); *supra* notes 862-67 and accompanying text.

utilization of such enabling legislation by pre-existing corporations. While there are those who appear to believe that this question is no longer one of importance,[942] others have recognized its continued significance.[943]

It has continued to be accepted doctrine[944] that, without the basis of either a pre-incorporation reserved power or a legislative grant of appraisal rights, a corporation could not make a fundamental change pursuant to post-incorporation enabling legislation without running afoul of the Impairment Clause.[945] It also has continued to be

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942. The subject was covered in every edition of The Foundation Press's *Cases and Materials on Corporations* from the 1951 edition by E. Merrick Dodd and Ralph J. Baker through the 1988 edition by William L. Cary and Melvin Aron Eisenberg. Yet it is omitted entirely from the Seventh Edition (published in 1995), whose Table of Cases does not even list *Trustees of Dartmouth College v. Woodward.*

943. The problem was recognized in Richard O. Kummert, *The Financial Provisions of the New Washington Business Corporation Act*, 41 WASH. L. REV. 207 (1966), in which the author gives a brief but penetrating analysis of the question as applied to Washington's new Business Corporation Act. *See id.* at 208-13.

The problem was discussed also in the following: Leslie J. Ayer, *The New Washington Business Corporation Act—Reserved Power of Legislature to Change*, 8 WASH. L. REV. 97, 99-104 (1934); Judson A. Crane, *Enlargement of Corporate Authority Under the Reserved Power*, 15 U. PITT. L. REV. 427 (1954); George D. Gibson, *The Virginia Corporation Law of 1956*, 42 VA. L. REV. 603, 603-15 (1956); and Kenneth K. Luce, *Legislative Amendment of Corporation Statutes—The Wisconsin Problem*, 30 MARQ. L. REV. 20, 32-53 (1946).

944. For the nineteenth-century view of the matter, see *supra* text accompanying notes 29-45.

945. In *Allen v. White*, 171 N.W. 52 (Neb. 1919), in which there was no reference to any reserved power, it was held that those in charge of a corporation could not utilize post-incorporation legislation to change the method of distributing profits from one based on stock ownership to one based on patronage. *See id.* at 52. The court said: "Such a course, if pursued, would deprive plaintiffs of dividends to which they were entitled under their contracts as original stockholders and would destroy their contractual rights. This neither the Legislature nor the defendants can lawfully do." *Id.*

In *Swan v. Barnes*, 184 S.E. 257 (W. Va. 1936), the court said:

> [W]here the statute under which a consolidation or merger is effected was in force at the time the constituent corporation of the objecting stockholder was organized, or, possibly, at the time the stock of the objecting stockholder in the constituent company was issued, then the objecting stockholder is bound by the terms of his contract of stock purchase of which the statute in question became a part, and cannot object to a consolidation or merger carried out upon fair terms pursuant to the statute. If, however, the statute under which the consolidation or merger was effected was not in force at the time the shares of the objecting stockholder in the constituent company were issued, then his shares are not subject, over his objection, or without his consent, either express or implied, to be carried into the consolidation or merger.

Id. at 258 (citations omitted).

In *South Western Railroad Co. v. Benton*, 58 S.E.2d 905 (Ga. 1950), when a railroad corporation was chartered in 1845 and the state did not adopt its reserved power until 1863, it was held that the corporation could not avail itself of 1933 legislation authorizing

accepted doctrine[946] that, if a state legislature acted pursuant to a pre-incorporation reserved power, it could—without violating the Impairment Clause—impose new conditions upon corporations[947] or

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one railroad corporation to sell its property to another such corporation with the assent of the holders of a majority of its stock and that an attempt to effect such a sale could be enjoined by minority shareholders. *See id.* at 913, 917-18.

In *State v. Alaska Airlines, Inc.*, 413 P.2d 352 (Wash. 1966) (en banc), when a corporation was organized in 1931 under an Alaskan statute that mandated cumulative voting and there was no reserved power in effect until 1957, it was held that the corporation could not avail itself of post-incorporation legislation (enacted in 1964) that permitted bylaw elimination of cumulative voting. *See id.* at 354, 358-59.

The importance of the reserved power is illustrated by two Missouri decisions in *State v. Holekamp Lumber Co.*, 331 S.W.2d 171 (Mo. Ct. App.), *rev'd*, 340 S.W.2d 678 (Mo. 1960), involving a 1957 charter amendment, extending the life of a corporation organized in 1908 for a second period of 50 years, approved by the holders of 58% of the outstanding stock and opposed by the holders of 38.7%. *See id.* at 173. Statutes enacted in 1943 authorized charter amendments changing the period of corporate duration upon a majority vote of shareholders. *See id.* at 174. However, the 1899 laws (in effect when the corporation was organized) provided that a corporation, upon a three-fourths shareholder vote and payment of a prescribed fee, could file a certificate accepting the provisions of general laws of the state relating to corporations and thereby have the corporation's existence extended as stated in the certificate of acceptance. *See id.* at 175-76. In the view of the court of appeals, neither the state constitution of 1875 nor any state statute in effect when the corporation was organized contained a reserved power; and, accordingly, on the ground that the corporation could not avail itself of the 1943 statutes (and had not complied with the 1899 laws), that court concluded that the charter amendment was invalid. *See id.* at 177, 181-82. Therefore, the court of appeals reversed the trial court, which had granted a motion to dismiss the complaint for failure to state a cause of action. *See id.* at 173, 184-85. However, it was the view of the supreme court that there was a sufficient reservation of power in the state's 1875 constitution (which was in effect when the corporation was organized); and, on that basis, the court concluded that the corporation could avail itself of the post-incorporation enabling legislation and rejected the contention of the minority shareholders that they had a vested right to have the corporation's existence terminated and its assets distributed in 1958. *See Holekamp Lumber Co.*, 340 S.W.2d at 680-82. Therefore, the supreme court reversed the court of appeals and affirmed the decision of the trial court. *See id.* at 679, 683.

946. For the nineteenth-century view of the matter, see *supra* text accompanying notes 65-69.

947. *See* Voeller v. Neilston Warehouse Co., 311 U.S. 531, 535 n.6 (1941) (indicating that a pre-incorporation reservation of the power to alter or amend a state's corporation law would sustain the application to a pre-existing corporation of a statute granting appraisal rights to shareholders dissenting from a sale-of-assets transaction); Phillips Petroleum Co. v. Jenkins, 297 U.S. 629, 636-37 (1936) (holding that, when there was a constitutional reservation of power to alter or repeal corporate charters, the legislature could validly impose upon existing corporations liability for injuries sustained by employees through the negligence of fellow employees, thereby substituting the rule of respondeat superior for the common-law fellow-servant rule); Erie R.R. Co. v. Williams, 233 U.S. 685, 699-701 (1914) (holding that the reserved power sustained the application to a pre-existing corporation of a statute requiring that employees be paid semimonthly in cash); Fair Haven & Westville R.R. Co. v. New Haven, 203 U.S. 379, 388-89 (1906) (holding that, under a reserved power, railroad companies could be subjected to post-incorporation legislation authorizing cities to impose assessments for paving and repaving

upon shareholders.[948] In addition, however, there has continued[949] to be a recognition of the difference between compulsory legislation and permissive enabling statutes.[950]

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along railroad tracks within the cities); Stanislaus County v. San Joaquin & King's River Canal & Irrigation Co., 192 U.S. 201, 211-13 (1904) (holding that, under a reserved power, a corporation could be subjected to post-incorporation legislation giving rate-fixing authority to a governmental agency); Gregg v. Granby Mining & Smelting Co., 65 S.W. 312, 313-14 (Mo. 1901) (holding that the reserved power sustained a post-incorporation mandating of cumulative voting); State v. Jefferson Lake Sulphur Co., 178 A.2d 329, 335-36 (N.J. 1962) (holding that, under the reserved power, a corporation could be subjected to the state's post-incorporation Custodial Escheat Act); New York Cent. & Hudson River R.R. Co. v. Williams, 92 N.E. 404, 407-09 (N.Y. 1910) (holding that the state legislature, acting under a reserved power, could constitutionally impose upon a railroad corporation the requirement that its employees' wages be paid semimonthly in cash); Noble State Bank v. Haskell, 97 P. 590, 594, 609 (Okla. 1908) (holding that a banking corporation could be required, by post-incorporation legislation enacted under a reserved power, to make payments into a depositors' guaranty fund).

948. In *Stockholders v. Sterling*, 300 U.S. 175 (1937), the Court sustained a post-incorporation statute, enacted pursuant to a reserved power, specifying a new remedy for enforcement of the liability of shareholders for debts of banking corporations to the extent of the par value of their shares. *See id.* at 179-83.

In some states, it was held that, under the reserved power, the legislature could constitutionally impose upon shareholders of banking corporations, by way of post-incorporation legislation, liability for debts of such corporations to the extent of the par value of their shares. *See* Rainey v. Michel, 57 P.2d 932, 942 (Cal. 1936); Melaven v. Schmidt, 283 P. 900, 900-01 (N.M. 1929); Smathers v. Western Carolina Bank, 135 N.C. 410, 418, 47 S.E. 893, 896 (1904).

949. *See supra* text accompanying note 70.

950. In *Berger v. United States Steel Corp.*, 53 A. 68 (N.J. 1902), in which the challenged transaction involved a pro rata exchange of bonds for outstanding shares of preferred stock, the court drew a distinction between different portions of the post-incorporation enabling legislation—upholding (as a valid exercise of the reserved power) a mandatory financial test that was "in the public interest, for the protection of creditors" but not applying a permissive voting test (allowing approval by two-thirds of each class present instead of the two-thirds of each class outstanding required by the general corporation statute at the time of incorporation). *See id.* at 75.

Cook's treatise says the following:

> The right of the legislature to amend a charter against the will of the stockholders has been the subject of much litigation. Such amendments are clearly divisible into two kinds. The first are those which, by their terms, are absolute and compulsory, and become a part of the charter irrespective of the action or willingness of the stockholders to accept them. Such amendments, excepting those which are made as police regulations, are unconstitutional and void, unless made under a reserved power to amend.

2 WILLIAM W. COOK, A TREATISE ON THE LAW OF CORPORATIONS HAVING A CAPITAL STOCK § 497, at 1025 (5th ed. 1903) (footnotes omitted). Cook further states:

> The second class of amendments to a charter—the amendments which occur most frequently and give rise to many difficulties—are those which allow the corporate directors or a majority of the stockholders in corporate meeting assembled to engage in a new or different or more extensive or more contracted business than that authorized by the original and unamended charter.

2 *id.* § 498, at 1028. Cook further states:

Thus, there remained the question of how to deal with enabling legislation that permitted a corporation to take an action not previously authorized or to take an action previously authorized but with a lesser shareholder vote than formerly required. The permission contained in such legislation was clearly available to a corporation organized subsequent to its enactment, because statutory law on the books at the time of incorporation would be considered part of the corporate charter.[951] But, if a previously existing corporation attempted to avail itself of such permissive legislation in effecting a transaction over the objection of a shareholder who would have been able to veto or enjoin such transaction under the law existing at the time of incorporation, would this involve an

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> The extent of the power of the legislature to amend a charter, where it has reserved that power, is not yet fully settled, and is full of difficulties. There is a strong tendency in the decisions, and a tendency which is deserving of the highest commendation, to limit the power of the legislature to amend a charter under this reserved power. It should be restricted to those amendments only in which the state has a public interest. Any attempt to use this power of amendment for the purpose of authorizing a majority of the stockholders to force upon the minority a material change in the enterprise is contrary to law and the spirit of justice.

2 *id.* § 501, at 1032-33.

951. *See supra* note 28 and accompanying text.

In *Peters v. United States Mortgage Co.*, 114 A. 598 (Del. Ch. 1921), injunctive relief was denied to a preferred shareholder who complained of a proposed charter amendment that would eliminate the right of preferred shareholders to participate in dividends paid in excess of specified percentages for the preferred and common stock. *See id.* at 599-600. The rationale was that the statute, which was in effect at the time of incorporation and thereby became a part of the preferred shareholder's contract, provided that the preferences given to a class of preferred stock could be altered upon approval by a class vote of the preferred shareholders whether or not otherwise entitled to vote. *See id.* at 600-01.

In *General Investment Co. v. American Hide & Leather Co.*, 129 A. 244 (N.J. 1925), involving a charter amendment creating a new class of prior preferred stock ranking ahead of then-outstanding cumulative preferred on which there was a substantial dividend arrearage, the court rejected the contention of complaining preferred shareholders that the creation of such a prior preferred violated their vested rights, because (by terms of the statute under which the corporation had been organized) there was included as part of the corporate charter a provision authorizing a corporation to amend its charter so as to create one or more classes of preferred stock. *See id.* at 245-46.

In *Goldman v. Postal Telegraph, Inc.*, 52 F. Supp. 763 (D. Del. 1943), the court held, in a case involving a Delaware corporation, that the liquidation preference of preferred stock could be reduced by a charter amendment made in accordance with pre-incorporation enabling legislation. *See id.* at 764, 767-68.

For other twentieth-century cases to the same general effect, see the following: *Harr v. Pioneer Mechanical Corp.*, 65 F.2d 332, 333, 335 (2d Cir. 1933); *Bernstein v. Kaplan*, 43 So. 581, 582 (Ala. 1907); *Detroit & Canada Tunnel Corp. v. Martin*, 91 N.W.2d 525, 531-33 (Mich. 1958); and *Williams v. National Pump Corp.*, 188 N.E. 756, 757-58 (Ohio Ct. App. 1933).

unconstitutional impairment of the obligation embodied in the charter contract existing between the corporation and its shareholders or the contract existing among the shareholders?[952]

II. APPROACHES TO SOLVING THE PROBLEM

Before coming to the question whether a corporation could avail itself of post-incorporation changes in combination law, it will be useful to examine the various theories that have evolved in other contexts as courts have wrestled with the question whether—notwithstanding the Impairment Clause—enabling statutes could be validly utilized by corporations in existence at the time of their enactment.

A. De Minimis Solution

One such theory, which may be thought of as the de minimis doctrine, held that a corporation could avail itself of post-incorporation enabling legislation if the resulting change in the charter contract would not be fundamental but only auxiliary.[953] In other words, the constitutional problem was solved by the simple rationale that it did not arise when the change was not material.[954]

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952. The fact that it is the corporation acting—in utilization of the legislation—does not avoid the constitutional question. Such action, because it is based on the enabling statute, is treated as action by the legislature. As the court said in *Lord v. Equitable Life Assurance Society*, 87 N.E. 443 (N.Y. 1909):

> We mention, only to overrule, the position that the Legislature did not amend the charter by authorizing the directors to amend it. When the Legislature authorizes a course of procedure whereby a charter may be acquired or amended, action in conformity thereto does not create the charter or make the amendment, but both come into existence through the operation of the statute. The amendment is the act of the Legislature the same as the charter itself, and neither has existence except as conferred by statute.

Id. at 452.

953. In *Woodfork v. Union Bank*, 43 Tenn. (3 Cold.) 488 (1866), the concept was stated as follows:

> [I]f the alterations proposed in the charter of a private corporation, by [post-incorporation] legislative enactment, are merely auxiliary and not fundamental, they may be accepted by a majority of the corporators; and, when so assented to, they are binding on the whole; but it is otherwise ... when the alterations are fundamental, radical, and vital—the acceptance must then be unanimous.

Id. at 500; *accord* Perkins v. Coffin, 79 A. 1070, 1075 (Conn. 1911); Everhart v. West Chester & Philadelphia R.R. Co., 28 Pa. 339, 352-53 (1857); Stevens v. Rutland & Burlington R.R. Co., 29 Vt. 545, 550 (Ch. 1851).

954. In *Herning v. Eason*, 739 P.2d 167 (Alaska 1987), it was held that members of a nonprofit corporation could avail themselves of post-incorporation legislation authorizing proxy voting because "a purely procedural change does not constitute a material alteration of a [charter] contract; thus, the [statutory] amendment permitting proxy voting

Pronouncements by the Supreme Court in the nineteenth century appear to support this theory.[955] And that Court's decision in a 1919 case[956] is best explained on the de minimis theory.[957]

On this ground, state courts—without reliance on any reserved power—have permitted utilization of post-incorporation statutes for a number of limited purposes. Thus, it was held, in each of two early cases, that a subscriber to stock in a railroad corporation was not relieved from the obligation of his subscription by an immaterial change in the route of the railroad.[958] In an 1863 Vermont case, it was held that a corporation could avail itself of post-incorporation legislation authorizing it to issue preferred stock with a guaranteed dividend, because this seemed "nothing more than a mode of raising money."[959] In 1884, it was held by Minnesota's highest court[960] that,

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does not violate the [Constitution's] contracts clause." *Id.* at 168 n.3; *see also* Morseburg v. Balyon, 621 F.2d 972, 979 (9th Cir. 1980) (indicating that a severe impairment having little justification would violate the Impairment Clause, while an insignificant impairment would require minimal justification to withstand constitutional scrutiny).

For a discussion of the rationale for this treatment of "non-fundamental" changes, see E. Merrick Dodd, Jr., *Dissenting Stockholders and Amendments to Corporate Charters* (pt. 1), 75 U. PA. L. REV. 585, 587-91 (1927).

955. *See* Clearwater v. Meredith, 68 U.S. (1 Wall.) 25, 40 (1863) ("[I]t is not every unimportant change which would work a dissolution of the contract.").

In *Pearsall v. Great Northern Railway*, 161 U.S. 646 (1896), the Court said:

> Nor does it follow, from the fact that the contract evidenced by the charter cannot be impaired, that the power of the legislature over such charter is wholly taken away, since statutes which operate only to regulate the manner in which the franchises are to be exercised, and which do not interfere substantially with the enjoyment of the main object of the grant, are not open to the objection of impairing the contract.

Id. at 665.

956. *See* Bank of Oxford v. Love, 250 U.S. 603 (1919). In this case, the banking corporation did not seek to avail itself of post-incorporation legislation; rather, it sought—unsuccessfully—to resist such legislation, which made it subject to examination by a new banking department and to an annual assessment for the maintenance of such department. *See id.* at 605-06.

957. The Court acknowledged that the corporation's charter constituted a contract protected by the Impairment Clause; but, with no reference to any reserved power, it concluded: "And we think it clear that no impairment of the corporate charter has resulted or will result from reasonable examinations and reports by duly authorized officers and the small prescribed payments." *Id.* at 607.

958. *See* Wilson v. Wills Valley R.R. Co., 33 Ga. 466, 469-70 (1863); Banet v. Alton & Sangamon R.R. Co., 13 Ill. 504, 513 (1851) (holding that, if post-incorporation legislation authorized a change of only an intermediate point in the line of a railroad, as distinguished from a change in the terminus of the line, a shareholder would not be relieved from the obligation of his stock subscription).

959. Rutland & Burlington R.R. v. Thrall, 35 Vt. 536, 545-46 (1863); *accord* City of Covington v. Covington & Cincinnati Bridge Co., 73 Ky. (10 Bush) 69, 76-77 (1873).

960. *See* Mower v. Staples, 20 N.W. 225 (Minn. 1884).

notwithstanding the Impairment Clause, the holders of a majority of the voting stock (over the objection of a minority shareholder) could accept and act upon post-incorporation legislation increasing a board's size from five to nine members.[961] In 1923, a New Jersey court held that a corporation could avail itself of post-incorporation legislation authorizing the issuance of no-par stock,[962] because such a change "does not seem ... of such a fundamental character as to make ... applicable"[963] the New Jersey rule that the reserved power (while sustaining post-incorporation changes in the charter contract between the state and the corporation) would not sustain material changes in the contract between the corporation and its shareholders or the contract among the shareholders.[964]

It was clear, however, that the de minimis doctrine could be applied only with respect to post-incorporation legislation authorizing changes that could reasonably be characterized as immaterial rather than fundamental. This doctrine—standing alone—could hardly sustain the application to pre-existing corporations of legislation authorizing the merger of one corporation into another or the sale of all of the assets of a prosperous corporation. Aside from dissolution and liquidation, there is no more tumultuous event in the life of a corporation than to be the one that disappears in a merger or that disposes of its productive property in a sale-of-assets transaction. Thus, the prohibition of the Impairment Clause required some other basis to justify a corporation's availing itself of post-incorporation legislation authorizing changes of such magnitude.

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961. *See id.* at 227. The court said:

> The principle upon which these [cited] cases appear to go is that alterations, or, as they are sometimes called, amendments, which do not change the nature, purpose, or character of a corporation or its enterprise [and are, therefore, not *fundamental*], but which are designed to enable the corporation to conduct its authorized business with greater facility, more beneficially, or more wisely, are *auxiliary* to the original object, and that, therefore, when one becomes a stockholder, he impliedly assents that such alteration or general amendment may be made.

Id. at 226. *But cf.* Johnson v. Tribune-Herald Co., 116 S.E. 810, 811 (Ga. 1923) (holding that a proposed charter amendment, providing that the number of directors could be fixed by the bylaws rather than by the charter, was a fundamental change requiring unanimous consent of the shareholders).

962. *See* Grausman v. Porto Rican-American Tobacco Co., 121 A. 895, 897-98 (N.J. Ch.), *aff'd on other grounds*, 122 A. 815 (N.J. 1923).

963. *Id.* at 897.

964. The court cited *Allen v. Francisco Sugar Co.*, 112 A. 887 (N.J. 1921), as the most recent case invoking the New Jersey rule. *See infra* note 1041 (third paragraph) (discussing *Allen*).

B. *Reserved Power Solution*

Most of the cases, dealing with the matter of whether a corporation—notwithstanding the prohibition of the Constitution's Impairment Clause—could avail itself of post-incorporation enabling legislation, have involved the question of the proper scope and reach of the reserved power adopted by the states in response to the dicta of Justice Story in the *Dartmouth College* case.[965] This has been a difficult subject,[966] and the courts have been far from united in dealing with it.[967] In attempting to bring some degree of clarity to this confused subject, it will be helpful to begin with pronouncements that have been made by the Supreme Court concerning the reserved

965. *See supra* notes 46-48 and accompanying text.

966. The subject is discussed in the following: Arno C. Becht, *Corporate Charter Amendments: Issues of Prior Stock and the Alteration of Dividend Rates*, 50 COLUM. L. REV. 900 (1950); Edward O. Curran, *Minority Stockholders and the Amendment of Corporate Charters*, 32 MICH. L. REV. 743 (1934); E. Merrick Dodd, Jr., *Amendment of Corporate Articles Under the New Ohio General Corporation Act*, 4 U. CIN. L. REV. 129, 150-66 (1930); Dodd, *supra* note 954; Dodd, *supra* note 70; Edward R. Hayes, *Extent of the Legislature's Reserve Power to Change Common Law Attributes of Corporations*, 13 VAND. L. REV. 261, 274-86 (1959); Norman D. Lattin, *A Primer on Fundamental Corporate Changes*, 1 W. RES. L. REV. 3 (1949); Luce, *supra* note 943, at 32-53; Gustavus Ohlinger, *Some Comments on the Reserved Power to Alter, Amend and Repeal Corporate Charters*, 29 MICH. L. REV. 432 (1931); Francis J. Putman, *State Interference, Under the Reservation Clause, with Contracts Between the Stockholders of Corporations*, 7 N.Y.U. L. REV. 487 (1929); William Clark Schmidt, *Constitutional Limitations upon Legislative Power to Alter Incidents of the Shareholder's Status in Private Corporations*, 21 ST. LOUIS L. REV. 12 (1935); Grover C. Bradstreet, Jr., Note, *Corporations: Constitutional Law: The Effect of the Reserved Power to Alter, Amend, or Repeal*, 22 CORNELL L.Q. 257 (1937); J.R. Cades, Note, *Constitutional and Equitable Limitations on the Power of the Majority to Amend Charters so as to Affect Shareholders' Interests in the Corporation*, 77 U. PA. L. REV. 256 (1928); Kenneth W. Fuller, Note, *Corporations: Constitutional Law: Power of State to Permit an Amendment to Articles*, 14 CORNELL L.Q. 85 (1929); Ralph C. Thomas, Note, *Corporations: Alteration of Shareholder's Rights: Scope of the Reserved Power*, 3 OKLA. L. REV. 222 (1950); Comment, *Corporations—Amendment of Corporate Charters—Power of the Legislature to Authorize Changes in Intracorporate Affairs*, 34 MICH. L. REV. 859 (1936); Comment, *Corporations—Charter Amendments—Delaware Dilemma*, 35 MICH. L. REV. 620 (1937); Note, *Limitations on the Reserved Right to Amend or Repeal Corporate Charters*, 7 COLUM. L. REV. 598 (1907); and Note, *Power of the State to Alter Corporate Charters*, 31 COLUM. L. REV. 1163 (1931).

967. *See* Yoakam v. Providence Biltmore Hotel Co., 34 F.2d 533, 546 (D.R.I. 1929) ("No effort will be made to reconcile all of the decided cases dealing with this problem. It cannot be done."); Somerville v. St. Louis Mining & Milling Co., 127 P. 464, 466 (Mont. 1912) ("Few questions have vexed the courts and text-writers more than the one arising over the construction to be given the reservation which the states make respecting corporations organized under their respective laws."); Breslav v. New York & Queens Elec. Light & Power Co., 291 N.Y.S. 932, 936 (App. Div. 1936) ("Whether an amendment to a charter is within or without the scope of the reserved power is difficult to determine. It is impossible to reconcile the decided cases dealing with the problem."), *aff'd per curiam*, 7 N.E.2d 708 (N.Y. 1937).

power. This will be followed by an examination of twentieth-century state court decisions attempting to interpret and apply the reserved powers of the respective states. (In the twentieth century, substantial changes were made in New Jersey's reserved power[968] and also in that of North Carolina,[969] but only minor changes were made in

968. The reserved power provisions contained in New Jersey's 1896 corporation statute are quoted *supra* in note 49 (fifth paragraph).

Those provisions were codified in 1937, *see supra* note 250 (first paragraph), as follows:

> 14:2-8. This title and all its amendments shall be a part of the charter of every corporation heretofore or hereafter formed hereunder, except so far as the same are inapplicable and inappropriate to the objects of the corporation.
>
> 14:2-9. This title may be amended or repealed at the pleasure of the legislature and every corporation created hereunder shall be bound by such amendment or repeal. Such amendments or repeal shall not take away or impair any remedy against a corporation or its officers for any liability which shall have been previously incurred.
>
> The charter of every corporation or any supplement thereto or amendment thereof shall be subject to alteration, suspension and repeal, in the discretion of the legislature, and the legislature may at pleasure dissolve any corporation.

Former N.J. STAT. ANN. §§ 14:2-8, 14:2-9 (West 1939).

When the New Jersey corporation statute was rewritten in 1968 (effective January 1, 1969), *see supra* note 250 (second paragraph), the reserved power was stated as follows:

> This act may be supplemented, altered, amended or repealed by the Legislature, and every corporation, domestic or foreign, to which this act applies shall be bound thereby.

N.J. STAT. ANN. § 14A:1-5 (West 1969).

969. The reserved power provisions contained in North Carolina's 1901 corporation statute are quoted *supra* in note 52 (second paragraph).

When the North Carolina statutes were codified in 1919, *see supra* note 252 (first paragraph), what had been section 6 of the 1901 corporation statute did not appear, and what had been section 7 of that statute was revised to read as follows:

> This chapter may be amended or repealed by the legislature, and every corporation is bound thereby; but such amendment or repeal shall not take away or impair any remedy against the corporation, or its officers, for any liability which has been previously incurred. This chapter and all amendments are a part of the charter of every corporation formed hereunder, so far as the same are applicable and appropriate to the objects of the corporation.

Former CONSOL. STAT. OF N.C. ANN. § 1135 (1919).

This provision was carried forward (verbatim) when the North Carolina statutes were re-codified as the North Carolina General Statutes in 1943, *see* former N.C. GEN. STAT. § 55-36 (1943), and continued in that form through 1956, *see* former N.C. GEN. STAT. § 55-36 (1950).

When North Carolina adopted its 1955 Business Corporation Act (effective July 1, 1957), *see supra* note 252 (second paragraph), the reserved power was stated therein as follows:

> The General Assembly reserves the power to amend or repeal the charter of any corporation hereafter or heretofore formed and to amend or repeal this Chapter or any part thereof, and the rights of any corporation or of any shareholder, director or officer in any corporation are subject to this reservation.

Delaware's reserved power.[970])

> This Chapter, including this reservation, is a part of the charter contract between the shareholders. The power so reserved includes the power to authorize charter amendments which are to be effectuated pursuant to consent by the shareholders in the manner permitted by this Chapter, as now enacted or as subsequently amended.

Former N.C. GEN. STAT. § 55-174 (1982). Additionally, the 1955 Act provided as follows:

> Any amendment of the charter made pursuant to this Chapter extends to all rights theretofore existing under the charter as fully as if this Chapter, including such future changes therein as may be made, had been in effect at the time of the filing of the original articles of incorporation.

Id. § 55-99(c).

Since the rewriting of North Carolina's Business Corporation Act in 1989 (effective July 1, 1990), *see supra* note 252 (third paragraph), its reserved power—following the language of section 1.02 of the 1984 Model Business Corporation Act—has been stated as follows:

> The General Assembly has power to amend or repeal all or part of this Chapter at any time and all domestic and foreign corporations subject to this Chapter are governed by the amendment or repeal.

N.C. GEN. STAT. § 55-1-02 (1990). Additionally, the new Act—following the language of section 10.01(b) of the 1984 Model Business Corporation Act—provides as follows:

> A shareholder of the corporation does not have a vested property right resulting from any provision in the articles of incorporation, including provisions relating to management, control, capital structure, dividend entitlement, or purpose or duration of the corporation.

Id. § 55-10-01(b).

970. The reserved power provision contained in Delaware's 1899 corporation statute is quoted *supra* in note 53 (second paragraph).

With minor changes, this provision became section 394 of the 1967 rewrite of Delaware's General Corporation Law, *see supra* note 251 (second paragraph), and it now provides as follows:

> This chapter may be amended or repealed, at the pleasure of the General Assembly, but any amendment or repeal shall not take away or impair any remedy under this chapter against any corporation or its officers for any liability which shall have been previously incurred. This chapter and all amendments thereof shall be a part of the charter or certificate of incorporation of every corporation except so far as the same are inapplicable and inappropriate to the objects of the corporation.

DEL. CODE ANN. tit. 8, § 394 (1991).

In *Davis v. Louisville Gas & Electric Co.*, 142 A. 654 (Del. Ch. 1928), the court said:

> It is to be noted that the language by which the power to amend was reserved by the Legislatures in Utah, New York and Montana is quite different from that found in our [reserved power]. In those states, the power to amend was simply reserved and there allowed to rest.... But here in Delaware the Legislature did not content itself with a bare expression of the reservation of power to amend. It proceeded further to say that the chapter as it was originally enacted "and all amendments thereof" should be a part of the charter of every corporation created under it. Thus all future amendments to the act were written by that language into the defendant's charter as effectively as was the original act.

Id. at 658. *But see* Yoakam v. Providence Biltmore Hotel Co., 34 F.2d 533 (D.R.I. 1929) (refusing to accept the Delaware court's broad reading of that state's reserved power);

1. Supreme Court's View of Reserved Power

The Supreme Court has addressed the reserved power on numerous occasions over the years, and the pronouncements by that Court have made it clear that the power of a state's legislature under a reserved power is not unlimited.[971]

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infra notes 1033-37 and accompanying text, and notes 1304-05 and accompanying text (discussing and quoting *Yoakam*).

971. In *Tomlinson v. Jessup*, 82 U.S. (15 Wall.) 454 (1872), the Court said:

> The reservation [of power to alter or repeal corporate charters] affects the entire relation between the State and the corporation, and places under legislative control all rights, privileges, and immunities derived by its charter directly from the State. Rights acquired by third parties, and which have become vested under the charter, in the legitimate exercise of its powers, stand upon a different footing....

Id. at 459.

In *Holyoke Co. v. Lyman*, 82 U.S. (15 Wall.) 500 (1872), the Court said:

> Vested rights, it is conceded, cannot be destroyed or impaired under such a reserved power, but it is clear that the power may be exercised, and to almost any extent, to carry into effect the original purposes of the grant and to protect the rights of the public and of the corporators, or to promote the due administration of the affairs of the corporation.
>
> ....
>
> ...Power to legislate, founded upon such a reservation, is certainly not without limit, but it may safely be affirmed that it reserves to the legislature the authority to make any alteration or amendment in a charter granted, subject to it, that will not defeat or substantially impair the object of the grant, or any rights which have vested under it, which the legislature may deem necessary to secure either the object of the grant or any other public right not expressly granted away by the charter.

Id. at 519, 522.

In *Railway Co. v. Philadelphia*, 101 U.S. 528 (1879), the Court said: "Vested rights, it is conceded, cannot be impaired under such a reserved power...." *Id.* at 540.

In *Looker v. Maynard*, 179 U.S. 46 (1900), the Court said:

> The effect of such a [reserved power] provision, whether contained in an original act of incorporation, or in a constitution or general law subject to which a charter is accepted, is, at the least, to reserve to the legislature the power to make any alteration or amendment of a charter subject to it, which will not defeat or substantially impair the object of the grant, or any right vested under the grant, and which the legislature may deem necessary to carry into effect the purpose of the grant, or to protect the rights of the public or of the corporation, its stockholders or creditors, or to promote the due administration of its affairs.

Id. at 52.

In *Fair Haven & Westville Railroad v. New Haven*, 203 U.S. 379 (1906), the Court said:

> The limitation upon the power of amendment of charters of corporations has been defined by this court several times. It is said in one case that such power may be exercised to make any alteration or amendment in a charter granted that will not defeat or substantially impair the object of the grant or any rights which have vested under it, which the legislature may deem necessary to secure either the object of the grant or any other public right not expressly granted away by

One of the limitations voiced by the Supreme Court is that the reserved power is inadequate to remove from the prohibition of the Impairment Clause any state legislation that impairs a pre-existing contract between a corporation and third parties.[972] It is now well established that a corporate charter, in addition to being a contract between the state and a corporation created under its laws, is also a contract between the corporation and its shareholders as well as a contract among those shareholders.[973] Thus, it follows that shareholders—if regarded as third parties—enjoy contractual rights, derived from the terms of the corporate charter, that merit protection from impairment pursuant to permissive post-incorporation

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the charter.

Id. at 388.

In *Berea College v. Kentucky*, 211 U.S. 45 (1908), the Court said:

> It is undoubtedly true that the reserved power to alter or amend is subject to some limitations, and that under the guise of an amendment a new contract may not always be enforcible upon the corporation or the stockholders; but it is settled "that a power reserved to the legislature to alter, amend or repeal a charter authorizes it to make any alteration or amendment of a charter granted subject to it, which will not defeat or substantially impair the object of the grant, or any rights vested under it, and which the legislature may deem necessary to secure either that object or any public right."

Id. at 57 (quoting Close v. Glenwood Cemetery, 107 U.S. 466, 476 (1882)).

In *Coombes v. Getz*, 285 U.S. 434 (1932), the Court said:

> The authority of a state under the so-called reserved power is wide; but it is not unlimited. The corporate charter may be repealed or amended, and, within limits not now necessary to define, the interrelations of state, corporation, and stockholders may be changed; but neither vested property rights nor the obligation of contracts of third persons may be destroyed or impaired.

Id. at 441-42.

In *Phillips Petroleum Co. v. Jenkins*, 297 U.S. 629 (1936), the Court said:

> The reserved power is not unlimited and cannot be exerted to defeat the purpose for which the corporate powers were granted, or to take property without compensation, or arbitrarily to make alterations that are inconsistent with the scope and object of the charter or to destroy or impair any vested property right.

Id. at 634-35.

972. *See Tomlinson*, 82 U.S. (15 Wall.) at 459 (quoted *supra* in note 971 (first paragraph)); *Coombes*, 285 U.S. at 441-42 (quoted *supra* in note 971 (seventh paragraph)).

This limitation has been echoed in state court decisions. *See* Miller v. Magline, Inc., 306 N.W.2d 533, 536 (Mich. Ct. App. 1981) ("Nonetheless, a state may not under its reserved power impair or destroy vested property rights or impair the contractual obligations of third parties."); Mayor of New York v. Twenty-Third St. Ry. Co., 21 N.E. 60, 62 (N.Y. 1889) ("Under its reserved power [the legislature] cannot deprive a corporation of its property, or interfere with or annul its contracts with third persons . . . .").

973. *See supra* notes 36-38 and accompanying text.

legislation.[974]

Another limitation—and one more frequently and forcefully voiced by the Supreme Court—is that the reserved power is not adequate to sustain state legislation that destroys vested rights.[975] The vested right doctrine is not only deeply entrenched in Supreme Court jurisprudence[976] but also frequently echoed in state court decisions.[977] Thus, if the rights of shareholders, derived from the terms of their charter contract, be regarded as vested rights, it would follow that the reserved power could not be invoked to sustain an abrogation of those rights by action taken pursuant to permissive post-incorporation legislation.[978]

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974. *See* Swan v. Barnes, 184 S.E. 257, 259 (W. Va. 1936) ("It requires no citation of authority to sustain the proposition that the rights and relationships arising upon the purchase of stock in a corporation are contractual, and that no state law can materially alter the rights arising under such a contract.").

975. *See* cases cited and quoted *supra* in note 971.

976. *See id.* In the dissenting opinion of Justice Field in *Sinking Fund Cases*, 99 U.S. 700 (1878), involving reserved powers contained in congressional legislation applicable to a federally chartered corporation, it was said: "There have been much discussion and great difference of opinion on many points as to the meaning and effect of a similar reservation in statutes of the States, but on the point that it does not authorize any interference with vested rights all the authorities concur." *Id.* at 758 (Field, J., dissenting).

977. *See* New Haven & Derby R.R. Co. v. Chapman, 38 Conn. 56, 70 (1871) ("The power thus reserved is in terms absolute; yet it is not an unlimited power. Like all other legislative powers it is subject to this important limitation, viz: it shall not be so exercised as to impair the obligation of a contract, or to destroy vested rights."); Hartford Accident & Indem. Co. v. W.S. Dickey Clay Mfg. Co., 24 A.2d 315, 322 (Del. 1942) ("The [reserved] power of amendment, as it affects the rights of shareholders, is broad, but it has limitations. As to what those limitations are judicial authority is unsettled. Certainly vested property rights may not be destroyed or impaired."); Venner v. Chicago City Ry. Co., 92 N.E. 643, 646 (Ill. 1910) ("Even where the power of the state to alter or amend a charter is expressly reserved in the grant, it is still subject to the limitation that it shall not be exercised in such a way as to destroy vested rights or impair the obligations of contracts."); Banner Transfer Co. v. Ockerman, 354 S.W.2d 514, 515-16 (Ky. 1961) ("This reserved power, however, is not without limits. It will not be exercised to destroy or substantially impair rights vested under the State's grant."); Commonwealth v. Essex Co., 79 Mass. (13 Gray) 239, 253 (1859) ("[T]he rule to be extracted is this; that where, under power in a charter, rights have been acquired and become vested, no amendment or alteration of the charter [pursuant to a reserved power] can take away the property or rights which have become vested under a legitimate exercise of the powers granted."); State *ex rel.* Northern Pac. Ry. Co. v. Railroad Comm'n, 121 N.W. 919, 923 (Wis. 1909) ("The right to alter or repeal existing charters is not without limitation when the question of vested property rights under the charter is involved. The power is one of regulation and control, and does not authorize interference with property rights vested under the power granted.").

978. *See* Keller v. Wilson & Co., 190 A. 115, 124-25 (Del. 1936); *infra* text accompanying notes 1014-18 (discussing *Keller*).

2. State Courts' Divergent Views

There has continued to be in the twentieth century, as there was in the nineteenth century,[979] a split among the state courts as to whether an expansive or a restrictive reading should be given to the reserved power.[980]

a. Expansive Reading of Reserved Power

(1) Twentieth-Century Decisions

The courts of some states adopted the expansive reading that a corporation could avail itself of permissive post-incorporation legislation, thereby altering rights of shareholders embodied in the charter contract, provided only that a reserved power existed at the time of the corporation's organization.

As had been the case in the nineteenth century,[981] this view of the matter continued to be taken by the courts of Massachusetts,[982] as

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979. *See supra* text accompanying notes 70-95.

980. The two schools of thought were described in *Bove v. Community Hotel Corp.*, 249 A.2d 89 (R.I. 1969), as follows:

> On the one side, there is a body of law which speaks of the three-fold nature of the stockholder's contract and, while agreeable to an exercise of the reserved power affecting only the contractual relationship between the state and the corporation, rejects as unconstitutional any exercise which affects the relationship between the stockholder and the corporation or between the stockholders inter sese. Under this view, subsequent legislation purporting to permit a corporate act to cancel accrued preferred dividends would obviously be an improper exercise of the power inasmuch as the essence of a preferred stockholder's contract is its definition of his relationship with the corporation and with the other stockholders vis-à-vis such matters as the distribution of the profits of the enterprise or the division of its capital and surplus account in the event of liquidation.
>
> The other side of the argument considers that the question is primarily one of statutory construction and that so long as the statute authorizes the corporate action, it should make no difference whether its enactment preceded or postdated the birth of the corporation or the issuance of its stock. The basis for this viewpoint is that the terms of the preferred stockholder's contractual relationship are not restricted to the specifics inscribed on the stock certificate, but include also the stipulations contained in the charter or articles of association as well as the pertinent provisions of the general corporation law. One of those provisions is, of course, the reserved power; and so long as it is a part of the preferred shareholder's contract, any subsequent legislation enacted pursuant to it, even though it may amend the contract's original terms, will not impair its obligation in the constitutional sense.

Id. at 96 (citations omitted).

981. *See supra* notes 73-81 and accompanying text.

982. *See* Delaware & Hudson Co. v. Boston R.R. Holding Co., 81 N.E.2d 553, 556 (Mass. 1948).

well as by those of New York,[983] by those of Rhode Island,[984] and by those of California[985] in the twentieth century.[986] The courts of other states also adopted the expansive reading of the reserved power in

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983. *See* Hinckley v. Schwarzschild & Sulzberger Co., 95 N.Y.S. 357 (App. Div. 1905); *infra* text accompanying notes 1240-44 (discussing *Hinckley*).

In *McNulty v. W. & J. Sloane*, 54 N.Y.S.2d 253 (Sup. Ct. 1945), the court said:

> Our courts have held generally that the "reserved power" extends not only to the contract between the corporation and the state but to the contract between the corporation and the stockholders or between the stockholders inter sese.
>
> ....
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> The contract between stockholders inter sese is not an unconditional contract. It is a contract subject to a condition that it may be changed or altered in the manner prescribed or authorized by the Legislature.

Id. at 258-260.

In *Garzo v. Maid of the Mist Steamboat Co.*, 104 N.E.2d 882 (N.Y. 1952), a corporation had been organized in 1892 for a term of 50 years; and, upon realizing in 1947 that its term had expired, it took steps to revive its existence and to make its duration perpetual under a statute enacted in 1944 authorizing such revival and extension of corporate existence upon approval by a majority vote of shareholders. *See id.* at 884-85. Claiming that application of the post-incorporation enabling statute to the defendant corporation would effect an unconstitutional deprivation of their vested rights, minority shareholders brought suit seeking a dissolution of the corporation and payment to them of their pro rata share of its assets. *See id.* at 884, 886. The court ruled against the plaintiffs, holding that the reserved power sustained the corporation's utilization of the post-incorporation enabling statute even though that statute provided no right of appraisal for dissenters. *See id.* at 886-88.

New York's expansive reading of the reserved power was applied in *M'Kee v. Chautauqua Assembly*, 130 F. 536 (2d Cir. 1904), in which the court said:

> Every member who enters into such an association is aware of the reservation of the power of the Legislature and of the possibility of its exercise, and must trust to the wisdom and justice of the Legislature that the power will not be abused; and those who become members contract subject to the reservation of power, and the courts are bound to read their agreement with the legislative condition.

Id. at 541 (citing Schenectady & Saratoga Plank Road Co. v. Thatcher, 11 N.Y. 102, 114 (1854)); *see supra* note 77 (discussing *Thatcher*).

984. *See* Bove v. Community Hotel Corp., 249 A.2d 89, 94-98 (R.I. 1969); *infra* text accompanying notes 1173-75 (discussing *Bove*).

985. *See* Tu-Vu Drive-In Corp. v. Ashkins, 391 P.2d 828, 831 (Cal. 1964) ("[Because of the reserved power, the shareholder] acquires his shares subject to the power of the corporation to alter its contract with him pursuant to statutory authority."); Rainey v. Michel, 57 P.2d 932, 942 (Cal. 1936) ("The contract between the stockholder and the corporation is subject to the exercise of this reserved power."); De Mello v. Dairyman's Co-operative Creamery, 167 P.2d 226, 228 (Cal. Dist. Ct. App. 1946) ("The right of the Legislature under the constitutional reservation of power to amend the corporate laws and thus change the rights and liabilities of stockholders is well established."); Heller Inv. Co. v. Southern Title & Trust Co., 61 P.2d 807, 809 (Cal. Dist. Ct. App. 1936) (quoting and following *Rainey*, 57 P.2d at 942).

986. Missouri's highest court had espoused the expansive reading in 1853. *See* Pacific R.R. v. Renshaw, 18 Mo. 210, 215 (1853); *supra* note 78 (discussing *Renshaw*). For Missouri's twentieth-century view, see *supra* note 945 (fifth paragraph).

the twentieth century. Montana's highest court did so in 1904[987] and in 1912.[988] The highest court of West Virginia took this view in 1906[989] and, notwithstanding an apparent embracing of the restrictive reading in 1937,[990] seems to have returned to the expansive reading in 1961.[991] Virginia's highest court embraced the expansive reading in 1912,[992] in 1953,[993] and in 1967.[994] The highest court of Iowa appears

987. *See* Allen v. Ajax Mining Co., 77 P. 47, 48-49 (Mont. 1904); *infra* text accompanying notes 1193-95 (discussing *Allen*).

988. In *Somerville v. St. Louis Mining & Milling Co.*, 127 P. 464 (Mont. 1912), it was held that, because the reserved power became part of the charter of a subsequently organized corporation and thereby made the shareholders' contract with the corporation subject to change pursuant to subsequent enabling legislation, a corporation could avail itself of a post-incorporation statute to make its stock assessable when authorized by the two-thirds consent of shareholders specified in the enabling legislation, notwithstanding the fact that the charter and the stock certificates stated that the stock was nonassessable. *See id.* at 465-66 (citing and following *Allen v. Ajax Mining Co.*, 77 P. 47 (Mont. 1904)). *But see* Enterprise Ditch Co. v. Moffitt, 79 N.W. 560, 561 (Neb. 1899) (holding that paid-up shares could not be subjected to assessment pursuant to post-incorporation legislation).

989. *See* Germer v. Triple-State Natural Gas & Oil Co., 54 S.E. 509, 513 (W. Va. 1906); *infra* text accompanying notes 1196-97 (discussing *Germer*).

990. In *Marshall County Bank v. Wheeling Dollar Savings & Trust Co.*, 193 S.E. 915 (W. Va. 1937), the court said:

> We are cognizant that since 1863 our Legislature has reserved the power to amend the corporate contracts of stockholders. However, that power may be exerted only to promote the corporation in the interest of the public, and even then the rights of minority stockholders must be fairly preserved. The power is remedial, not oppressive. It may not be exercised, directly or indirectly, to increase materially the liability of an unwilling stockholder. That power "should be restricted to those amendments only in which the state has a public interest. Any attempt to use this power of amendment for the purpose of authorizing a majority of the stockholders to force upon the minority a material change in the enterprise is contrary to law and the spirit of justice.... [T]he power to make a new contract for the stockholders is not thereby given to the legislature. The legislature may repeal the charter, but cannot force any stockholder into a contract against his will."

Id. at 918 (citation omitted) (quoting 2 WILLIAM W. COOK, A TREATISE ON THE LAW OF CORPORATIONS HAVING A CAPITAL STOCK § 501, at 1661-62 (8th ed. 1923)).

991. *See* Diamond v. Parkersburg-Aetna Corp., 122 S.E.2d 436, 445-46 (W. Va. 1961) (quoting at length from *Germer v. Triple-State Natural Gas & Oil Co.*, 54 S.E. 509 (W. Va. 1906)).

992. In *Winfree v. Riverside Cotton Mills Co.*, 75 S.E. 309 (Va. 1912), the court said:

> It seems that such a reservation of power to the state prescribed by the laws in force when the charter is granted, whether written in the Constitution, in general laws, or in the charter itself, qualifies the grant, and that the subsequent exercise of that power cannot be regarded as an act impairing the obligation of contracts.
>
> ....
>
> ... The [constitutional] provision that the charter shall be held ... under the provisions and subject to all the requirements, terms, and conditions of the Constitution and of any laws passed in pursuance thereof, so far as applicable, is

to have followed the expansive reading in 1929,[995] and Minnesota's highest court did so (in a confused way) in 1950.[996] The Delaware courts have not been entirely consistent, but they have generally embraced the expansive reading of the reserved power.[997] In 1974,

> not limited to the relations between the state and the corporation, but applies as well to the relations between the state and the stockholders, the corporation and the stockholders, and between the stockholders themselves.
>
> That this is the construction which should be placed upon the language used is shown by the construction which has generally, if not universally, been placed upon the language reserving the power to the state to amend, alter, or repeal a charter. Although the power reserved is to alter, amend, or repeal the charter, it is not limited to changes or alterations solely between the state and the corporation, but authorizes amendments and alterations within certain limitations directly affecting the stockholders in their relations to the state, to the corporation, and to each other.

Id. at 310-11.

993. *See* French v. Cumberland Bank & Trust Co., 74 S.E.2d 265, 269 (Va. 1953); *infra* text accompanying notes 1245-47 (discussing *French*).

994. *See* O'Brien v. Socony Mobil Oil Co., 152 S.E.2d 278, 286-87 (Va. 1967).

995. In *Wall v. Bankers' Life Co.*, 223 N.W. 257 (Iowa 1929), it was held that, because of a reserved power, the corporation could avail itself of post-incorporation enabling legislation to convert itself into a different kind of insurance company. *See id.* at 263-64. (No shareholder rights were involved; the complainants were certificate holders under the original form of insurance handled by the company. *See id.* at 259-60.)

996. *Sherman v. Pepin Pickling Co.*, 41 N.W.2d 571 (Minn. 1950), represents a misunderstanding of what the reserved power question is all about. The court treated statutes (authorizing changes in preferred stock by way of charter amendments), which were "in effect when the defendant was incorporated," as a power reserved *to corporations* to alter rights of preferred shareholders. *See id.* at 576-79. It was in this context that the court (after referring to Justice Story's suggestion in the *Dartmouth College* case) said the following:

> Where a statute authorizes the formation of a corporation upon compliance with its provisions and the statute contains provisions reserving the right to alter by amendment the rights of stockholders, the statute becomes part of the articles of incorporation (the corporate charter) and of any stock issued thereunder as effectively as if printed therein at length, and it operates not only to confer upon the corporation reserved power to alter by amendment the rights of stockholders, but also to notify them of such reserved power. In other words, where the right to so amend is reserved, the contract between the corporation and its stockholders and among the stockholders themselves, arising from their stock ownership, is not an unconditional one, but is rather one subject to the condition that it may be changed or altered in the manner authorized by the statute.

Id. at 576.

997. In *Davis v. Louisville Gas & Electric Co.*, 142 A. 654 (Del. Ch. 1928), holders of Class B stock sought to enjoin the filing of a charter amendment, authorized by post-incorporation legislation enacted under a reserved power, whereby Class A stock would be made non-redeemable and Class B stock would lose a preferential right to dividends in excess of a stated amount for each class. *See id.* at 655. The complainants argued for adoption of the restrictive reading of the reserved power, but the court adopted the expansive reading—in part because the Delaware reserved power, in addition to

reserving to the legislature the power to amend or repeal the statute, provided that the statute and all amendments thereof shall be a part of every corporation's charter. *See id.* at 656-58; *supra* note 970 (third paragraph) (quoting *Davis*). The court noted, as an alternative ground for its denial of injunctive relief, the fact that the corporate charter reserved to the corporation the right to amend the charter "in the manner now or hereafter prescribed by statute." *Davis*, 142 A. at 658-59.

In *Gow v. Consolidated Coppermines Corp.*, 165 A. 136 (Del. Ch. 1933), the court cited *Davis* (above) in applying to a corporation post-incorporation legislation providing that the number of directors "shall be fixed by, or in the manner provided in the by-laws." *Id.* at 139. However, based on the court's conclusion that this statutory provision was mandatory rather than permissive, *see id.* at 139-41, *Gow* would appear to fall within the class of cases dealing with the imposition of new conditions by the legislature, *see supra* notes 947-48 (citing cases holding that state legislatures could impose new conditions upon corporations or upon shareholders pursuant to a pre-incorporation reserved power).

In *Keller v. Wilson & Co.*, 190 A. 115 (Del. 1936), it was held that the right to be paid dividend arrearages on preferred stock—being a vested right—could not be abrogated by a charter amendment effecting a recapitalization pursuant to post-incorporation legislation enacted under a reserved power. *See id.* at 124-25; *infra* text accompanying notes 1014-18 (discussing *Keller*).

In *Hartford Accident & Indemnity Co. v. W.S. Dickey Clay Manufacturing Co.*, 24 A.2d 315 (Del. 1942), the court said:

> [T]here is impliedly written into every corporate charter as a constituent part thereof the pertinent provisions of the State Constitution and statutes. Specifically, Section 83 of the Corporation Law declares that all amendments to the law shall be a part of the charter of every corporation formed under it except in so far as they are inapplicable or inappropriate to the objects of such corporation. Regarding the charter as a contract, it has such status as between the State and the corporation, as between the corporation and its shareholders, and, in some respects, as between the shareholders among themselves. The contract rights of the shareholders, in the sense of interrelations inter sese, do not rest upon an unchangeable base, but are subject to alteration under the amendatory provisions of the General Law. The power of amendment, as it affects the rights of shareholders, is broad, but it has limitations. As to what those limitations are judicial authority is unsettled. Certainly vested property rights may not be destroyed or impaired. Keller v. Wilson & Co. But every decision in this State has upheld the general right of the corporation to affect the position of an existing class of stock by the creation of a class or classes having preferred rights or superior positions....
>
> ... The power to amend and the method of exercising the power are parts of the contract. Section 10 of Article 1 of the Federal Constitution does not apply. Phillips Petroleum Co. v. Jenkins.

Id. at 321-22 (citations omitted).

In *Weinberg v. Baltimore Brick Co.*, 108 A.2d 81 (Del. Ch. 1954), *aff'd*, 114 A.2d 812 (Del. 1955), the court, citing *Davis* and *Gow* (above), held that a corporation could avail itself of post-incorporation legislation authorizing the payment of "nimble dividends" and, on that basis, denied injunctive relief to a holder of common stock seeking to prevent payment of dividends on preferred stock. *See id.* at 83-84.

In *Coyne v. Park & Tilford Distillers Corp.*, 154 A.2d 893 (Del. 1959), it was held that a parent corporation could avail itself of Delaware's 1957 short-form merger statute and thereby cash out the minority interest in a 96%-owned subsidiary that was in existence prior to enactment of the 1957 statute. *See id.* at 894, 897-98; *infra* text accompanying notes 1256-63 (discussing *Coyne*).

North Carolina's highest court adopted the expansive reading of the reserved power.[998] A result consistent with the expansive reading was reached by Indiana's highest court in 1993.[999]

(2) Vested Right Override

When a state's highest court adopted the expansive reading of the reserved power, this appeared to provide a basis for corporations of that state to avail themselves of any and all post-incorporation enabling statutes. Nevertheless, in a subsequent case, a court of that state might still conclude that a particular shareholder right was "vested" and therefore protected from change pursuant to permissive post-incorporation legislation. Moreover, if a shareholder contended that his contractual rights had been unconstitutionally impaired

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In *Rothschild International Corp. v. Liggett Group, Inc.*, 474 A.2d 133 (Del. 1984), the court upheld a cash-out merger, saying the following:

> [A]s a matter of law, stock issued or purchased prior to the Legislature's authorization of cash mergers does not entitle the stockholder to any vested right of immunity from the operation of the cash merger provision. Further, it is settled that the State has the reserved power to enact laws having the effect of amending certificates of incorporation and any rights arising thereunder.

Id. at 137 (citing *Coyne*, 154 A.2d at 897).

998. In *Adair v. Orrell's Mutual Burial Ass'n*, 284 N.C. 534, 201 S.E.2d 905 (1974), the court said:

> When a Legislature reserves the right to amend or repeal a *Charter*, it retains the power to change the contract between the corporation and the State and the contracts between the corporation and its stockholders so that a later repeal or amendment of the Charter does not result in an unconstitutional impairment of the contract.

Id. at 538, 201 S.E.2d at 908.

In *Webb v. Morehead*, 251 N.C. 394, 111 S.E.2d 586 (1959), the court, while not employing an expansive reading of the reserved power, held that a post-incorporation statute (enacted in 1901) could be applied to invalidate a pre-existing quorum bylaw that was valid at the time of its adoption (prior to 1900). *See id.* at 395-99, 111 S.E.2d at 587-90. The court reached this result notwithstanding earlier decisions by the same court to the effect that rights could not be altered by a retroactive application of statutes that came into effect after such rights had vested. *See* Lester Bros. v. Pope Realty & Ins. Co., 250 N.C. 565, 568, 109 S.E.2d 263, 266 (1959); Bank of Pinehurst v. Derby, 218 N.C. 653, 657-58, 12 S.E.2d 260, 263 (1940).

999. In *FGS Enterprises, Inc. v. Shimala*, 625 N.E.2d 1226 (Ind. 1993), the court did not discuss the question whether a reserved power should be given the expansive or the restrictive reading but, instead, focused most of its attention on the question whether a reserved power—enacted in 1949, inadvertently repealed in 1978, and purportedly reinstated in 1986 retroactive to 1978—should be deemed to have been in effect in 1983 when the corporation was organized. *See id.* at 1228-29. Concluding that it should be, the court held that the corporation could avail itself of post-incorporation legislation (enacted in 1987) authorizing reverse stock splits and payment of cash for fractional shares, whereby minority shareholders were cashed out through a 1-for-242 reverse stock split. *See id.* at 1227, 1229.

through the utilization of post-incorporation legislation, a state court decision applying an expansive reading of the reserved power would not be binding on the federal courts. An explication of each of these points follows.

(a) State Decisions

Because there is some confusion about the vested right doctrine, it is important that attention be focused on the precise matter to be examined. Thus, attention should not be diverted by recognition of the fact that the vested right doctrine did not preclude changes with respect to a corporation or its shareholders pursuant to *compulsory* post-incorporation legislation enacted under a reserved power.[1000] The focus here is on *permissive* legislation; and the question is whether, in a state where an expansive reading of the reserved power had been adopted previously, a court could nevertheless apply the vested right doctrine to preclude a change in shareholder rights pursuant to permissive post-incorporation legislation.

Two cases in New York, where an expansive reading of the reserved power had been adopted,[1001] provide an affirmative answer to this question. In *Lord v. Equitable Life Assurance Society*,[1002] the court considered the voting right of a shareholder to be a vested right of property and, on that basis, clearly indicated that it would

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1000. In *Sherman v. Smith*, 66 U.S. (1 Black) 587 (1861), it was held that, because of the reserved power, it was proper to give effect to post-incorporation legislation that imposed on shareholders liability for subsequent debts of banking corporations (to the extent of the par value of their shares) even though the general statute under which the corporation had been organized expressly provided that shareholders would not be subject to such liability. *See id.* at 590-91, 593-94; *supra* text accompanying note 67 (discussing *Sherman*).

In *Miller v. State*, 82 U.S. (15 Wall.) 478 (1872), when a city had been authorized by statute to subscribe for $300,000 of a railroad corporation's $800,000 authorized capital and to name four of its thirteen directors, and thereafter (when only $255,200 had been paid in beyond the $300,000 paid in by the city) another statute was enacted authorizing the city to name seven of the thirteen directors, effect was given to the latter statute as a valid exercise of the state's reserved power notwithstanding the contention that the right to name all but four of the directors had become vested in shareholders other than the city. *See id.* at 489-91, 498-99.

In *Looker v. Maynard*, 179 U.S. 46 (1900), it was held that, when a power of amendment or repeal was reserved in the state constitution of 1850 and a corporation was organized in 1870 (under a general law enacted in 1869) with a charter providing for straight voting, it was proper to give effect to an 1885 statute mandating that shareholders of any corporation (organized under a general law of the state) be given the right to vote cumulatively in the election of directors. *See id.* at 51, 54; *supra* text accompanying notes 68-69 (discussing *Looker*).

1001. *See supra* notes 75-77 and accompanying text, and note 983 (first paragraph) and accompanying text.

1002. 87 N.E. 443 (N.Y. 1909).

invalidate the utilization of post-incorporation legislation to limit the right of shareholders to vote for all of the directors while giving them undiluted power to elect a specified portion of the total.[1003] A more telling New York case is that of *Breslav v. New York & Queens Electric Light & Power Co.*,[1004] in which it was held that the reserved power did not sustain the utilization of post-incorporation legislation to amend a corporation's charter so as to make non-callable preferred stock subject to redemption, because the non-redeemable feature of that stock constituted a vested right of the preferred shareholders.[1005]

Michigan provides another such example. In *Attorney General v. Looker*,[1006] decided in 1897, that state's highest court had held that an 1885 statute mandating cumulative voting was binding on an 1870 corporation whose charter provided for straight voting.[1007] The court based its decision on an expansive reading of the reserved power

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1003. *See id.* at 448-53; *cf. In re* Mt. Sinai Hosp., 164 N.E. 871, 874-76 (N.Y. 1928) (acknowledging that if the right to vote for trustees was a property right, the legislature might not have the power to take away that right, but concluding that a legislative act amending the charter of a charitable corporation to require that trustees be elected by other trustees whose terms had not expired, rather than by members of the organization, was within the legislature's reserved power).

1004. 291 N.Y.S. 932 (App. Div. 1936), *aff'd per curiam*, 7 N.E.2d 708 (N.Y. 1937). This case is discussed in Note, *Alteration of Redemption Features of Preferred Stock by Charter Amendment*, 46 YALE L.J. 1055 (1937).

1005. The court said:

> What is the nature and character of plaintiff's interest as the present holder of noncallable preferred stock? Is it a vested interest which may not be divested without plaintiff's assent, or a defeasible interest subject to extinguishment by the holders of record of two-thirds of the outstanding shares? We believe it is a vested property right inherent in her ownership....
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> ....
>
> ...Defendants are attempting, under the guise of classification or reclassification of the preferred stock, to impair the obligation of plaintiff's contract with the corporation and to divest plaintiff of her present vested and permanent interest in the corporation. This we hold the statute does not authorize, and if it does, it is unconstitutional.

Breslav, 291 N.Y.S. at 940-41. *But see* Garzo v. Maid of the Mist Steamboat Co., 104 N.E.2d 882, 886-88 (N.Y. 1952) (holding that the reserved power sustained a corporation's utilization of a post-incorporation enabling statute); *supra* note 983 (third paragraph) (discussing *Garzo*).

1006. 69 N.W. 929 (Mich. 1897), *aff'd sub nom.* Looker v. Maynard, 179 U.S. 46 (1900); *see supra* note 1000 (third paragraph) (discussing *Looker*).

1007. *See Looker*, 69 N.W. at 932. In *City of Detroit v. Detroit & Howell Plank-Road Co.*, 5 N.W. 275 (Mich. 1880), it had been held that, notwithstanding a reserved power, a plank-road corporation could not be subjected to post-incorporation legislation prohibiting such corporations from maintaining toll gates within the corporate limits of any city. *See id.* at 281.

contained in the state's 1850 constitution[1008] and a rejection of the contention that the right to straight voting constituted a vested right protected by the Impairment Clause from legislative alteration.[1009] However, in *Sutton v. Globe Knitting Works*,[1010] decided in 1936, when the plaintiff had acquired shares of preferred stock under a corporate charter providing that such shares "shall be redeemed at par on January 25, 1932," and thereafter, pursuant to enabling legislation enacted in 1931, the charter was amended (by the class vote prescribed in the enabling statute) to change the redemption date to January 25, 1957, the Michigan Supreme Court held that the 1931 enabling statute could not be applied to deprive the plaintiff of the right to have his stock redeemed on January 25, 1932. The court based its decision on its view that the plaintiff's right of redemption was a vested right, which was protected from change under the saving provisions of the 1931 statute,[1011] and whose abrogation pursuant to the enabling provision of that statute could not be sustained under the reserved power contained in the state's 1908 constitution.[1012] (It

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1008. The court said:

> It is claimed by the counsel [for those seeking to sustain the right of straight voting] that the method of electing the directors of the ... Company [as prescribed by the charter] was made in pursuance of the [general law under which the corporation had been organized], and constitutes a contract between the stockholders of the company, which the legislature cannot set aside; and it is asserted that the minority stockholders law [prescribing cumulative voting] changes the contract between the stockholders, and is therefore within the constitutional provision which forbids impairing the obligation of contracts. It would seem to be a complete reply to this view to say that the stockholders knew when they entered this corporation that the constitution reserved to the legislature the right to amend, alter, or repeal the law under which the corporation was organized. The stockholders are as much bound by this constitutional provision as though it was contained in the articles of incorporation.

Looker, 69 N.W. at 931.

1009. The court said:

> We do not think it can be said that the minority law changes the character of the business in which the ... Company is engaged, or that it takes away any substantial right acquired by the corporation. It changes the terms of office of the directors, and provides for a representation on the board of directors of a minority of the stockholders. We do not think this disturbs any vested right such as is referred to by the cases cited by counsel....

Id. at 932.

1010. 267 N.W. 815 (Mich. 1936).

1011. *See id.* at 817 ("The inescapable conclusion is that notwithstanding the broad terms in which [the enabling section] of the act is expressed, the Legislature clearly and conclusively intended [by the saving provisions] to preserve vested rights of the character here asserted by plaintiff.").

1012. The court said:

should be added that, in two subsequent cases, Michigan courts refused to invalidate—under the vested right doctrine—utilization of post-incorporation enabling legislation enacted under a reserved power.[1013])

The context in which the vested right doctrine has been applied most frequently—in invalidating attempts to alter shareholder rights through the use of post-incorporation enabling legislation enacted under a reserved power—is that involving charter amendments designed to eliminate dividend arrearages on cumulative preferred stock.[1014] And the best known case in this context is *Keller v. Wilson*

> Notwithstanding the ingenious presentation of [defendant's] contention [that the saving provisions of the statute related only to creditors' rights], it seems clear that the redemption right of plaintiff as a preferred stockholder is something more and different in character than an ordinary incidental right of a stockholder, such as voting for the election of a director of the company, and that his right is contractual in nature. . . . [W]e think the following statement of the United States Supreme Court is applicable to the instant case:
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> "The authority of a state under the so-called reserved power . . . is wide; but is not unlimited. The corporate charter may be repealed or amended, and, within limits not now necessary to define, the interrelations of state, corporation, and stockholders may be changed; but neither vested property rights nor the obligation of contracts of third persons may be destroyed or impaired."

Id. at 818 (quoting Coombes v. Getz, 285 U.S. 434, 441-42 (1932)).

1013. In *Stott v. Stott Realty Co.*, 284 N.W. 635 (Mich. 1939), when a reserved power existed prior to the corporation's organization, it was held that a shareholder had no vested right in the termination of the corporation's existence for failure to pay its privilege fees and that it was appropriate for the corporation to avail itself of post-incorporation enabling legislation (enacted after the plaintiffs had filed their complaint seeking appointment of a receiver to wind up the corporation's business) by which corporations were authorized to make late payment of their privilege fees and thereby revive their corporate existence. *See id.* at 640.

In *Miller v. Magline, Inc.*, 306 N.W.2d 533 (Mich. Ct. App. 1981), it was held that a corporation could avail itself of post-incorporation legislation (enacted under a reserved power) authorizing an extension of corporate existence by vote of a simple majority of the outstanding shares, even though the law in effect at the time of the corporation's organization required an extension of corporate existence to be approved by two-thirds of the outstanding shares. *See id.* at 536; *infra* text accompanying notes 1248-49 (discussing *Miller*).

1014. A survey of cases on the point is contained in *Western Foundry Co. v. Wicker*, 85 N.E.2d 722, 728-32 (Ill. 1949), and its Annotation, *Validity of Cancellation of Accrued Dividends on Preferred Corporate Stock*, 8 A.L.R.2D 893 (1949).

Among the numerous articles and notes on this subject are the following: Arno C. Becht, *The Power to Remove Accrued Dividends by Charter Amendment*, 40 COLUM. L. REV. 633 (1940); John F. Meck, Jr., *Accrued Dividends on Cumulative Preferred Stocks: The Legal Doctrine*, 55 HARV. L. REV. 71 (1941); Joseph B. Kelly, Note, *Accrued Dividends—No Mirage in Ohio*, 18 U. CIN. L. REV. 172 (1949); and Will J. Schaaf, Jr., Note, *Corporations: Amendment of Articles to Eliminate Dividends Accrued on Cumulative Preferred Shares*, 32 CORNELL L.Q. 586 (1947).

& Co.,[1015] decided by the Delaware Supreme Court in 1936. Eight years earlier, in the case of *Davis v. Louisville Gas & Electric Co.*,[1016] Delaware's chancery court had considered both the restrictive and the expansive reading of that state's reserved power and had clearly opted for the expansive reading.[1017] Yet, in *Keller*, the supreme court held that a shareholder's right to be paid accumulated dividends on preferred stock (before payment of any dividend on common stock) constituted a vested right and, therefore, any effort to abrogate such right by way of a charter amendment adopted pursuant to post-incorporation legislation enacted under a reserved power would be unconstitutional.[1018]

A final point needs to be made concerning state court treatment of the vested right doctrine. It involves the Delaware Supreme Court's decision in *Federal United Corp. v. Havender*[1019]—decided four years after that court's decision in *Keller v. Wilson & Co.*[1020] In *Havender*, it was held that dividend arrearages on cumulative preferred stock could be eliminated through the device of a merger with a wholly owned subsidiary pursuant to a pre-incorporation merger statute that provided appraisal rights for dissenters.[1021] This decision led to the strange assertions that *Havender* "broke Keller's back"[1022] and "marked the end of 'vested rights.' "[1023] But, the U.S.

1015. 190 A. 115 (Del. 1936).

1016. 142 A. 654 (Del. Ch. 1928).

1017. *See id.* at 656-58; *supra* note 997 (first paragraph) (discussing *Davis*).

1018. The court stated the question to be

> whether the State, under its reserved power[,] may authorize a corporation created by it at a time when the law, as then existing, did not permit the abrogation of dividends on cumulative preferred stock accrued through passage of time, to abolish such dividends by virtue of a statute passed after the creation of the corporation and the issuance of such stock....

Keller, 190 A. at 118. The court answered this question in the negative on the ground that the right of a holder of cumulative preferred to accrued but unpaid dividends must "be regarded as a vested right of property secured against destruction by the Federal and State Constitutions." *Id.* at 125; *accord* Wheatley v. A.I. Root Co., 69 N.E.2d 187, 194-96 (Ohio 1946). *But see* O'Brien v. Socony Mobil Oil Co., 152 S.E.2d 278, 284-87 (Va. 1967) (holding that the constitutional rights of a holder of preferred stock were not violated by the corporation's amendment of its charter to cancel dividend arrearages).

1019. 11 A.2d 331 (Del. 1940).

1020. 190 A. 115 (Del. 1936); *see supra* note 1018 and accompanying text (discussing *Keller*).

1021. *See Havender*, 11 A.2d at 338-39. This case is discussed in Note, *Accrued Dividends in Delaware Corporations—From Vested Right to Mirage*, 57 HARV. L. REV. 894, 894-95 (1944).

1022. Hottenstein v. York Ice Mach. Corp., 136 F.2d 944, 951 (3d Cir. 1943) ("[W]e must conclude that Havender broke Keller's back.").

1023. George D. Gibson, *How Fixed Are Class Shareholder Rights?*, 23 LAW &

Supreme Court having made the vested right doctrine a part of reserved power jurisprudence,[1024] only that Court—certainly not a state court—can bring that doctrine to an end. Moreover, the merger in *Havender* was effected under *pre*-incorporation legislation so that the Impairment Clause was not implicated in *Havender* as it had been in *Keller*. Additionally, it is now well understood[1025] that the right of appraisal (available in *Havender* but not in *Keller*) played a major role in the *Havender* outcome.[1026] Finally, a leading authority on Delaware corporate law pointed out in 1972 that the vested right principle had not been overruled in that state.[1027]

CONTEMP. PROBS. 283, 286 (1958) ("In retrospect, it is now apparent that [*Havender*] marked the end of 'vested rights' . . . .").

1024. *See supra* note 971 and text accompanying notes 975-78.

1025. *See* WILLIAM L. CARY & MELVIN A. EISENBERG, CASES AND MATERIALS ON CORPORATIONS 1284 (6th ed. 1988) ("As between *Keller* and *Havender*, there is the significant difference that if the direct amendment technique is permitted it is a cramdown without appraisal, while under the merger technique a dissenter is entitled to appraisal."); Weiss, *supra* note 4, at 645-46.

Manning states:

> The court in *Havender* purported to find other grounds for distinguishing the two cases, but it paused to note that under the Delaware corporation statute the plaintiff in *Keller* did not have the appraisal remedy available to him while the plaintiff in *Havender* did. Most observers have felt that this was the key difference . . . .

Manning, *supra* note 115, at 228 (footnotes omitted).

1026. In *Havender*, the court said:

> To say [as in *Keller*] that the right to [accumulated] dividends may not be destroyed by charter amendment under Section 26 of the General Law which, when the corporation was formed and the stock issued, did not authorize the destruction of the right, and with no alternative right in the shareholder to demand payment in money of the value of his stock, is not to say that the right may not be compounded [as in *Havender*] under the merger provisions of the law which warn the shareholder that his right is defeasible, and which, if he is dissatisfied, entitle him to demand and receive the money value of his shares. There is a clear distinction between the situations recognized by the General Law and the modes of procedure applicable to each of them . . . .

Federal United Corp. v. Havender, 11 A.2d 331, 342 (Del. 1940); *see also* Wessel v. Guantanamo Sugar Co., 35 A.2d 215, 216-17 (N.J. Ch.) (noting the same distinction), *aff'd per curiam sub nom.* Murphy v. Guantanamo Sugar Co., 39 A.2d 431 (N.J. 1944).

1027. Folk states:

> Even though . . . dividend arrearages could be modified in the course of a merger, the fundamental principle of "vested rights" has never been specifically overruled. Indeed, outright abandonment of the principle, as distinguished from evasion in practice, may be impossible in view of the declaration of the Supreme Court of the United States that "neither vested property rights nor the obligation of contracts of third persons may be destroyed or impaired" pursuant to the state's reserved power to amend the statute or to authorize charter amendments.

FOLK, *supra* note 459, at 560 (citing and quoting Coombes v. Getz, 285 U.S. 434, 442

(b) Federal Decisions

Even if a state court decided that a particular right was not constitutionally protected from abrogation pursuant to post-incorporation legislation, such a decision could be overridden by the U.S. Supreme Court.[1028] That Court's decision in *Coombes v. Getz*[1029] provides an example of such an override with respect to a right of a creditor.[1030] Another example is provided by *Superior Water, Light &*

(1932)).

1028. Early pronouncements supporting this proposition are to be found in the following cases: *Piqua Branch of the State Bank v. Knoop*, 57 U.S. (16 How.) 369, 391-92 (1853); *Jefferson Branch Bank v. Skelly*, 66 U.S. (1 Black) 436, 443-44 (1861); *Murray v. Charleston*, 96 U.S. 432, 441-42 (1877); *Louisville Gas Co. v. Citizens' Gas Co.*, 115 U.S. 683, 697 (1885); and *Douglas v. Kentucky*, 168 U.S. 488, 501-02 (1897).

In *Coombes v. Getz*, 285 U.S. 434 (1932), the Court said:

> The decision of the supreme court of a state construing and applying its own constitution and laws generally is binding upon this court; but that is not so where the contract clause of the Federal Constitution is involved. In that case this court will give careful and respectful consideration and all due weight to the adjudication of the state court, but will determine independently thereof whether there be a contract, the obligation of which is within the protection of the contract clause, and whether that obligation has been impaired; and, likewise, will determine for itself the meaning and application of state constitutional or statutory provisions said to create the contract or by which it is asserted an impairment has been effected.

Id. at 441; *see also* Haberlach v. Tillamook County Bank, 293 P. 927, 929 (Or. 1930) ("[W]hether the passage of a state law impairs the obligation of a contract is a federal question, in the determination of which the rulings of the state court are not binding upon the federal courts.").

1029. 285 U.S. 434 (1932).

1030. In *Coombes*, a creditor of a corporation brought suit against a director to recover under a constitutional provision (said to have the force of a statute) making directors liable to creditors and shareholders for moneys embezzled by officers while such directors were in office. *See id.* at 439-40. While the appeal of a judgment against the plaintiff was pending, the constitutional provision was repealed, and the state court granted the defendant's motion to dismiss the appeal on the ground that the cause of action had abated. *See id.* at 440. In the state court's opinion supporting its denial of a rehearing, it was acknowledged that the directors' liability imposed by the constitutional provision was contractual in nature and thereby became a part of the contract between the creditor and the corporation; but the position was taken that, under the state's constitutional reservation of power to alter or repeal laws concerning corporations, the repeal of the provision for directors' liability was a contingency known at the time the contract was made because the reserved power was as much a part of the contract as was the liability provision; and, while acknowledging that "the reserved power, however broad, cannot be exercised so as to impair a vested property right," the state court held that the remedy formerly given by the state constitutional provision was not such a right. *See* Coombes v. Franklin, 4 P.2d 157, 157 (Cal. 1931) (en banc), *rev'd sub nom.* Coombes v. Getz, 285 U.S. 434 (1932). The Supreme Court reversed, holding that the plaintiff's right to enforce the contractual liability created pursuant to the constitutional provision had become vested prior to the repeal of that provision. *See Coombes*, 285 U.S. at 442. The Court said that, while the repeal put an end to the liability rule for the future, such repeal "did not and

Power Co. v. City of Superior,[1031] involving rights of a corporation, in which the Supreme Court reversed a state court's validation of post-incorporation legislation enacted under a reserved power and held, instead, that the legislation was invalid (as applied to the corporation) because of the Impairment Clause.[1032]

While *Coombes* involved a vested right of a creditor and *Superior* involved rights of a corporation, a lower federal court's decision in *Yoakam v. Providence Biltmore Hotel Co.*[1033] involved a right of shareholders. In this case, it was held (with respect to a Delaware corporation) that a charter provision, requiring that $20,000 be paid each year into a sinking fund for the retirement of shares of preferred stock, could not be eliminated by a charter amendment made pursuant to post-incorporation enabling legislation enacted under a reserved power. Having referred to the Delaware decision of *Davis v. Louisville Gas & Electric Co.*,[1034] in which the chancellor (after noting special wording in Delaware's reserved power statute) had said that "all future amendments to the [corporation] act were written by that [reserved power] language into the defendant's charter as effectively as was the original act,"[1035] the

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could not destroy or impair the previously vested right of the creditor (which in every sense was a property right) to enforce his cause of action upon the contract." *Id.* (citations omitted).

1031. 263 U.S. 125 (1923).

1032. In this case, a water company, acting pursuant to its charter, entered into a contractual arrangement with a municipality whereby the company would supply water to the municipality for a term of 30 years, at the end of which time the arrangement would be renewed for another 30 years or the municipality would purchase the water works for a price determined in accordance with a specified procedure. *See id.* at 126-28. Before expiration of the first 30 years, the legislature enacted the state's Public Utility Law purporting to convert utility franchises into indeterminate permits. *See id.* at 131-32. When the first 30 years expired, the company asked that the municipality either renew the franchise or purchase the water works; but the municipality refused to renew, denied its obligation to purchase, and took steps under the Public Utility Law to condemn the entire plant. *See id.* at 133. The state's highest court held that, under the state's pre-incorporation reserved power, the Public Utility Law was permissible and had the effect of making the company's franchise one of indeterminate duration with the result that the company's franchise had not come to an end and thus no purchase obligation had arisen. *See* Superior Water, Light & Power Co. v. City of Superior, 181 N.W. 113, 123-24 (Wis. 1921), *rev'd*, 263 U.S. 125 (1923). The Supreme Court reversed, citing the Impairment Clause, and holding that "[i]t was beyond the competency of the legislature to substitute an 'indeterminate permit' for rights acquired under a very clear contract." *Superior*, 263 U.S. at 137.

1033. 34 F.2d 533 (D.R.I. 1929).

1034. 142 A. 654 (Del. Ch. 1928); *see supra* notes 970 (third paragraph) and 997 (first paragraph).

1035. *Davis*, 142 A. at 658; *see supra* note 970 (third paragraph) (quoting *Davis*).

federal court refused to accept this as dispositive of the issue[1036] and proceeded to make its own determination as to the scope and reach of the reserved power.[1037]

b. Restrictive Reading of Reserved Power

(1) Twentieth-Century Decisions

The restrictive reading of the reserved power was that this power related solely to changes in the charter contract between the state and the corporation[1038] and, therefore, a pre-existing reserved power did not sustain a corporation's utilization of permissive post-

1036. The court said:

> The decisions of the Delaware courts have been studied with the greatest deference. I am compelled, however, to the conclusion that they do not settle the point here involved. A federal court may be bound by the interpretation placed upon a state statute by a court of last resort of that state, but is not bound by the decision of the state court as to whether so interpreted there is a resulting impairment of the "obligation of contracts" or the taking of property "without due process of law," within the meaning of the Constitution of the United States. The issue presented necessitates an examination of the scope and effect of a reservation of power by a state to amend by future act any enabling legislation under which a corporation is organized.

Yoakam, 34 F.2d at 544.

1037. The court said:

> At the outset, it is important to keep in mind that we are dealing with a reservation, a refusal to part with power. No reservation can be construed as giving or vesting in the state a power which it did not before have. The state has no power to impair the obligation of contracts to which it is not a party. No reservation, however artfully worded, can give it that power.
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> ....
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> ... There [in the charter] are included the provisions essential to corporate existence, the restrictive provisions imposed by the state, which together constitute the contract with the state. There are also often included various agreements between the stockholders and the corporation and between the stockholders inter sese. It is a convenient place to record them. But to say that, because they are there recorded, the state may by direct act, or by empowering a majority so to do, impair the obligation of such commitments, is to ignore the substance and character of the subject-matter and to be led astray by the title to the document.
>
> ....
>
> To say that a general reservation on the part of the state of a right to repeal or enact future amendments to the corporation law gave to the state a power to authorize the cancellation of this [sinking fund] agreement, is to disregard every sound principle of law and to misconstrue legal history.

Id. at 545-47.

1038. The Wyoming Constitution, as quoted in *Drew v. Beckwith, Quinn & Co.*, 114 P.2d 98 (Wyo. 1941), provided that " '[a]ll laws relating to corporations may be altered, amended or repealed by the legislature at any time when necessary for the public good and general welfare.' " *Id.* at 103 (quoting WYO. CONST. art. X, § 1).

incorporation legislation to alter a shareholder's contract rights vis-à-vis the corporation or his fellow shareholders.[1039]

As had been the case in the nineteenth century,[1040] this view of the matter continued to be taken in the twentieth century by the courts of New Jersey at least through 1921.[1041] Wisconsin, which was

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1039. The Pennsylvania Constitution of 1857, as quoted in the *Pennsylvania College Cases*, 80 U.S. (13 Wall.) 190 (1871), contained the following provision:

> "The legislature shall have power to *alter, revoke, or annul any charter of incorporation hereafter conferred by or under any special or general law*, whenever, in their opinion, it may be injurious to the citizens of the Commonwealth; in such manner, however, that no injustice shall be done to the *corporators*."

Id. at 196 (alteration in original) (quoting PA. CONST. of 1857, art. I, § 26). Similar provisions appeared in the Arkansas Constitution of 1874, as quoted in *St. Louis, Iron Mountain & St. Paul Railway Co. v. Paul*, 173 U.S. 404, 406 (1899) (quoting ARK. CONST. of 1874, art. XII, § 6), in the Colorado Constitution, as quoted in *Pratt v. South Pueblo Building & Loan Ass'n*, 1 Colo. N.P. Dec. 171, 177 (Dist. Ct. 1901) (quoting COLO. CONST. art. XV, § 3), and in the Alabama Constitution of 1875, as quoted in *Avondale Land Co. v. Shook*, 54 So. 268, 269-70 (Ala. 1911) (quoting ALA. CONST. of 1875, art. XIV, § 10).

1040. *See supra* text accompanying notes 94-95 and 136-52.

1041. In *Berger v. United States Steel Corp.*, 53 A. 68 (N.J. 1902), the court stated:

> It must be conceded that it is firmly settled in our jurisprudence that the right reserved . . . to amend, alter, or repeal charters extends only to the modification or destruction of rights as between the state and the corporation, but that the rights of the stockholders inter sese can in no respect be impaired except in so far as impairment may result from an alteration required by the public interest. Kean v. Johnson, Zabriskie v. Railroad Co., and Mills v. Railroad Co. are cases under the act of 1846, and the Newark Library Ass'n Case dealt with the right of amendment and repeal under the act of 1846 [sic 1896?].

Id. at 73-74 (citations omitted).

In *Einstein v. Raritan Woolen Mills*, 70 A. 295 (N.J. Ch. 1908), it was held that a corporation chartered by special act in 1869 could not, over the objection of a single shareholder, avail itself of post-incorporation legislation to effect a charter amendment increasing its capital stock, creating a class of preferred, and converting its outstanding common into the new preferred. *See id.* at 295, 297. The court said:

> This [charter limitation on the amount of capital stock] I take it is a limitation upon the power of the company which is part of the contract existing between the stockholders among themselves and between the stockholders and the corporation itself, and that it cannot be abrogated or avoided by the corporation or by its directors, or by any majority, however large, of its stockholders against the objection of the holder of a single share. This is on the ground that such action would violate that provision of the federal Constitution which prohibits the states from passing any laws which impair the obligation of contracts. . . .
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> . . . .
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> . . . I must hold that this [post-incorporation enabling legislation] is merely the consent of the state that the stockholders may, if they all agree, do the things which are provided for in that act; but, if all the stockholders do not agree, the act cannot be held to be a portion of the charter of the corporation or an amendment thereto. This is specifically held in Kean v. Johnson, Zabriskie v.

early in adopting the restrictive reading,[1042] continued to adhere to this view in the twentieth century.[1043] Also Kentucky, which adopted this reading in the nineteenth century,[1044] continued to adhere to this view in the twentieth century.[1045] New Hampshire adopted this view in an 1887 decision,[1046] and that decision was cited with approval in a 1932 New Hampshire decision (involving a change, under the

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> Hackensack Railroad Co., Black v. United Railroad & Canal Companies, Mills v. N.J. Central Railroad Co., and many other cases which have ingrafted this doctrine into our law so deeply as to be beyond disturbance.

Id. at 296-97 (citations omitted).

In *Allen v. Francisco Sugar Co.*, 112 A. 887 (N.J. 1921), a corporation proposed to effect a 10-year lease of most of its revenue-producing property pursuant to post-incorporation enabling legislation authorizing such a lease (with the assent of two-thirds in interest of the stockholders) but making no provision for appraisal rights. *See id.* at 888. A minority shareholder—even though his shares were part of an issue of stock made after the enabling legislation was enacted—succeeded in his suit for a preliminary injunction. *See id.* at 889. The court said:

> In Zabriskie v. Hackensack & New York Railroad Co., it was held that a legislative charter is a contract between the state and the corporation which the state cannot impair; and that corporators or partners associated for a special purpose specified in their charter or articles of partnership cannot change that purpose without the consent of all the corporators or partners; and that a reservation in a charter that the state may, at any time, alter, amend, or repeal it is a reservation made by the state for its own benefit, and is not intended to affect or change the rights of corporators as between each other. Nor does it authorize the state to authorize one part of the stockholders, for their own benefit, at their mere option, to change their contract with the other part....

Id. (citation omitted).

The decision in *Fornataro v. Atlantic Coast Building & Loan Ass'n*, 163 A. 240 (N.J. Sup. Ct. 1932), giving retrospective effect to a post-incorporation statute regulating withdrawals from savings and loan associations, did not represent a repudiation of the *Zabriskie* doctrine. *See id.* at 244. It treated a utilization of the reserved power as an exercise of the police power in the context of a financial crisis brought on by the Great Depression. *See id.* at 244-45.

1042. *See supra* text accompanying notes 86-87.

1043. *See* Luce, *supra* note 943, at 45-48.

1044. *See supra* note 88 and accompanying text.

1045. In *Ayers v. Burley Tobacco Growers Cooperative Ass'n*, 344 S.W.2d 836 (Ky. 1961), when the limited life of an incorporated association was changed to perpetual existence by its board of directors, under post-incorporation legislation that authorized such action to be taken by director action alone (whereas the corporation law in effect at the time of incorporation required shareholder approval of any extension of corporate existence), it was held that the vested right of shareholders to vote on charter amendments could not be abrogated under the state's reserved power but that the action of the directors should nevertheless be sustained because of the right of each member to withdraw from the association and receive the value of his interest in cash. *See id.* at 838, 839-40; *see also* Donohue v. Heuser, 239 S.W.2d 238, 239-40, 245 (Ky. 1951) (upholding a consolidation effected pursuant to post-incorporation legislation enacted under a reserved power, but noting that dissenters were accorded the right of appraisal).

1046. *See supra* note 89 and accompanying text.

reserved power, of the charter contract between the state and the corporation).[1047] In Georgia, the restrictive reading of the reserved power had been adopted in 1889,[1048] and that reading was echoed in a 1929 dictum;[1049] however, in 1940, it was held that one corporation could merge with another pursuant to post-incorporation enabling legislation (notwithstanding a minority shareholder's effort to enjoin the merger) simply because a reserved power antedated the corporation's organization.[1050]

Among the state courts adopting the restrictive reading of the reserved power in the twentieth century were the following: a lower Colorado court in 1901,[1051] the highest court of Utah in 1907,[1052] and,

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1047. *See* Lorenz v. Stearns, 161 A. 205, 207, 209 (N.H. 1932).

1048. *See supra* note 90 and accompanying text.

1049. In *McKenzie v. Guaranteed Bond & Mortgage Co.*, 147 S.E. 102 (Ga. 1929), the court said:

> It may be conceded that the charter of a corporation is a contract of a dual character: First, a contract between the state, which grants the charter, and the corporation; second, a contract between the corporation and its members. And while the state, in its reserved power to do so, can alter and amend the charter, and the corporation itself cannot object to the alteration, even the state has no power to make any material or essential alteration in the contract between the members themselves and the corporation.

Id. at 103-04.

1050. *See* Barnett v. D.O. Martin Co., 11 S.E.2d 210 (Ga. 1940); *infra* text accompanying notes 1164-66 (discussing *Barnett*).

1051. In *Pratt v. South Pueblo Building & Loan Ass'n*, 1 Colo. N.P. Dec. 171 (Dist. Ct. 1901), it was held that a corporation could not avail itself of post-incorporation enabling legislation (enacted under a reserved power) to extend the life of the corporation, unless the complaining shareholder was given a right of appraisal. *See id.* at 182. After quoting several authorities, the court said:

> I conclude, therefore, that the restriction of the federal constitution being removed by the reservation of power made for the protection of public interests, the state can make any amendments or alterations which it may deem necessary so as to change the relations between the corporation and itself, and may thereby indirectly effect [sic] the relations between the members of the corporation; and second, that by virtue of its sovereignty the state may make any immaterial changes and alterations in the contract as between the corporators themselves which may be regarded as in promotion and in furtherance of the original design. Beyond this it cannot go.

Id. at 178.

1052. In *Garey v. St. Joe Mining Co.*, 91 P. 369 (Utah 1907), it was held that a corporation could not, over the objection of minority shareholders, avail itself of post-incorporation legislation authorizing the holders of two-thirds of the corporate stock to adopt a charter amendment making non-assessable stock subject to assessment. *See id.* at 369-70, 374-75. The court said:

> From the texts and the cases it will be seen that under the reservation the state is not only unauthorized to alter or amend charters of existing corporations in such a way as will change the fundamental character of the corporation, impair the object of the grant, or rights vested thereunder, but it is also

more recently, Ohio's highest court in 1946,[1053] Oklahoma's highest

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> unauthorized to alter or amend them in such a way as will impair the contractual relations or rights of the stockholders among themselves, or between the corporation and its stockholders; and it will also be seen that under the reserved power the Legislature has only the right to amend the charter, or laws with respect thereto, which it would have had in the event it had been decided in the Dartmouth College Case that the federal Constitution did not apply to corporate charters.... Because of the reserved power the state may now amend or alter the charter, so far as affecting the contract with itself, and so long as it does not change the fundamental character of the corporation or impair any vested rights acquired thereunder. But, as stated by the authorities, the right is reserved for the benefit of the state and of the public and for public purposes. The power can only be exercised to the extent that the state is interested. It can alter or modify any right, privilege, or immunity granted by it. It cannot, however, reach out and impair the obligations of contracts existing between the corporation and its members, or among the corporators themselves, any more than it can impair the obligations of contracts existing between other individuals.

Id. at 374, *followed in* A.C. Frost & Co. v. Coeur d'Alene Mines Corp., 92 P.2d 1057, 1061 (Idaho 1939), and Jacobson v. Backman, 401 P.2d 181, 183 (Utah 1965).

1053. In *Wheatley v. A.I. Root Co.*, 69 N.E.2d 187 (Ohio 1946), it was held that a corporation could not avail itself of post-incorporation enabling legislation to sustain a charter amendment eliminating dividend arrearages on preferred stock. *See id.* at 194-96. The court's decision was based on the restrictive view of the reserved power, as set forth in the following excerpt (quoted by the court) from Fletcher's *Cyclopedia of the Law of Private Corporations*:

> "The true view is that the power to alter, amend or repeal charters is reserved by the state 'solely' for the purpose of avoiding the effect of the decision in the Dartmouth College case; that the charter of a corporation is a contract between the state and the corporation within the constitutional prohibition against laws impairing the obligation of contracts, and that the purpose of the reservation is to enable the state to impose such restraints upon corporations as the Legislature may deem advisable for protection of the public. Such power is not reserved in any sense for the benefit of the corporation, or of a majority of the stockholders, upon any idea that the Legislature can alter the contract between the corporation and its stockholders, nor for the purpose of enabling it to do so."

Id. at 195 (Fletcher's footnotes and the court's citation omitted, and minor capitalization added by court) (quoting 13 WILLIAM MEADE FLETCHER ET AL., CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 5776, at 86-87 (perm. ed. rev. vol. 1943)); *accord* Schaffner v. Standard Boiler & Plate Iron Co., 83 N.E.2d 192, 195-96 (Ohio 1948).

In *Allen v. Scott*, 135 N.E. 683 (Ohio 1922), it had been held that shareholders of an insolvent banking corporation organized in 1909 were liable to creditors (who became such after January 1, 1913) under a constitutional provision, adopted (in 1912 effective January 1, 1913) under a reserved power, that made shareholders of banking corporations responsible for debts of such corporations to the extent of the par value of their shares. *See id.* at 684-86. And by way of dicta in *Harper v. Ampt*, 32 Ohio St. 291 (1877), Ohio's highest court had said:

> [T]he state, through its legislature, possessed complete power—
>
> ....
>
> 2. To alter or amend the charter as to the mode of electing directors, or to make any other amendment within the object and scope of the corporation, for the better regulation of such company. It can not be said that such an

court in 1949,[1054] and Pennsylvania's highest court in 1952.[1055]

(2) Public Interest Antidote

When a state's highest court adopted the restrictive reading of that state's reserved power, it would likely have done so on the ground that the reservation was intended (and therefore should be interpreted) to relate solely to alteration or repeal of the charter contract between the state and the corporation.[1056] This would mean

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> amendment violates any contract within the meaning of the federal constitution.
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> The power reserved to alter or amend the charter entered into and formed part of the terms of the contract, and the stockholders held their chartered privileges subject to its exercise.

Id. at 295-96.

1054. In *Yukon Mill & Grain Co. v. Vose*, 206 P.2d 206 (Okla. 1949), it was held that a corporation could not avail itself of post-incorporation enabling legislation to effect a charter amendment to make its non-redeemable preferred stock redeemable. *See id.* at 209-11. The court said:

> We adopt the view that whether or not a power to amend a corporate charter reserved to the state by statute or constitution protects a proposed change in the obligation of a corporation to its stockholders, authorized under enabling legislation enacted subsequent to the issuance of the corporate stock affected, depends upon whether the proposed change is directed toward those features of the contract in the corporate charter in which the state has an interest, or relates to those features dealing with the private rights between the stockholders and the corporation, or between the stockholders inter se; and we hold that the reservation of power to amend corporate charters is applicable only to those features of the contract affected with public interest, and the private rights of the stockholder as against the corporation or his fellow stockholders are protected from alteration by the inhibition against the impairment of contracts.

Id. at 209.

1055. In *Schaad v. Hotel Easton Co.*, 87 A.2d 227 (Pa. 1952), the court said:

> But, while there is a conflict of authority on the subject, the preferable view would seem to be that this reserved power of the State to alter or amend charters of incorporation, although wide, is not unlimited, and that it can properly be exercised only to amend a charter so far as it represents a contract between the corporation and the State, and not in respects as to which it constitutes a contract between the corporation and the shareholders or between the shareholders themselves. That is the view presently taken of the extent of the reserved power by many, if not most, of the courts which have considered the question.

Id. at 232. For comments on this decision, see Note, *Elimination of Accrued Dividends: Possible Obstacles for the Pennsylvania Corporation*, 101 U. PA. L. REV. 663 (1953).

1056. The point was well expressed in *Pratt* when the court said:

> I presume it was never doubted that the charter of a corporation is a contract between the members of the corporation, *inter se*. The decision in the Dartmouth college case was not necessary to settle that point. The great question there debated was the relation of the corporation to the sovereign power, and the principle settled was that the charter of a corporation is a contract as between itself and the state. It is universally conceded that the sole

that the reserved power provided no basis for sustaining a corporation's utilization of permissive post-incorporation legislation to effect a change in shareholder rights existing under the charter contract; and, absent some other sustaining basis, the state court could be expected to enjoin (at the behest of a complaining shareholder) any effort to effect such a change pursuant to such legislation.

This, however, left matters in an unsatisfactory state. It meant that a single dissenting shareholder could block any effort of the majority to make use of permissive post-incorporation legislation,[1057] unless some other basis could be found to sustain the making of a change pursuant to the enabling statute. This led some courts to resort, for a time, to a bizarre "public interest" doctrine.

(a) Emergence of Doctrine

There emerged the doctrine that a corporation could avail itself of a post-incorporation enabling statute, enacted pursuant to a reserved power, if the enabling legislation had been enacted in the public interest. This doctrine appears to have had its origin in New Jersey where, in the absence of a statutory right of appraisal, there was no other basis upon which to sustain an action taken by the holders of some specified majority of the shares (less than all) under an enabling statute enacted subsequent to incorporation.[1058]

> purpose of the reservations made by the states is to meet that decision and counteract its effects. If this be true, it necessarily follows that such reservations were made for the purpose of affecting the relation of a corporation to the state which created it, and for that purpose only, and must be construed accordingly.

Pratt, 1 Colo. N.P. Dec. at 175.

1057. It was this concern that led New Jersey's highest court, in *Brundage v. New Jersey Zinc Co.*, 226 A.2d 585 (N.J. 1967), to abandon that state's century-old *Zabriskie* doctrine. The court said:

> [W]e ... believe that the time has come for express disavowal of *Zabriskie* as having no proper place in modern corporate law. Its notions as to unanimity may have had some force in the days when commerce was conducted largely through individuals and small partnerships or closely held corporations; they have no force in today's society of large corporate enterprises such as [the two corporations involved in a merger] with their thousands of stockholders spread throughout the nation.

Id. at 595.

1058. Gibson colorfully stated the matter as follows:

> Once committed to this [*Zabriskie*] line of approach there was no escape except by completing the tunnel at the other end. The New Jersey Courts came out into the open again by inventing a formula that the contract among the stockholders, while not normally subject to the reserved power to amend, "would be so considered if in the public interest" to do so.

The doctrine appears to have derived from a misunderstanding of something that New Jersey's highest court had said in its 1902 decision in *Berger v. United States Steel Corp.*,[1059] namely, that "the rights of the stockholders inter sese can in no respect be impaired [pursuant to the reserved power] except in so far as impairment may result from an alteration required by the public interest."[1060] To the extent that this statement indicated that post-incorporation legislation (enacted pursuant to a reserved power) could validly *compel*—in the public interest—an alteration of the rights of shareholders as embodied in their charter contract, this was a correct statement of then-prevailing law.[1061] However, no one familiar with New Jersey law, as it had evolved up to that time, could take the statement by the *Berger* court to mean that *permissive* enabling legislation, enacted under a reserved power but unaccompanied by a statutory right of appraisal, could be utilized by a pre-existing corporation to allow some specified shareholder majority (over the objection of minority holders) to effect a significant change in shareholder rights embodied in the charter contract.[1062] Indeed, the *Berger* decision itself drew the distinction between compulsory and permissive legislation.[1063]

Nonetheless, for a time in New Jersey, there blossomed the notion that enabling legislation enacted pursuant to that state's reserved power could be utilized by a pre-existing corporation to alter rights of its shareholders so long as the legislation had been enacted in the public interest.[1064] The most thorough espousal of this doctrine came in the 1953 decision of *A.P. Smith Manufacturing Co. v. Barlow*,[1065] in which the court sustained a corporate donation to Princeton University made pursuant to post-incorporation enabling legislation.[1066]

Gibson, *supra* note 943, at 604-05.

1059. 53 A. 68 (N.J. 1902).

1060. *Id.* at 74; *see supra* note 1041 (first paragraph) (quoting *Berger*).

1061. *See supra* notes 67-69 and accompanying text.

1062. *See supra* text accompanying notes 94-95 and 136-52.

1063. *See supra* note 950 (first paragraph) and accompanying text.

1064. *See* Murray v. Beattie Mfg. Co., 82 A. 1038, 1040 (N.J. 1912); Bucsi v. Longworth Bldg. & Loan Ass'n, 194 A. 857, 860 (N.J. 1937); *In re* Collins-Doan Co., 70 A.2d 159, 163-65 (N.J. 1949).

1065. 98 A.2d 581 (N.J. 1953).

1066. *See id.* at 587-90. The court said:

> In the early case of Zabriskie v. Hackensack & New York Railroad Company, the court was called upon to determine whether a railroad could extend its line, above objection by a stockholder, under a legislative enactment passed under

(b) Flaw in Doctrine

This doctrine had grave deficiencies. Certainly the Impairment Clause of the Constitution contains no exception for state laws that are enacted in the public interest. Indeed, one may assume that all state laws are enacted in what the legislature perceives to be the public interest. But, if one takes the position that no law passed in the public interest runs afoul of the Impairment Clause and if one accepts the proposition that all state laws are enacted in the public interest, then the Impairment Clause becomes a nullity.

The "public interest" doctrine seems to be nothing more than a case of confusion with the police power of a state.[1067] As noted above,[1068] the police power does, indeed, override the Impairment Clause.[1069] But the police power has limits.[1070] Traditionally, it has

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> the reserve power after the incorporation of the railroad. Notwithstanding the breadth of the statutory language and persuasive authority elsewhere (Durfee v. Old Colony & Fall River Railroad Company), it was held that the proposed extension of the company's line constituted a vital change of its corporate object which could not be accomplished without unanimous consent. The court announced the now familiar New Jersey doctrine that although the reserved power permits alterations in the public interest of the contract between the state and the corporation, it has no effect on the contractual rights between the corporation and its stockholders and between stockholders *inter se.* Unfortunately, the court did not consider whether it was not contrary to the public interest to permit the single minority stockholder before it to restrain the railroad's normal corporate growth and development as authorized by the Legislature and approved, reasonably and in good faith, by the corporation's managing directors and majority stockholders. Although the later cases in New Jersey have not disavowed the doctrine of the Zabriskie case, it is noteworthy that they have repeatedly recognized that where justified by the advancement of the public interest the reserved power may be invoked to sustain later charter alterations even though they affect contractual rights between the corporation and its stockholders and between stockholders *inter se.*

Id. at 587-88 (citations omitted).

1067. *See id.* at 589 ("The legislative function recognized here may be considered somewhat akin to that under the police power generally where private interests frequently are called upon to give way to the paramount public interest.").

1068. *See supra* text accompanying notes 55-61.

1069. In *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234 (1978), the Court said:

> First of all, it is to be accepted as a commonplace that the Contract Clause does not operate to obliterate the police power of the States. "It is the settled law of this court that the interdiction of statutes impairing the obligation of contracts does not prevent the State from exercising such powers as are vested in it for the promotion of the common weal, or are necessary for the general good of the public, though contracts previously entered into between individuals may thereby be affected. This power, which in its various ramifications is known as the police power, is an exercise of the sovereign right of the Government to protect the lives, health, morals, comfort and general welfare of the people, and is paramount to any rights under contracts between individuals."

related essentially to the public health, safety, and morals; and, when it has been extended to economic necessity, the necessity generally has arisen from an emergency situation.[1071]

There is little wonder that, in 1967, New Jersey's highest court elected to pursue a different tack in attempting to avoid the restrictions of the century-old *Zabriskie* doctrine.[1072]

Id. at 241 (quoting Manigault v. Springs, 199 U.S. 473, 480 (1905)).

In *Indiana ex rel. Anderson v. Brand*, 303 U.S. 95 (1938), the Court said:

> Our decisions recognize that every contract is made subject to the implied condition that its fulfillment may be frustrated by a proper exercise of the police power but we have repeatedly said that, in order to have this effect, the exercise of the power must be for an end which is in fact public and the means adopted must be reasonably adapted to that end....

Id. at 108-09.

See generally Note, *Power of the State to Alter Corporate Charters*, *supra* note 966 (discussing the power of the states to alter contractual relations despite constitutional restrictions).

1070. *See* New Orleans Gas Co. v. Louisiana Light Co., 115 U.S. 650, 670-73 (1885); *supra* note 61 and accompanying text.

It has been specifically held that the police power does not sustain a post-incorporation change in the mode of voting at corporate elections. *See* State *ex rel.* Haeussler v. Greer, 78 Mo. 188, 194-95 (1883) (holding that, when the charter provided for straight voting in the election of directors and a post-incorporation constitutional provision mandated cumulative voting, the latter was inapplicable).

1071. The leading case is *Home Building & Loan Ass'n v. Blaisdell*, 290 U.S. 398, 442-48 (1934).

Cases holding that economic legislation impairing contractual rights can be sustained as an exercise of the police power, when an economic emergency exists, include the following: *Veix v. Sixth Ward Building & Loan Ass'n*, 310 U.S. 32, 38-41 (1940); and *Bucsi v. Longworth Building & Loan Ass'n*, 194 A. 857, 863-65 (N.J. 1937).

Cases holding that economic legislation impairing contractual rights cannot be sustained as an exercise of the police power, in the absence of an economic emergency, include the following: *Treigle v. Acme Homestead Ass'n*, 297 U.S. 189, 194-98 (1936); *W.B. Worthen Co. v. Thomas*, 292 U.S. 426, 431-34 (1934); and *Sonoma County Organization of Public Employees v. County of Sonoma*, 591 P.2d 1, 10-11 (Cal. 1979).

In *City of El Paso v. Simmons*, 379 U.S. 497 (1965), the Court upheld the application of a 1941 Texas statute that imposed a five-year limit on the right of reinstatement of a forfeited land contract entered into in 1910 under an 1895 statute that imposed no such limit. *See id.* at 498-501. In so doing, the Court reversed a ruling of the Court of Appeals for the Fifth Circuit "that the right to reinstate was a vested contractual right and that the [Impairment Clause] prohibited the application of the 1941 statute to the contract here in question." *Id.* at 501. In reaching its result, the Supreme Court relied on the concept that protection of the "vital interests" or "general welfare" of the people is within the sovereign power of a state. *See id.* at 508. On that basis, the Court, after noting that "[t]he general purpose of the legislation enacted in 1941 was to restore confidence in the stability and integrity of land titles and to enable the State to protect and administer its property in a businesslike manner," *id.* at 511-12, concluded that "a statute of repose was quite clearly necessary," *id.* at 516.

1072. In *Brundage v. New Jersey Zinc Co.*, 226 A.2d 585 (N.J. 1967), the court said:

> Judge Waugh noted below that the exercise here of the reserve power was

c. Switching from Restrictive to Expansive Reading

If one discarded the public interest doctrine as being flawed, the restrictive reading of the reserved power precluded any reliance on that power to sustain a change in shareholder rights pursuant to permissive post-incorporation legislation. Thus, under the restrictive reading (and in the absence of a right of appraisal for dissenters), such a change in rights could be effected only with the unanimous consent of shareholders; and, in the case of a widely held corporation, it was virtually impossible to obtain such consent.[1073] This requirement of unanimity came to be seen as an intolerable state of affairs, and the perception grew that there was a need for greater flexibility in the modern corporate era.[1074] This led the highest courts of some states, where the restrictive reading had been adopted at an earlier time, to switch their allegiance to an expansive reading of the reserved power.

(1) Examples of Switching

The most noteworthy instance of such a switch came in New Jersey in 1967. Until their resort to the public interest doctrine earlier in this century,[1075] the courts of New Jersey—from *Zabriskie* in 1867 through *Allen* in 1921—had been steadfast in their adherence to the restrictive reading of the reserved power.[1076] Then, in *Brundage v. New Jersey Zinc Co.*,[1077] believing "that the time has come for

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> justified by the public interest in providing for orderly corporate growth and development through fair and democratic processes. While we believe this to be entirely sound, we also believe that the time has come for express disavowal of *Zabriskie* as having no proper place in modern corporate law.

Id. at 595.

1073. In *Seattle Trust & Savings Bank v. McCarthy*, 617 P.2d 1023 (Wash. 1980), the court said:

> The defendant contends ... that preemptive rights, once accorded, become a vested and contractual right and cannot be divested without the unanimous consent of the shareholders. It is not disputed that as a practical matter, where corporate stock is widely held, it is virtually impossible to secure the participation of all stockholders in an election. Therefore, if the defendant's view is correct, a corporation in the position of the plaintiff cannot amend its articles to deny preemptive rights.

Id. at 1025.

1074. *See supra* note 1057. For a well-researched article containing a good depiction of the movement of the law toward greater corporate flexibility, see William J. Carney, *Fundamental Corporate Changes, Minority Shareholders, and Business Purposes*, 1980 AM. B. FOUND. RES. J. 69.

1075. *See supra* text accompanying notes 1064-66.

1076. *See supra* note 1041 and text accompanying notes 94-95 and 136-52.

1077. 226 A.2d 585 (N.J. 1967).

express disavowal of *Zabriskie* as having no proper place in modern corporate law,"[1078] New Jersey's highest court embraced the expansive reading of the reserved power[1079]—to the delight of some observers.[1080]

The State of Washington provides another example. In *State ex rel. Swanson v. Perham*,[1081] decided in 1948, the court refused to apply a 1933 statute, providing for cumulative voting, to a corporation organized in 1919 under a statute providing for straight voting. As an alternative ground for its decision,[1082] the court embraced a restrictive reading of the reserved power contained in the state's constitution.[1083]

1078. *Id.* at 595; *see supra* notes 1057 and 1072.

1079. The court said:

> The power reserved in our organic and statutory law was broadly phrased and broadly intended. It should liberally be viewed as part and parcel of the tripartite arrangements between the State, the corporation and the stockholders, and thus viewed, as permitting reasonable corporate charter amendments having legitimate business ends.

Brundage, 226 A.2d at 595 (citations omitted).

1080. In *Asarco Inc. v. Court*, 611 F. Supp. 468 (D.N.J. 1985), the court said the following:

> There was a time when the New Jersey courts limited severely the extent to which legislation could permit directors and stockholders to alter or readjust the rights and powers of stockholders inter sese or to expand the powers of the Board of Directors. This limitation on legislative power, and thus on corporate power, was forcefully espoused in the ancient and now unlamented case of *Zabriskie v. Hackensack and New York Railroad Co.* Unanimous stockholder consent was required to effect substantial changes in the corporate structure and relationships, and the Legislature was held powerless to decree otherwise, for to do so would impinge upon the basic contractual rights of stockholders.
>
> This doctrine eroded over the years, and *Zabriskie* was finally laid to rest in *Brundage v. New Jersey Zinc Co.* After *Brundage* it was clear that under New Jersey law the power which the state had reserved over corporations was a part of a tripartite arrangement between the State, the corporation and its stockholders, permitting the Legislature to expand and modify the powers of corporations as the needs of society or sound corporate governance dictated. The Legislature has wide powers to change and expand the power of corporations. A corporation may exercise fully the powers conferred by the Business Corporation Act, and is in no way inhibited by the rejected principles set forth in *Zabriskie.*

Id. at 475 (citations omitted).

1081. 191 P.2d 689 (Wash. 1948), *overruled by* Seattle Trust & Sav. Bank v. McCarthy, 617 P.2d 1023, 1027 (Wash. 1980) (en banc).

1082. *See id.* at 693-94. The decision was based, in part, on the court's conclusion that the right to straight voting constituted a vested right acquired before enactment of the 1933 statute and was therefore protected by the saving clause of that statute. *See id.*

1083. The court said:

> Even where there is no saving clause in the constitutional or legislative reservation of power, the reserved power of the state to alter or amend charters of existing corporations is not unlimited. The state may still not pass laws

However, in *Seattle Trust & Savings Bank v. McCarthy*,[1084] decided in 1980, it was held that a corporation organized in 1905 could avail itself of a statute enacted in 1979 authorizing the elimination of preemptive rights by charter amendment. Believing it "manifest that flexibility is vital to the functioning and growth of corporations, as is the democratic concept of majority rule,"[1085] the court overruled *Perham*,[1086] embraced the expansive reading of the reserved power,[1087] and rejected the contention that the preemptive right was vested and therefore protected from divestment without the unanimous consent of shareholders.[1088]

Alabama is a third state whose highest court changed from a restrictive to an expansive reading—although purportedly on the ground of a difference in the wording of the reserved power as contained in that state's constitutions of 1875 and 1901.[1089] In *Avondale Land Co. v. Shook*,[1090] decided in 1911, it was held that majority shareholders could not amend the corporate charter pursuant to post-incorporation enabling legislation enacted under a reserved power contained in the state's constitution of 1875. This decision was based on a restrictive reading of the reserved power.[1091]

> altering or amending charters of such corporations in such a way as will change their fundamental character or impair the object of the grant or rights vested thereunder, or in such way as will impair the contractual relations or rights of stockholders among themselves or existing between them and the corporation.

Id. at 696.

1084. 617 P.2d 1023 (Wash. 1980) (en banc).

1085. *Id.* at 1027.

1086. *See id.*; State *ex rel.* Swanson v. Perham, 191 P.2d 689 (Wash. 1948), *overruled by McCarthy*, 617 P.2d at 1027.

1087. The court, after referring to Kummert, *supra* note 943 (first paragraph), at 209-12, stated:

> As he said there, the majority of courts which have considered the problem have found the reservation of the amendment power to be a part of the shareholder's contract, with the result that the shareholder is deemed to have consented in advance to the State's exercise of a power to amend the charter or to authorize the corporation to do so.

McCarthy, 617 P.2d at 1026-27.

1088. The court did not consider that a vested right might be exempt from the impact of an expansive reading of the reserved power. Rather, it appears to have taken the position that the expansive reading prevented a right from becoming vested. *See id.* at 1027.

1089. Alabama's 1875 constitution provided: "All general laws and special acts passed pursuant to this section [providing for the formation of corporations] may be altered, amended or repealed." ALA. CONST. of 1875, art. XIV, § 1. Its 1901 constitution provided: "The charter of any corporation shall be subject to amendment, alteration, or repeal under general laws." ALA. CONST. of 1901, art. XII, § 229.

1090. 54 So. 268 (Ala. 1911).

1091. In this case, when neither the corporation's charter nor the statute under which it

In *Randle v. Winona Coal Co.*,[1092] decided ten years later, the court, in upholding a charter amendment made by a corporation organized after adoption of the state's 1901 constitution, appears to have treated the case as one involving the reserved power question (even though the enabling legislation had been enacted in 1919 and the corporation was not organized until 1921). While the court (almost incidentally) gave voice to an expansive reading of the reserved power,[1093] it did not disavow *Avondale* but, instead, seemed to proceed on the ground that the reserved power contained in the 1901 constitution was broader than that in the constitution of 1875.[1094] Then, in *Mobile Press Register, Inc. v. McGowin*,[1095] it was held that a corporation organized in 1932 could avail itself of post-incorporation legislation, enacted in 1951 pursuant to the reserved power contained in the state's 1901 constitution, to effect a charter amendment that eliminated the shareholders' common-law preemptive right. The

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was organized (in 1884) contained any authorization for charter amendments, and majority shareholders proposed to amend the charter (in 1909) pursuant to enabling legislation enacted (in 1907) under a reserved power contained in the state constitution (since 1875), the court concluded that the charter could not be amended over the objection of minority shareholders. *See id.* at 269-70. The court quoted with approval, and based its decision on, the following excerpt from Cook's treatise:

> "The extent of the power of the Legislature to amend a charter, where it has reserved that power, is not yet fully settled, and is full of difficulties. There is a strong tendency in the decisions, and a tendency which is deserving of the highest commendation, to limit the power of the Legislature to amend a charter under this reserved power. It should be restricted to those amendments only in which the state has a public interest. *Any attempt to use this power of amendment for the purpose of authorizing a majority of the stockholders to force upon the minority a material change in the enterprise is contrary to law and the spirit of justice.* Under such reserved power the Legislature has only that right to amend the charter which it would have had in case the Dartmouth College Case had decided that the federal Constitution did not apply to corporate charters. In fact, the historical origin of this reservation of the right to amend was due to the effort of the various states of the Union to escape from the decision in the Dartmouth College Case. By this reserved right the restraint of the federal Constitution is done away with. *But the power to make a new contract for the stockholders is not thereby given to the Legislature.* The Legislature may repeal the charter, but cannot force a stockholder into a contract against his will."

Id. at 270 (alterations in original) (quoting 2 WILLIAM W. COOK, A TREATISE ON THE LAW OF CORPORATIONS HAVING A CAPITAL STOCK § 501, at 1314-16 (6th ed. 1908), with Cook's footnotes omitted and minor changes in capitalization).

1092. 89 So. 790 (Ala. 1921).

1093. *See id.* at 797 ("The Legislature may, under its reserved power, authorize corporators or members to amend the corporate charter or articles in compliance with constitutional and statutory requirements." (citations omitted)).

1094. *See id.* at 798.

1095. 124 So. 2d 812, 820 (Ala. 1960).

court embraced the expansive reading of the reserved power,[1096] and it, too, placed emphasis on the difference in the 1875 and 1901 reservations of power.[1097] Moreover, the court rejected the complainants' contention that their preemptive right amounted to a vested right, and it did so on the ground that its reading of the reserved power precluded any such contention.[1098]

(2) Flaw in Switching

But there was a problem in all of this. It appears to be accepted doctrine that, when a contract (including a corporate charter) is entered into, all existing laws that are relevant become part of that contract.[1099] This includes not only applicable statutes[1100] but also

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1096. The court said:

> Hence, when the stock held by appellees was issued the corporation's charter and each certificate of stock contained, as effectually as if actually written therein, the provision from [the 1901 constitution] that the charter of the corporation "shall be subject to amendment, alteration, or repeal under general laws." In legal effect, this power to amend under general laws was consented to by the stockholders when they purchased their stock. Consequently, the exercise of this power by the corporation pursuant to general laws would not impair the obligation of a contract. Any contractual rights the stockholders might have acquired incident to their stock ownership were subject to the condition that such rights could be changed in accordance with general laws thereafter enacted by the legislature. In other words, the stockholders may be said to have been put on notice that changes, such as here proposed, might later be authorized by general laws.

Id. at 821 (quoting ALA. CONST. of 1901, art. XII, § 229).

1097. The court said:

> It seems to us that one significant distinction between the reservations in the two Constitutions is this: The power reserved in the 1875 Constitution authorized the state, acting by and through the legislature, to alter, amend, or repeal laws affecting corporations, in contrast to the additional reservation in the 1901 Constitution that "the charter of any corporation shall be subject to amendment, alteration, or repeal under general laws." Thus, the right of the corporation to amend its charter so as to affect the contract relationship between the corporation and its stockholders and the stockholders inter se was not clearly reserved in the 1875 Constitution as we think it is in the 1901 Constitution.

Id. at 823 (quoting ALA. CONST. of 1901, art. XII, § 229).

1098. *See id.* at 823-24.

1099. *See* Von Hoffman v. City of Quincy, 71 U.S. (4 Wall.) 535, 550 (1866) ("It is also settled that the laws which subsist at the time and place of the making of a contract, and where it is to be performed, enter into and form a part of it, as if they were expressly referred to or incorporated in its terms."); McLaren v. Pennington, 1 Paige Ch. 102, 109 (N.Y. Ch. 1828) ("[A] general law of the state where the contract was made, and which was in force at the making of such contract, is to be taken as a part of the contract.").

1100. *See supra* note 39 and accompanying text. In *State ex rel. Swanson v. Perham*, 191 P.2d 689 (Wash. 1948), *overruled by* Seattle Trust & Sav. Bank v. McCarthy, 617 P.2d 1023, 1027 (Wash. 1980) (en banc), the court said:

pertinent court decisions.[1101] In a fairly recent decision of the Supreme Court,[1102] the doctrine was stated as follows:

> The laws of the state in which a corporation is organized, whether such laws be of constitutional or statutory origin, enter into and become a part of its *articles of incorporation*. As expressed by the authorities, the charter of a corporation organized under general law consists of its articles of incorporation, the existing state constitution, the particular statute under which the corporation is formed, and all other general laws applicable thereto.

Id. at 693; *see also* Franzblau v. Capital Sec. Co., 64 A.2d 644, 647 (N.J. Super. Ct. Ch. Div. 1949); Salt Lake Auto. Co. v. Keith-O'Brien Co., 143 P. 1015, 1017 (Utah 1914) ("That section [of the corporation statute under which the company was organized] is as much a part of the articles of incorporation as though it were specifically referred to or set forth at large therein.").

1101. Although it did not involve a charter contract, the case of *Muhlker v. New York & Harlem Railroad Co.*, 197 U.S. 544 (1905), illustrates the point. In this case, it was held that, when decisions of the state's highest court antedating plaintiff's 1888 acquisition of real property in New York City had construed contracts of conveyance as according easements of light and air to owners of land abutting city streets, it constituted a violation of the Impairment Clause when the same court (reversing its earlier position) gave effect to an 1892 statute making provision for operation of an elevated railroad over the street fronting on plaintiff's property without making provision for compensation for the taking of plaintiff's easement rights. *See id.* at 570-71. The Court said:

> When the plaintiff acquired his title those cases were the law of New York, and assured to him that his easements of light and air were secured by contract as expressed in those cases, and could not be taken from him without payment of compensation.
>
> And this is the ground of our decision. We are not called upon to discuss the power or the limitations upon the power, of the courts of New York to declare rules of property or change or modify their decisions, but only to decide that such power cannot be exercised to take away rights which have been acquired by contract and have come under the protection of the Constitution of the United States. And we determine for ourselves the existence and extent of such contract. This is a truism; and when there is a diversity of state decisions the first in time may constitute the obligation of the contract and the measure of rights under it. Hence the importance of the elevated railroad cases and the doctrine they had pronounced when the plaintiff acquired his property.

Id.

There were other pronouncements by the Supreme Court to the effect that interpretative decisions of state courts, existing at the time of the making of a contract, entered into and formed a part of the terms of the contract. In *Warburton v. White*, 176 U.S. 484 (1900), the Court said:

> [W]here it is asserted that a contract has been entered into on the faith of the state laws, existing at the time when it was made, the construction of such laws, which was settled at the time of the making of the contract, by the court of last resort of the State, will be adopted and applied by this court in considering the nature of the contract right relied upon.

Id. at 495; *accord* Ennis Water Works v. City of Ennis, 233 U.S. 652, 657-58 (1914); Great S. Fire Proof Hotel Co. v. Jones, 193 U.S. 532, 547-48 (1904); *see also* Jones v. Missouri-Edison Elec. Co., 144 F. 765, 770 (8th Cir. 1906) ("The statutes, the charter and the by-laws of the corporation, as well as the settled law of the land at the time he takes his stock, are read into, and become a part of [a shareholder's] agreement.").

1102. *See* United States Trust Co. v. New Jersey, 431 U.S. 1 (1977).

> The obligations of a contract long have been regarded as including not only the express terms but also the contemporaneous state law pertaining to interpretation and enforcement. "This Court has said that 'the laws which subsist at the time and place of the making of a contract, and where it is to be performed, enter into and form a part of it, as if they were expressly referred to or incorporated in its terms.' " This principle presumes that contracting parties adopt the terms of their bargain in reliance on the law in effect at the time the agreement is reached.[1103]

Under this doctrine, it would seem that, when a corporation was organized in a given state, the resulting charter contract would include, not only the pertinent provisions of that state's constitution and its corporation statute including of course its reserved power (whether contained in the constitution or the statute), but also any existing judicial interpretation of the state's reserved power. And, if prior to such incorporation a restrictive reading of the reserved power had been adopted, the result would be a charter contract providing that resort could not be had to the reserved power to sustain a utilization by such corporation of permissive post-incorporation legislation to effect a material change in the rights of its shareholders.[1104]

Applying this analysis, one would have to conclude that, while there was a valid basis for sustaining the merger in *Brundage v. New Jersey Zinc Co.* (namely, the presence of appraisal rights for dissenters), the case was wrongly decided on the ground employed by the court in reaching its decision. This case involved a 1966 long-form merger of Zinc into its parent corporation, approved by the two-thirds shareholder vote specified by the merger statute then in effect. But Zinc had been organized in 1880—thirteen years after the *Zabriskie* decision adopting New Jersey's restrictive reading of that

1103. *Id.* at 19-20 n.17 (citation omitted) (quoting Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 429-30 (1934) (quoting Von Hoffman v. City of Quincy, 71 U.S. (4 Wall.) 535, 550 (1866))).

1104. Gibson stated this concept as follows:

> [New Jersey's] judges developed the view that a charter was a bundle of contracts, first between the corporation and the state, second between the corporation and its stockholders, and third among the stockholders themselves, and that only the first of these was within the purpose of the reserved power to amend. What this really meant was that for the purposes of a charter amendment changing the relative participation of two classes, it was as if there were no reserved power to amend, and the *Dartmouth College* case still bound the future to the past.

Gibson, *supra* note 943, at 604 (footnote omitted).

state's reserved power,[1105] and thirteen years before the adoption of New Jersey's first merger statute of general applicability.[1106] Plaintiffs sought to invalidate the merger on the ground that its consummation required the unanimous consent of Zinc's shareholders because, under the *Zabriskie* doctrine, the corporation could not avail itself of permissive post-incorporation legislation authorizing mergers with less than unanimous shareholder approval. Instead of following New Jersey precedents and validating the merger on the ground that the merger statute accorded appraisal rights to dissenters,[1107] the court elected to base its decision on the reserved power and made this case the occasion for switching to an expansive reading of that power.[1108] But, if one accepts the thesis embodied in the quotation from *United States Trust Co. v. New Jersey* set forth above,[1109] the court's analysis in *Brundage* was clearly flawed: it was the law at the time of Zinc's 1880 incorporation that one corporation could not be merged into another in the absence of legislative authorization,[1110] and no such authorization (applicable to Zinc) then existed in New Jersey;[1111] it was also the law in New Jersey at the time of Zinc's incorporation—as established by *Zabriskie*[1112]—that the reserved power could not be extended "to giving a power to one part of the corporators as against the other, which they did not have before";[1113] and, because this reading of the reserved power became part of the Zinc shareholders' charter contract protected by the Impairment Clause from change,[1114] it follows that there was no

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1105. *See supra* text accompanying notes 94-95.

1106. *See* Brundage v. New Jersey Zinc Co., 226 A.2d 585, 593 (N.J. 1967) ("Zinc was incorporated in 1880 before the passage of New Jersey's first merger enactment. That enactment authorized the merger of corporations 'organized or to be organized under any law or laws of this state.' " (quoting Act of Mar. 8, 1893, ch. 67, § 1, 1893 N.J. Laws 121, 121)); *supra* text accompanying notes 174-75 (describing the origins of this 1893 statute).

1107. *See supra* text accompanying notes 96-100 and 136-52.

1108. *See Brundage*, 226 A.2d at 593-96; *supra* text accompanying notes 1075-80 (discussing *Brundage*).

1109. *See supra* text accompanying notes 1102-03.

1110. *See* Clearwater v. Meredith, 68 U.S. (1 Wall.) 25, 39 (1863) ("The power of the legislature to confer such authority [to merge and consolidate] cannot be questioned, and without the authority, railroad corporations organized separately, could not merge and consolidate their interests.").

1111. *See supra* note 1106 and accompanying text.

1112. *See supra* text accompanying notes 94-95.

1113. Zabriskie v. Hackensack & N.Y. R.R., 18 N.J. Eq. 178, 186 (Ch. 1867), *overruled by* Brundage v. New Jersey Zinc Co., 226 A.2d 585, 594-95 (N.J. 1967).

1114. In *Sauer v. City of New York*, 206 U.S. 536 (1907), the Court explained the rationale of *Muhlker v. New York & Harlem Railroad Co.*, 197 U.S. 544 (1905) (*see supra* note 1101 (first paragraph) (discussing *Muhlker*)), as follows:

basis (aside from the right of appraisal) upon which to justify Zinc's utilization of the post-incorporation statute authorizing mergers upon a two-thirds shareholder vote. While the expansive reading of the reserved power adopted by the *Brundage* court may—as a matter of state law—be applicable to New Jersey corporations organized after the date of that decision (January 23, 1967), the foregoing analysis brings into question any effort to apply *Brundage's* expansive reading (absent a right of appraisal) to any New Jersey corporation organized during the preceding hundred years (that is, since the 1867 decision in *Zabriskie*).

The analysis would be different in the case of the switch to the expansive reading of Washington's reserved power made in *Seattle Trust & Savings Bank v. McCarthy*.[1115] The reason is that *State ex rel. Swanson v. Perham*,[1116] in which the restrictive reading was adopted, was not decided until 1948; and, therefore, that reading could not have been a part of the charter contract of the 1905 corporation involved in *McCarthy*. The question remains, however, whether (in the absence of a right of appraisal) Washington's new expansive reading of the reserved power can be applied validly to a Washington corporation organized between the 1948 decision in *Perham* and the 1980 decision in *McCarthy*.

The switch made in Alabama raises an interesting question for Alabama corporations, organized after the 1911 decision in *Shook* and before the 1921 decision in *Randle* or (possibly) the 1960 decision in *McGowin*,[1117] when and if they attempt to utilize post-incorporation enabling legislation to alter rights of their shareholders (in the absence of appraisal rights for dissenters).

> When Muhlker acquired his title the elevated railroad cases had declared the law of New York and it was here held that he had the right to rely upon his contract as in them it had been interpreted.... This court, in order to obtain jurisdiction and to declare that a Federal right was violated, was obliged to hold, and did hold, that the two cases were identical, and that in deciding the *Muhlker case* the Court of Appeals had in effect overruled the *Elevated Railroad Cases* .... The theory upon which the *Muhlker case* stands and upon which it was put in the opinion of the court, is that in deciding against Muhlker the state court had overruled its own decisions, and changed the interpretation of the contract upon which he had the right to rely.

Sauer, 206 U.S. at 555-56.

1115. 617 P.2d 1023 (Wash. 1980) (en banc); *see supra* text accompanying notes 1084-88 (discussing *McCarthy*).

1116. 191 P.2d 689 (Wash. 1948), *overruled by* Seattle Trust & Sav. Bank v. McCarthy, 617 P.2d 1023, 1027 (Wash. 1980) (en banc); *see supra* text accompanying notes 1081-83 (discussing *Perham*).

1117. *See supra* text accompanying notes 1089-98.

C. *Appraisal Right Solution*

The foregoing discussion concerning limitations on the utility of the reserved power does not imply a necessary enshrinement of the rule of unanimity. There is another—and better—means by which the utilization of enabling legislation by pre-existing corporations can be sustained. It is simply a matter of according appraisal rights to dissenting shareholders.

Even in a state whose highest court had adopted an expansive reading of the reserved power, a court (state or federal) could nevertheless invalidate a fundamental change in the charter contract, made under post-incorporation enabling legislation, by applying the vested right doctrine.[1118] If a state's highest court had adopted a restrictive reading of the reserved power (and if it was recognized that the public interest antidote was flawed[1119]), it followed that the reserved power would not sustain a fundamental change in shareholder rights made pursuant to permissive post-incorporation legislation. In either case, some other basis was needed to avoid the prohibition of the Impairment Clause and thus to sustain any change so fundamental that the de minimis doctrine[1120] would not be applicable.

The needed basis was supplied when dissenting shareholders were accorded a right of appraisal.[1121] A statutory right of appraisal avoided the Impairment Clause problem under either of two rationales.

1. Alteration of Remedy Rationale

The first rationale, under which the granting of a statutory right of appraisal for dissenters could sustain an alteration of minority shareholders' contract rights pursuant to post-incorporation enabling legislation, is based on the doctrine—recognized by the Supreme

1118. *See supra* text accompanying notes 1001-18 and 1028-37.

1119. *See supra* text accompanying notes 1064-72.

1120. *See supra* text accompanying notes 953-64.

1121. In *Pratt v. South Pueblo Building & Loan Ass'n*, 1 Colo. N.P. Dec. 171 (Dist. Ct. 1901), the question was whether a corporation organized in 1881 for a period of 20 years could avail itself of post-incorporation enabling legislation (enacted in 1899 pursuant to a reserved power) that authorized corporations to extend the period of their existence with the approving vote of a majority of the outstanding stock. *See id.* at 173-74. The court, having concluded that the reserved power must be given a restrictive reading, saw that the only way to allow the majority shareholders to extend their corporation's existence was to accord a right of appraisal to the complaining shareholder. *See id.* at 182; *supra* note 1051 (discussing *Pratt*).

Court in the nineteenth century[1122] and also in the twentieth century[1123]—that a state legislature could change the remedy for enforcing a contract without impairing the obligation of such contract.[1124] In other words, if a shareholder was given the right to receive the fair value of his stock in lieu of his right to veto or enjoin a transaction that would be contrary to his charter contract, it could then be said that there had been no impairment of the obligation of his contract.[1125]

1122. *See* Ogden v. Saunders, 25 U.S. (12 Wheat.) 213, 327-28 (1827) ("[A] great variety of instances may readily be imagined, in which the legislature of a State might alter, modify, or repeal existing remedies, and enact others in their stead without the slightest ground for a supposition that the new law impaired the obligation of contracts."); Sturges v. Crowninshield, 17 U.S. (4 Wheat.) 122, 200 (1819) ("The distinction between the obligation of a contract, and the remedy given by the legislature to enforce that obligation,... exists in the nature of things. Without impairing the obligation of the contract, the remedy may certainly be modified as the wisdom of the nation shall direct.").

The distinction between invalid alteration of the substantive terms of a contract and valid changes in the remedy for its enforcement was discussed also in *Von Hoffman v. City of Quincy*, 71 U.S. (4 Wall.) 535, 550-54 (1866), in which the Court said: "It is competent for the States to change the form of the remedy, or to modify it otherwise, as they may see fit, provided no substantial right secured by the contract is thereby impaired." *Id.* at 553; *accord* Read v. Frankfort Bank, 23 Me. 318, 321-22 (1843) ("A remedy for a party may be changed or wholly taken away by the legislature without contravening the constitution of the United States."); McLaren v. Pennington, 1 Paige Ch. 102, 108 (N.Y. Ch. 1828) ("The decision of the court in *The Bank of Columbia v. Oakley* [17 U.S. (4 Wheat.) 235 (1819)] was only an assertion of the ... well settled principle of constitutional law, that a state may pass a law materially altering the remedy of one of the parties to a contract, although it cannot pass a law impairing the obligation thereof....").

1123. *See* Richmond Mortgage & Loan Corp. v. Wachovia Bank & Trust Co., 300 U.S. 124, 128-31 (1937); Oshkosh Waterworks Co. v. Oshkosh, 187 U.S. 437, 439 (1903), *followed in* National Sur. Co. v. Architectural Decorating Co., 226 U.S. 276, 283 (1912).

1124. The doctrine and cases are discussed in *United States Trust Co. v. New Jersey*, 431 U.S. 1, 19-21 n.17 (1977), *Home Building & Loan Ass'n v. Blaisdell*, 290 U.S. 398, 427-34 (1934), and *Woodbine Savings Bank v. Shriver*, 236 N.W. 10, 12-13 (Iowa 1931).

For general discussion of this subject, see THEODORE SEDGWICK, A TREATISE ON THE RULES WHICH GOVERN THE INTERPRETATION AND APPLICATION OF STATUTORY AND CONSTITUTIONAL LAW 643-64 (1857), and Robert L. Hale, *The Supreme Court and the Contract Clause* (pt. 3), 57 HARV. L. REV. 852, 872-84 (1944).

1125. This is an appropriate place to consider the implications of a provision of New Jersey's constitution. The provision, as it read in 1844 and continues to read today, is as follows: "The Legislature shall not pass any... law impairing the obligation of contracts, or depriving a party of any remedy for enforcing a contract which existed when the contract was made." N.J. CONST. art. IV, § 7, ¶ 3. The prohibition against any law "depriving a party of any remedy for enforcing a contract which existed when the contract was made" would seem to preclude, as a matter of New Jersey state law, any argument that a statute impairing the obligation of a pre-existing contract could be sustained—under the alteration of remedy rationale—by according a right of appraisal to dissenters.

2. Eminent Domain Rationale

The second rationale is based on the doctrine that, when an enabling statute accorded a right of appraisal to dissenting shareholders, this constituted an exercise of the state's power of eminent domain, and therefore a pre-existing corporation could utilize such enabling legislation notwithstanding the Impairment Clause. As had been the case in the nineteenth century,[1126] this continued to be accepted doctrine in New Jersey in the twentieth century.[1127] Moreover, the doctrine found acceptance in a 1906

1126. *See supra* text accompanying notes 96-100.

1127. In *New Jersey & Hudson River Railway & Ferry Co. v. American Electric Works*, 81 A. 989 (N.J. 1911), a merger was effected, not pursuant to post-incorporation legislation, but pursuant to the merger provisions of the act under which the merger partners had been organized—merger provisions that accorded appraisal rights to dissenters. *See id.* at 989-90. The court said:

> It is, of course, familiar and well-settled law that a majority of the stockholders of a corporation cannot effect a consolidation with another corporation without unanimous consent, unless the right of consolidation has been conferred by legislation that may be read into the contract of incorporation. And on familiar principles a consolidation that is attempted to be made in violation of the rights of minority stockholders may at their instance be restrained by injunction, on the ground that it would violate their contract rights, and thus, in effect, take their property without their consent. We may concede, for the purposes of the argument, that the Legislature, in furtherance of a public use, might authorize a consolidation to be made at the will of a majority of the stockholders, notwithstanding the objection of the minority in interest, and without previous legislative authority that could be read into the contract of incorporation, provided provision were at the same time made for compensating the dissenters. And we might in such a case regard the action of the majority as amounting in effect to a taking of the property of the minority stockholders for public use, and deal with it as strictly and technically as would be proper in the case of proceedings taken to condemn the lands of an outside party for public use.

Id. at 991 (citation omitted); *see also* Outwater v. Public Serv. Corp., 143 A. 729, 732 (N.J. Ch. 1928), *aff'd per curiam*, 146 A. 916 (N.J. 1929) (referring to the right of appraisal as "the statutory grant of eminent domain in this limited form"); *infra* note 1161 and accompanying text (discussing the treatment of a statutory right of appraisal as an exercise of the power of eminent domain).

In *Group No. 23 of the Ass'n of the Sons of Poland v. Association of the Sons of Poland*, 187 A. 356 (N.J. 1936), in which a non-profit New Jersey corporation had been organized (in 1911) under a statute (of 1898) that permitted mergers only with other corporations organized under the same statute, it was held that complaining shareholders could enjoin the New Jersey corporation from merging into a New York corporation pursuant to a post-incorporation statute (enacted in 1932 under New Jersey's 1846 reserved power) that authorized non-profit corporations to merge with foreign corporations. *See id.* at 356-58. The court based its holding, in part, on the fact that the non-profit corporation statute, unlike the business corporation statute, accorded no right of appraisal to persons dissenting from a merger. *See id.* at 359. The court said:

> "When complainants became members of the defendant and accepted its certificate of insurance, a reciprocal relation arose between complainants and

decision by the U.S. Supreme Court,[1128] in a 1927 opinion by the highest court of Massachusetts,[1129] in a 1929 decision by Rhode Island's highest court,[1130] in a 1936 dictum by West Virginia's highest court,[1131] in a 1940 decision by New Hampshire's highest court,[1132] and in twentieth-century commentaries.[1133] Additionally, a 1904 decision

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> defendant on the one hand, and between complainants and their fellow members on the other hand.... In associating together under defendant's charter, defendant's members became bound in equity to refrain from combining together and, by a majority vote over the objection of a substantial minority, take advantage of permissive legislation to merge, if thereby a material change would result in the enterprise in which all had mutually agreed to embark and the contracts or status of the minority would be impaired.
>
> ....
>
> ... When a corporation organized under our general corporation act merges with another, its stockholders are not compelled to exchange their shares for stock in the merged corporation or, in case of dissenting stockholders, to accept what the merged corporation decides should be paid them. Dissenting stockholders may apply to our courts for an appraisement to determine the full value of their stock and to have such value paid them. But not so under the terms of the proposed merger. Complainants will be compelled to become members of the merged corporation ...."

Id. at 358-59 (quoting affirmed opinion of court below) (citation omitted); *see also In re* Paterson & Hudson River R.R. Co., 94 A.2d 657 (N.J. 1953) (treating a provision of appraisal rights for dissenters as a valid exercise of the power of eminent domain); *supra* text accompanying note 110 (discussing *In re Paterson*).

1128. *Offield v. New York, New Haven & Hartford Railroad Co.*, 203 U.S. 372 (1906), involved a Connecticut statute authorizing any railroad company that acquired more than three-fourths of the capital stock of another such corporation to purchase the minority shares at their appraised value upon a finding by a judge that such purchase was for the public interest. *See id.* at 376. Treating the taking of the minority shareholder's stock as an exercise of the state's power of eminent domain, the Court rejected the plaintiff's contention that the statute impaired his contract rights as a shareholder. *See id.* at 378.

1129. *See In re* Opinion of the Justices, 159 N.E. 55, 67-68 (Mass. 1927).

1130. *See* Narragansett Elec. Lighting Co. v. Sabre, 146 A. 777, 784 (R.I. 1929); *infra* text accompanying notes 1185-86 (discussing *Sabre*).

1131. *See* Swan v. Barnes, 184 S.E. 257, 259 (W. Va. 1936).

1132. *Perkins v. New Hampshire Power Co.*, 11 A.2d 811 (N.H.), *aff'd on reh'g*, 13 A.2d 475 (N.H. 1940), involved a sale of assets by one utility company to another pursuant to legislation that authorized such transfer and provided an appraisal right for dissenting shareholders of the transferor. *See id.* at 812-13. The court viewed the granting of appraisal rights to dissenters as a valid exercise of the state's power of eminent domain. *See id.* at 812.

1133. In 1915, the state of the law was summarized as follows:

> In England since Parliament is unhampered by any written constitution and has full and complete control over the affairs of corporations it may authorize the consolidation of corporations without regard to the consent of their stockholders. In this country, however, as heretofore shown, the organization of a corporation creates a contract between the stockholders of the corporation, which is entitled to the protection of the provision of the federal constitution prohibiting the several states from enacting any statute impairing the obligation of contracts. The consolidation of one corporation with another is

by the North Carolina Supreme Court applied this doctrine to validate a corporate merger effected pursuant to post-incorporation enabling legislation even though there was no reserved power in effect when the merging corporation was organized.[1134] And, as recently as 1975, the Delaware Chancery Court said that "[t]he power of a stockholder majority to override minority dissenters and remit them to the cash appraisal remedy is 'analogous to the right of eminent domain.' "[1135]

> a fundamental change in the purposes of the constituent corporations; and it is a general principle controlling consolidation that such action must receive the assent of every stockholder in the consolidating bodies, unless the power to consolidate has been conferred by legislation that may be read into the contract of incorporation. However, it seems to be settled, according to the better view at least, that under the power of eminent domain a state may authorize the consolidation of quasi-public corporations without the assent of all of the stockholders, upon making provision for the payment to dissenting stockholders of the value of their stock. The title to this species of property is no more secure against invasion, where the public use requires it, than is the ownership of real estate under this paramount right in the public.

7 RULING CASE LAW § 140, at 165-66 (William M. McKinney & Burdett A. Rich eds., 1915) (footnotes omitted). For a general discussion, see Annotation, *Power to Condemn, or Authorize the Condemnation of, Capital Stock of a Public Utility*, 81 A.L.R. 1071 (1932).

1134. *See* Spencer v. Seaboard Air Line Ry. Co., 137 N.C. 107, 119-23, 49 S.E. 96, 101-02 (1904); *supra* notes 107-09 and accompanying text (discussing *Spencer*).

1135. Francis I. duPont & Co. v. Universal City Studios, Inc., 343 A.2d 629, 634 (Del. Ch. 1975) (quoting FOLK, *supra* note 459, at 331). A similar statement had been made in *Federal United Corp. v. Havender*, 11 A.2d 331 (Del. 1940):

> While [the right of dissatisfied shareholders] to dissent is admitted, the public policy of the state declared by the [appraisal] statute, somewhat analogous to the right of eminent domain, does not permit a dissenting shareholder, as against an affirmative vote of two thirds, to veto a merger agreement if its terms are fair and equitable in the circumstances of the case.

Id. at 338-39.

However, the lower court's decision in *Meade v. Pacific Gamble Robinson Co.*, 51 A.2d 313 (Del. Ch. 1947), *aff'd*, 58 A.2d 415 (Del. 1948), can be taken as a holding that the statutory right of appraisal is not the equivalent of an exercise of the power of eminent domain. In this appraisal proceeding following a merger, the lower court rejected the shareholder's contention that he should receive interest on the appraisers' award from the effective date of the merger because the right of appraisal is analogous to the right of condemnation and, in a condemnation proceeding, interest is allowed (as a part of just compensation) from the date of the taking. *See id.* at 315-20. The appellate court sustained the denial of interest from the date of the merger, but it did not discuss the analogy of the right of appraisal to the right of condemnation in reaching its decision. *See Meade*, 58 A.2d at 417-18.

Reference should be made to a statement by the lower court in the *Meade* case (above). By way of dictum, the chancery court stated that "[a] merger statute unaccompanied by an appraisal statute in favor of dissenters is not only constitutional (no vested right being involved), but lawful action thereunder gives dissenters no cause of action to recover the value of their shares." *Meade*, 51 A.2d at 317. However, it is clear,

3. The Public Use Question

The argument has been made that the granting of a statutory right of appraisal to shareholders dissenting from a corporate transaction does not meet the eminent domain requirement that the taking be for a "public use."[1136] However, most courts have abandoned the notion that use by the public is required to sustain an exercise of the power of eminent domain, and they have come to the view that public advantage or benefit is sufficient.[1137] Moreover, it has come to be recognized that a substantial public interest is served by facilitating desirable corporate changes[1138] including corporate

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from other passages in the opinion, that the court had in mind a pre-incorporation (rather than a post-incorporation) merger statute. *See id.* at 316-17. This point is underscored by the court's citation of *Mayfield v. Alton Railway, Gas & Electric Co.*, 65 N.E. 100 (Ill. 1902) (involving a merger effected pursuant to pre-incorporation enabling legislation). *See Meade*, 51 A.2d at 317; *supra* note 28 (third paragraph) (discussing *Mayfield*).

1136. For example, Levy states:

> The suggestion is made that, if there is a provision for paying dissenters in the proposed corporate plans or if they are given the right to demand payment, the action under the amendment becomes less harsh and should lead the court to permit the majority move "as a sort of eminent domain." The fallacy of this argument seems to be the need to resort to the concept of eminent domain in situations where no public enterprise or purpose is necessarily involved and where the rule is therefore inapplicable.

Levy, *supra* note 332, at 424 n.18 (quoting Fuller, *supra* note 966, at 89); *see also* Spencer v. Seaboard Air Line Ry. Co., 137 N.C. 107, 129, 49 S.E. 96, 104 (1904) (Douglas, J., dissenting) (arguing that the right of eminent domain cannot be invoked in favor of a railroad consolidation because it does nothing for the good of the public).

1137. This position was arrived at by a New Jersey court more than a century and a half ago in *Scudder v. Trenton Delaware Falls Co.*, 1 N.J. Eq. 694, 726-30 (Ch. 1832) (holding that the legislature could constitutionally grant the power of eminent domain to a corporation whose purpose was to build a raceway to supply water power to others for use in manufacturing, and considering it adequate that a "public benefit" be anticipated by the legislature in granting the power). *See also* Hawaii Hous. Auth. v. Midkiff, 467 U.S. 229, 241 (1984) ("[W]here the exercise of the eminent domain power is rationally related to a conceivable public purpose, the Court has never held a compensated taking to be proscribed by the Public Use Clause.").

The matter is discussed in the following: Lawrence Berger, *The Public Use Requirement in Eminent Domain*, 57 OR. L. REV. 203 (1978); Philip Nichols, Jr., *The Meaning of Public Use in the Law of Eminent Domain*, 20 B.U. L. REV. 615 (1940); and Comment, *The Public Use Limitation on Eminent Domain: An Advance Requiem*, 58 YALE L.J. 599 (1949).

1138. In *Davis v. Louisville Gas & Electric Co.*, 142 A. 654 (Del. Ch. 1928), the court said:

> Even conceding, if need be, that the power of amendment reserved by the Legislature can extend only to those matters that are of public concern, yet it does not follow that the amendment here under debate [authorizing a stock reclassification] is to be condemned. This is for the reason that the problem of financing corporate needs is so vital to the continuance in existence of corporations created under the act, the matter of stock, its kinds, classifications

combinations generally and mergers in particular.[1139]

III. TREATMENT OF POST-INCORPORATION ALTERATIONS IN COMBINATION LAW

Having examined the differing ways in which the courts have resorted to the reserved power solution or the appraisal right solution in addressing—in other contexts—the issue of whether the Impairment Clause of the Constitution prevents a corporation from utilizing post-incorporation enabling legislation, the next matter to be examined is how those solutions have been applied in the context of post-incorporation statutes that either authorize new modes of corporate combination or modify the requirements for effecting a combination.

A. *Post-Incorporation Authorization*

One is not likely to find in a general corporation statute—even an early one—any express prohibition against a corporation's being

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> and relative rights, is so intimately associated with that problem, that it is difficult to escape the conclusion that the character of the statutory regulations defined by the Legislature for the meeting of that problem might very well be regarded as affected with a public interest and concern.

Id. at 658.

1139. In *Salt Dome Oil Corp. v. Schenck*, 41 A.2d 583 (Del. 1945), the court said:

> At common law it was within the power of a single stockholder to prevent a merger. It was when the idea became generally accepted that in the interest of changing economic conditions mergers should be permitted despite the opposition of minorities that statutes were enacted in many states, as in this State, which took away from the individual stockholder, the power to defeat the consolidation, and in return offered him compensation in money if he elected to sever his connection with the corporation. Merger statutes are enacted, not in aid of dissenting shareholders alone, but are as well in aid of majority stockholders, and also in aid of the public welfare if the notion is not entirely outmoded that healthy business corporations are in some degree conducive to the general good.

Id. at 587 (citation omitted).

In *Spencer v. Seaboard Air Line Railway Co.*, 137 N.C. 107, 49 S.E. 96 (1904), a case in which the court validated a merger effected pursuant to post-incorporation enabling legislation (enacted without benefit of a reserved power) on the ground that the legislation's provision of a right of appraisal for dissenting shareholders constituted a valid exercise of the state's power of eminent domain, the court said: "We find no more difficulty in holding that the condemnation of [the dissenting minority shareholder's] stock is for a public use than did [the court in *Raleigh & Gaston Railroad Co. v. Davis*, 19 N.C. 451 (1837)] in finding that the railroad was originally constructed for such use." *Spencer*, 137 N.C. at 125, 49 S.E. at 103. The *Davis* case, cited by the court, was the seminal decision in North Carolina holding that the power of eminent domain could be conferred by the legislature upon a private corporation for the purpose of acquiring land needed to build a railroad. *See Davis*, 19 N.C. at 468-70.

merged into another, against its selling all of its assets while prosperous, or against a class of its stock being the subject of a share exchange. This does not mean, however, that an unwilling shareholder has no contractual right—protected under the Impairment Clause—against consummation of such a transaction pursuant to post-incorporation legislation. A shareholder may have contractual rights with respect to what a corporation is not authorized to do as well as rights relating to what it is empowered to do.[1140]

1. Decisions in Merger Cases

Because a merger—at least from the perspective of shareholders of the disappearing corporation—clearly entailed a fundamental change, there was the inevitable question whether a corporation could constitutionally avail itself of post-incorporation legislation authorizing mergers.[1141] Absent either a reserved power or a right of appraisal, it was clear that the answer to this question was in the negative.[1142] Thus, the question was whether either a reserved power or a right of appraisal was sufficient (or necessary) to remove from

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1140. *See supra* notes 41-42 and accompanying text.

In *Bingham v. Savings Investment & Trust Co.*, 138 A. 659 (N.J. Ch. 1927), involving a merger, the court said:

> [The cited cases], relied upon by the complainants, settled the law in this state, that articles of incorporation constitute a contract between stockholders to engage only in the enterprise stipulated to be undertaken, and for the prosecution of which they contributed their capital for mutual gain, and that any radical change in the object for which the corporation was formed, even by legislative permission or mandate, violates the obligation of their contract.

Id. at 659-60.

In *Central Railroad Co. v. Collins*, 40 Ga. 582 (1869), in which it was said that a railroad corporation could not, without the consent of every shareholder, avail itself of post-incorporation legislation to justify its purchase of a large block of stock in another railroad corporation, the court pointed out (with respect to the argument that the post-incorporation legislation authorized the purchase):

> To this it may, in the first place, be replied, that any such power, though expressly granted, does not bind any of the stockholders who do not consent to it. Each stockholder has rights in the nature of contract, rights in the limitations, as well as in the grants to the corporation, and even the Legislative will cannot, under the Constitution of the United States, impair those contract rights by making him, against his will, an adventurer in an enterprise not contemplated by the original charter.

Id. at 632.

1141. The matter is discussed in Annotation, *Constitutional and Statutory Provisions Relating to Consolidation, Merger, or Reorganization of Corporations as Applicable Retrospectively to Corporation Previously Chartered*, 131 A.L.R. 734 (1941).

1142. *See supra* notes 40-45 and accompanying text.

the prohibition of the Impairment Clause a utilization of enabling merger legislation by a pre-existing corporation.

a. Nineteenth-Century Cases

While there were several nineteenth-century cases involving the reserved power question in the context of corporate mergers, there was little in the way of a pattern to their holdings.

Some of those cases looked in the direction of sustaining the utilization of post-incorporation merger legislation on the basis of a pre-incorporation reserved power. Thus, in an 1859 Connecticut case,[1143] the court validated the consolidation of a Connecticut corporation with a corporation of Rhode Island on the ground that the Connecticut legislature's subsequent ratification of the consolidation constituted a valid exercise of the reserved power contained in the Connecticut corporation's special-act charter. In an 1894 Massachusetts case,[1144] it was held that, because of a pre-incorporation reserved power, a corporation could enter into a consolidation upon receiving the approving vote of a majority in interest of the shareholders as prescribed in post-incorporation legislation authorizing such consolidation. Also, in an 1895 California case,[1145] it was held, on the basis of an expansive reading of the reserved power,[1146] that a corporation could avail itself of a post-incorporation statute authorizing consolidations with a less-than-unanimous vote of shareholders.

Decisions in other early merger cases looked in a different direction. In a federal case involving an Indiana corporation, decided in 1866,[1147] the court (at the behest of a complaining shareholder) enjoined the consummation of a consolidation pursuant to post-incorporation legislation, the court noting that the enabling statute—being permissive rather than mandatory—could be utilized by the pre-existing corporation only with the consent of every shareholder, notwithstanding the fact that the corporation's special-act charter contained a reserved power to alter or amend. In an 1888 Kentucky case,[1148] it was held that the consolidation of two corporations could

1143. *See* Bishop v. Brainerd, 28 Conn. 289, 296-99 (1859).

1144. *See* Hale v. Cheshire R.R. Co., 37 N.E. 307, 307 (Mass. 1894).

1145. *See* Market St. Ry. Co. v. Hellman, 42 P. 225, 229 (Cal. 1895).

1146. *See supra* note 80.

1147. *See* Mowrey v. Indianapolis & Cincinnati R.R. Co., 17 F. Cas. 930, 932-33 (C.C.D. Ind. 1866) (No. 9891); *infra* notes 1299-1300 and accompanying text (discussing *Mowrey*).

1148. *See* Botts v. Simpsonville & Buck Creek Turnpike Co., 10 S.W. 134, 134-35 (Ky. 1888).

be accomplished only with unanimous consent of the shareholders, notwithstanding post-incorporation legislation authorizing such transaction to be effected upon the approval of "a majority of the stockholders of the two companies," and that such a consolidation could not be effected even when the enabling legislation was enacted pursuant to a reserved power unless it could be shown that the complaining shareholders would not be harmed by the consolidation.

In none of these nineteenth-century merger cases did the opinion refer to a statutory right of appraisal. Reference should be made, however, to another nineteenth-century merger case, *Lauman v. Lebanon Valley Railroad Co.*,[1149] in which it was held (with no reference in the opinion to any reserved power) that a merger pursuant to post-incorporation legislation could not go forward unless security was given for payment to the dissenting shareholder of the value of his stock—a kind of judicially mandated right of appraisal.[1150]

b. Twentieth-Century Cases

As indicated by the cases outlined below,[1151] state courts in the twentieth century have generally held that a corporation organized prior to enactment of a merger statute could avail itself of the post-incorporation legislation to effect a merger with the less-than-unanimous shareholder vote specified in the enabling statute.[1152] While all but the first of the outlined cases involved enabling merger legislation enacted pursuant to a pre-incorporation reserved power, it is interesting to note the degree to which the outcome in several of the cases was influenced by the fact that the post-incorporation enabling legislation accorded a right of appraisal to dissenters.[1153]

1149. 30 Pa. 42 (1858).

1150. *See id.* at 49. This doctrine continued to be followed in Pennsylvania well into the twentieth century. *See* Barnett v. Philadelphia Mkt. Co., 67 A. 912, 913 (Pa. 1907); Nice Ball Bearing Co. v. Mortgage Bldg. & Loan Ass'n, 166 A. 239, 240 (Pa. 1933).

1151. The case of *Winfree v. Riverside Cotton Mills Co.*, 75 S.E. 309 (Va. 1912), is omitted from the outline because, while the merger involved in this case was effected under legislation enacted in 1903 by a corporation organized in 1882, the 1903 merger statute was held to be applicable (under the analysis of the court) by reason of a charter amendment made in 1904 and a provision of the state constitution to the effect that any corporation electing to make any amendment of its charter would be presumed thereby to have agreed to subject itself to all applicable laws then in effect. *See id.* at 311.

1152. *See* Norton v. Union Traction Co., 110 N.E. 113, 118 (Ind. 1915) ("Where the Legislature has reversed [sic reserved?] the right to alter or amend a corporation charter, and, after its incorporation, authorizes a consolidation, it is held by the greater weight of American authority that a dissenting stockholder may not prevent consolidation.").

1153. Even in *Winfree*, one of the factors alluded to by the court, in holding that a

In 1904, in *Spencer v. Seaboard Air Line Railway Co.*,[1154] the court upheld a merger pursuant to post-incorporation legislation authorizing the merger to be effected upon approval by a majority shareholder vote. The merger was validated even though the corporation utilizing the enabling statute had been organized before the state adopted its first reserved power. The reason for its validation was that the enabling statute accorded the right of appraisal to dissenting shareholders, which the court considered to be a valid exercise of the state's power of eminent domain.[1155]

In 1908, in *Colby v. Equitable Trust Co.*,[1156] it was held (over the protest of a minority shareholder seeking injunctive relief) that a corporation could be merged into another, pursuant to post-incorporation legislation, upon the two-thirds vote of shareholders prescribed in the enabling legislation. While this result was based on the existence of a pre-incorporation reservation of the power to alter or repeal corporate charters,[1157] the court also placed emphasis on the fact that the enabling merger statute accorded the right of appraisal to dissenting shareholders[1158] (though it did not characterize this as an

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corporation could avail itself of post-incorporation merger legislation, was the right of appraisal accorded to dissenters by that legislation. *See Winfree*, 75 S.E. at 312. The court said:

> While under the provisions of [the enabling legislation] the Riverside Cotton Mills Company had the right to consolidate with the Dan River Power & Manufacturing Company by a majority vote, any stockholder of either corporation who did not give his assent to such consolidation and was dissatisfied therewith had the right to refuse to become a stockholder in the consolidated corporation, and was entitled to receive from such consolidated corporation the fair cash value of his stock as of the day before the vote for consolidation was cast, and a summary remedy was provided for ascertaining the value of such stock and to secure its payment to the dissenting stockholder.

Id.

1154. 137 N.C. 107, 49 S.E. 96 (1904).

1155. *See id.* at 119-23, 49 S.E. at 101-02; *supra* notes 107-09 and accompanying text, and note 1130 and accompanying text (discussing *Spencer*).

1156. 108 N.Y.S. 978 (App. Div.), *aff'd per curiam*, 84 N.E. 1111 (N.Y. 1908).

1157. *See id.* at 980-81. On this point, the court relied (in part) on the decision in *Hinckley v. Schwarzschild & Sulzberger Co.*, 95 N.Y.S. 357 (App. Div. 1905). *See infra* text accompanying notes 1240-44 (discussing *Hinckley*).

1158. The court said:

> Here the merger of the Equitable Trust Company, if the merger be permitted to take place, will result in the extinction of that corporation, and the transfer of its assets to the new corporation, but its property is not confiscated, nor is the corporation deprived of vested property rights. The property is sold to the merged corporation upon the terms provided in the merger agreement, and ample provision is made under the statute authorizing the merger by which any stockholder who is unwilling to assent to the terms can obtain the value of his stock in cash. The act provides that any stockholder who does not agree to the

exercise of the power of eminent domain).

In 1927, in *Bingham v. Savings Investment & Trust Co.*,[1159] when a corporation (organized in 1890) sought to merge two other corporations into itself pursuant to post-incorporation legislation (enacted in 1925), authorizing such a merger with a two-thirds vote of shareholders and providing an appraisal right for dissenters, minority shareholders sought to enjoin the transaction on the ground that the corporation could not avail itself of the post-incorporation legislation (over the objection of the complainants) "because to do so would impair the obligation of the corporations' contract with its stockholders, and the undertaking inter sese of the stockholders, in violation of the fundamental law."[1160] The court denied the injunction, in part on the ground that a merger does not impact on a shareholder of the surviving corporation in the way that it does with respect to a shareholder of the disappearing corporation, but principally on the ground that the enabling statute provided compensation to dissenters by way of the appraisal right in the nature of an exercise of the power of eminent domain.[1161]

> terms of the merger agreement may object to it and demand payment of his stock, and, if not paid, he may apply to the Supreme Court for the appointment of three appraisers to fix and determine the value of his stock, and the expenses of such determination have to be borne by the corporation itself.

Colby, 108 N.Y.S. at 981.

1159. 138 A. 659 (N.J. Ch. 1927), *aff'd*, 140 A. 321 (N.J. 1928).

1160. *Id.* at 659.

1161. The court said:

> Kean v. Johnson, Zabriskie v. Hackensack & N. Y. R. Co., Black v. Delaware & R. Canal Co., and Mills v. Central R. Co., relied upon by the complainants, settled the law in this state, that articles of incorporation constitute a contract between stockholders to engage only in the enterprise stipulated to be undertaken, and for the prosecution of which they contributed their capital for mutual gain, and that any radical change in the object for which the corporation was formed, even by legislative permission or mandate, violates the obligation of their contract.... They are authority for the proposition that a majority of the stockholders cannot alter their contract inter sese, though the Legislature authorized it; i.e. that the reserve power of the state over corporate grants was not intended to authorize a majority of stockholders to change the contract. The doctrine is, of course, to be applied subject to the police power of the state, and it has no place if the articles of incorporation or the statute under which corporations come into being permit such changes. The power of the state, however, under its reserve power, to alter or amend charters, in respect of the contract created *between the state and the corporation*, is absolute, to protect the rights of the public, carry into effect the original purposes of the grant, and to promote the due administration of corporate affairs; and if, incidentally, injury to stockholders ensues, they must submit under their implied contract with the state to suffer it. The office of the reserve power, in our organic and statutory law, is to safeguard the public interests in corporate grants, which without the

In 1931, in *Kirby v. Saginaw Hotels Co.*,[1162] the court denied relief to a complaining shareholder who sought to set aside a consolidation effected pursuant to post-incorporation enabling legislation. The decision was based on the fact—of dubious relevance—that the plaintiff had acquired her shares (from her husband) after the enabling legislation had been enacted.[1163]

> reservation would, under the rule in the Dartmouth College Case, be an irrevocable contract.

Id. at 659-60 (citations omitted). The court said further:

> The legislative expression predicates the Merger Act to be in the public interest—peculiarly a legislative function—and also to be within the reserve power over corporate contracts. The reserve power to *repeal* charters is absolute. Every corporation accepts the corporate privilege with notice that it may be withdrawn at the will of the Legislature. The extinction of a charter by merger is nothing short of a repeal of the charter to a stockholder unwilling to go along with the merger. As to him the merger is not an alteration or amendment of the grant, but a complete destruction of it. Destroying, the state has a care not to take away or destroy the stockholder's investment and safeguards it by providing compensation by appraisal at fair value. With the compensation provision present, there can be no longer any question as to the power of the state under the reserve power to repeal, alter, or amend the charter of any corporation in any respect, if the change be in the public interest.
>
> This view was entertained by the New York Supreme Court, and affirmed by the Court of Appeals, in *Colby v. Equitable Trust Co.* It finds support in the almost uniform legislative practice of the states, of providing compensation in corporate consolidations, and in the approval by our Court of Appeals, as being in the nature of an exercise of the power of eminent domain.

Id. at 661 (citation omitted).

1162. 235 N.W. 153 (Mich. 1931).

1163. *See id.* at 153. Courts have differed on the question whether the contract rights of a shareholder should be determined on the basis of the law in existence at the time of the corporation's organization or at the time the shareholder acquired his shares. *See* John K. McNulty, *Corporations and the Intertemporal Conflict of Laws*, 55 CAL. L. REV. 12, 31-32 n.65 (1967).

In *Zobel v. American Locomotive Co.*, 44 N.Y.S.2d 33 (Sup. Ct. 1943), when complaining shareholders attacked a merger, the court did not consider "whether the correct rule is that stockholders take subject to such statutes as exist when they acquire their stock or subject only to such as existed when the corporation issued the stock." *Id.* at 36.

In *Johnson v. Bradley Knitting Co.*, 280 N.W. 688 (Wis. 1938), the court considered a shareholder to be bound by statutes in effect at the time of his becoming a shareholder. *See id.* at 692; *accord* Detroit & Canada Tunnel Corp. v. Martin, 91 N.W.2d 525, 530-31 (Mich. 1958); *see also* Luce, *supra* note 943, at 22-24 (arguing for the determination of shareholders' rights as of the time they acquire their stock).

It would seem that the better rule is the one followed in *Allen v. Francisco Sugar Co.*, 112 A. 887 (N.J. 1921), in which the court said:

> Because it appears in the present case that the complainant did not acquire his shares of stock until after the passage of the [post-incorporation enabling legislation], the contention of counsel of appellant [i.e., the corporation that sought to avail itself of the enabling legislation] is that the complainant is not in the position of a stockholder who had acquired his shares of stock before

In 1940, in *Barnett v. D.O. Martin Co.*,[1164] the court refused to enjoin the merger of two corporations even though both had been organized prior to enactment of the enabling merger statute. While that statute accorded appraisal rights to dissenters,[1165] the opinion made no reference to that fact. Rather, the court's decision was based on the fact that a power of amendment or repeal had been reserved to the legislature prior to organization of the corporations

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> the act was passed, and therefore he must be considered as one whose "rights" as a shareholder were fixed by the statute at the time he bought his stock.
>
> ....
>
> It seems to us that to adopt the contention of counsel of appellant to the effect that the "rights" of the stockholder are fixed at the time he purchased his stock, and not by the original charter of the corporation, would be to lay down a rule which would tend to inextricable confusion. There would be as many varied and distinct rights of stockholders depending upon the time of purchase as there were alterations in the charter affecting such rights.
>
> A person proposing to buy stock could only properly protect himself against imposition of terms not warranted by the original compact, by having a sort of title search made to every stock certificate purchased. To impose such a burden on stock would destroy its value in the business world. It would detract from its negotiability. The sound rule must therefore be that the buyer of stock whenever purchased comes into the original compact. He buys a share in that compact as well as in the property.

Id. at 889; *see also* Loewenthal v. Rubber Reclaiming Co., 28 A. 454, 456 (N.J. Ch. 1894) ("Each new holder of stock by transfer becomes a party to the original contract between the stockholders, and entitled to all its benefits.").

Schramm v. Done, 293 P. 931 (Or. 1930), involved a banking corporation organized, with capital of $15,000, in 1907, at which time the state's constitution provided that shareholders of all corporations would be liable for corporate indebtedness only to the extent of the amount subscribed but unpaid on their stock. *See id.* at 931-32. In 1912, the state constitution was amended to impose double liability on shareholders of banking corporations for the benefit of bank depositors. *See id.* at 932. Thereafter, on three occasions (1914, 1919, and 1924), there were stock increases aggregating $25,000—all subscribed and fully paid. *See id.* at 931. The bank failed in 1926, and the superintendent of banks proceeded to assess every shareholder an amount equal to the par value of the shares held by such holder. *See id.* at 932. Because there was no reserved power in effect when the corporation was organized (such a power not having been adopted by the legislature until 1915), it was held that the original issue of stock could not be subjected to the liability imposed by the post-incorporation constitutional amendment without impairing the obligation of the subscription contracts in violation of the Impairment Clause. *See id.* at 933-35. As to the stock issued in the 1914-1924 period, it was held that the double liability could be imposed validly, because the 1912 amendment of the state constitution became a part of the subscription contracts for the increases in stock. *See id.* at 935-36. The result of this decision was that there were two classes of the same stock—a matter not addressed in this case but one alluded to in the case of *Haberlach v. Tillamook County Bank*, 293 P. 927, 930 (Or. 1930), decided by the same court on the same day.

1164. 11 S.E.2d 210 (Ga. 1940).

1165. *See* Act of Jan. 28, 1938, [no chapter number], § 20, 1937-38 Extra Session Ga. Laws 214, 233-35.

involved.[1166]

In 1949, in *Beloff v. Consolidated Edison Co.*,[1167] the court upheld a short-form cash-out merger effected pursuant to post-incorporation enabling legislation, the merger having been challenged by dissenting shareholders of the disappearing subsidiary. While the opinion does not equate the statutory grant of appraisal rights with an exercise of the state's power of eminent domain, it does make clear that the availability of appraisal rights for dissenters played a determinative role in the outcome of the case.[1168]

In 1967, in *Brundage v. New Jersey Zinc Co.*,[1169] the court refused to set aside the merger of a subsidiary into its parent (upon a two-thirds shareholder vote) even though the subsidiary had been organized prior to enactment of legislation authorizing such a merger. Because the post-incorporation enabling statute accorded a right of appraisal to dissenters, the court could have proceeded on the basis of the eminent domain analysis that the New Jersey courts had applied from *Black* in 1873[1170] to *Bingham* in 1927.[1171] Instead,

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1166. The court said:

> The authorities above referred to and the reasoning on which they are based demonstrate, in our opinion, the correctness of the proposition that where the reserved power existed at the time of their creation, the General Assembly may authorize pre-existing corporations to merge or consolidate upon the affirmative vote of less than all of the stockholders.

Barnett, 11 S.E.2d at 216; *accord* Baugh v. Citizens & S. Nat'l Bank, 281 S.E.2d 531, 532-33 (Ga. 1981) (following *Barnett*).

1167. 87 N.E.2d 561 (N.Y. 1949).

1168. After stating that the reserved power "authorizes the Legislature to make appropriate non-confiscatory statutory provisions for mergers," *id.* at 564, the court continued as follows:

> It is ... well settled that if the merger ... is duly consummated in accordance with the statutes, the remedy of appraisal and payment is the only one available to dissenting shareholders, and that such dissenters on such an appraisal are entitled to receive fair and full compensation for all their rights.... In short, the merged corporation's shareholder has only one real right; to have the value of his holding protected, and that protection is given him by his right to an appraisal.

Id. (citations omitted); *accord* Willcox v. Stern, 219 N.E.2d 401, 404 (N.Y. 1966) (stating, in the context of an unsuccessful Fourteenth Amendment challenge to a short-form cash-out merger, that "[s]o long as the value of petitioner's interest is compensable [by way of the right of appraisal], he has no constitutionally protected right to continue as a stockholder").

1169. 226 A.2d 585 (N.J. 1967); *see supra* text accompanying notes 1075-80 (discussing *Brundage*). There is a discussion of this case in Neill G. McBryde, Comment, *Corporations—Reserved Powers and Fundamental Corporate Changes—Protection of Minority Stockholders' Interests*, 46 N.C. L. REV. 931 (1968).

1170. *See* Black v. Delaware & Raritan Canal Co., 24 N.J. Eq. 455 (1873); *supra* text accompanying notes 96-100 (discussing *Black*).

the court decided to disavow New Jersey's century-old *Zabriskie* doctrine and to embrace an expansive reading of the state's reserved power.[1172] Nonetheless, it did so "bearing in mind" (among other things) "the broad appraisal rights afforded to dissenters" under the statute.

In 1969, in *Bove v. Community Hotel Corp.*,[1173] the court refused to enjoin a proposed merger of a corporation into its newly created wholly owned subsidiary, when the sole purpose of the merger was to eliminate the parent's preferred stock and dividend arrearages thereon, when such a recapitalization by charter amendment would have required a unanimous vote of the preferred shareholders, and the enabling merger statute (requiring a vote of two-thirds of the shares of that class) was enacted after the parent's incorporation. Noting that some courts had adopted a restrictive reading of the reserved power while others had adopted an expansive reading,[1174] this court opted for the expansive reading to the effect that "alterations [in the stockholder's contractual rights] are permitted by the stockholder's contract into which the law reads the reserved power to amend or repeal."[1175]

2. Decisions in Sale-of-Assets Cases

There has been a split in the decisions involving the validity of sale-of-assets transactions effected pursuant to post-incorporation legislation authorizing such transactions upon a favorable vote of some specified majority of the shares of the selling corporation.

1171. *See* Bingham v. Savings Inv. & Trust Co., 138 A. 659 (N.J. Ch. 1927), *aff'd*, 140 A. 321 (N.J. 1928); *supra* text accompanying notes 1159-61 (discussing *Bingham*).

1172. The court said:

> The power reserved in our organic and statutory law was broadly phrased and broadly intended. It should liberally be viewed as part and parcel of the tripartite arrangements between the State, the corporation and the stockholders, and thus viewed, as permitting reasonable corporate charter amendments having legitimate business ends. Under this approach there can be no question with respect to the application here of the two-thirds vote provision of our present merger statute, bearing in mind not only the broad appraisal rights afforded to dissenters, but also the broad protection afforded to them under the settled and continuing New Jersey doctrine that a merger, even though it complies procedurally with the statutory requirements, must also satisfy basic equitable requirements of good faith and fair treatment.

Brundage, 226 A.2d at 595-96 (citations omitted).

1173. 249 A.2d 89 (R.I. 1969).

1174. *See id.* at 96; *supra* note 980 (quoting *Bove*).

1175. *Bove*, 249 A.2d at 97.

a. Cases Not Permitting Sale or Lease of Assets Unless Provision Made for Right of Appraisal

In New Jersey, as early as 1873, it was held that a corporation could avail itself of post-incorporation legislation authorizing a lease of all of its assets only when such enabling legislation accorded a right of appraisal to dissenters.[1176] And, in 1886, a New Jersey court invalidated a 999-year lease of a railroad corporation's line to another company because the post-incorporation enabling legislation, though enacted pursuant to a pre-incorporation reserved power, gave no right of appraisal to dissenters.[1177]

This nineteenth-century doctrine continued to be followed in New Jersey well into the twentieth century. In *Allen v. Francisco Sugar Co.*,[1178] decided in 1921, the court—adhering to the restrictive reading of the reserved power[1179]—refused to allow a corporation to enter into a ten-year lease of practically all of its revenue-producing property pursuant to a post-incorporation statute that authorized such leases but made no provision for dissenters' appraisal rights.[1180] In *In re Paterson & Hudson River Railroad Co.*,[1181] decided in New Jersey in 1953, it was held that a corporation (which had been granted a perpetual charter in 1831 with no reservation of a power to alter or repeal) could validly sell all of its assets to its parent corporation because, even if action under the post-incorporation enabling statute (which accorded appraisal rights to shareholders dissenting from such a transaction) were to be considered an impairment of the contractual rights of minority shareholders, such impairment would not be unconstitutional for the reason that the statute represented a valid exercise of the state's power of eminent domain.[1182]

This doctrine—that the validity of a corporation's utilization of post-incorporation legislation authorizing a sale or lease of corporate assets depended, not upon the question whether there was a pre-

1176. *See* Black v. Delaware & Raritan Canal Co., 24 N.J. Eq. 455, 468-73 (1873); *supra* text accompanying notes 96-100 (discussing *Black*).

1177. *See* Mills v. Central R.R. Co., 2 A. 453, 454-55, 460 (N.J. Ch. 1886); *supra* notes 147-48 and accompanying text (discussing *Mills*).

1178. 112 A. 887 (N.J. 1921).

1179. *See id.* at 889; *supra* note 1041 (third paragraph) (discussing *Allen*).

1180. *See Allen*, 112 A. at 888-89; Act of Mar. 24, 1899, ch. 150, § 1, 1899 N.J. Laws 334, 334; *supra* note 182 and accompanying text (quoting and discussing the statute).

1181. 94 A.2d 657 (N.J. 1953).

1182. *See id.* at 659-60; *supra* text accompanying note 110 (discussing *In re Paterson & Hudson River Railroad Co.*).

existing reservation of power to alter or amend, but upon the question whether dissenters were accorded appraisal rights—was not confined to New Jersey. In *Dow v. Northern Railroad*,[1183] a railroad corporation, whose special-act charter (granted in 1844) contained a reserved power of amendment or repeal, was enjoined—at the behest of two minority shareholders—from carrying out a 99-year lease of its property to another railroad company, when such lease had been entered into pursuant to post-incorporation legislation (enacted in 1883) that authorized such leases to be made upon approval by a two-thirds vote of stockholders but "contain[ed] no provision for the compensation of dissenting stockholders."[1184] In *Narragansett Electric Lighting Co. v. Sabre*,[1185] when a special-act charter authorized the corporation to acquire all of the assets of another utility corporation upon the approval of two-thirds of the outstanding stock of the selling corporation and with appraisal rights accorded to the seller's dissenting shareholders, it was held that the provision of appraisal rights for the seller's dissenters constituted legislative authorization of a taking by eminent domain with the result that there was no violation of the Impairment Clause of the Constitution.[1186]

The lesson of *Dow*[1187] was not overlooked in New Hampshire. Two years after that 1887 decision, the statute authorizing a railroad corporation to lease its property to another such corporation was amended to provide appraisal rights for dissenters,[1188] and this change was characterized by New Hampshire's highest court as an exercise of the state's power of eminent domain.[1189] Nor did the teaching of *Mills* in 1886[1190] go unnoticed in New Jersey. When that state, in 1893, authorized the leasing of property by one street railway corporation to another, the statute included a provision according appraisal rights to dissenters.[1191] On the other hand, it was the failure

1183. 36 A. 510 (N.H. 1887).

1184. *Id.* at 511.

1185. 146 A. 777 (R.I. 1929).

1186. *See id.* at 784; *supra* notes 62-64 and accompanying text (citing and quoting cases holding that exercise of the power of eminent domain does not violate the Impairment Clause).

1187. *See supra* text accompanying notes 1183-84.

1188. *See In re* Laconia St. Ry., 52 A. 458, 459 (N.H. 1902).

1189. *See* Perkins v. New Hampshire Power Co., 11 A.2d 811, 812 (N.H.), *aff'd on reh'g*, 13 A.2d 475 (N.H. 1940); *supra* note 1128 (discussing *Perkins*).

1190. *See* Mills v. Central R.R. Co., 2 A. 453, 454-55, 460 (N.J. Ch. 1886); *supra* text accompanying note 1177 (discussing *Mills*).

1191. *See* Dickinson v. Consolidated Traction Co., 114 F. 232, 250-55 (C.C.D.N.J. 1902), *aff'd*, 119 F. 871 (3d Cir. 1903).

of New Jersey's 1899 leasing statute (applicable to corporations other than railroad and canal companies) to make provision for appraisal rights that led to the result in *Allen*.[1192]

b. Cases Permitting Sale of Assets Under Expansive Reading of Reserved Power

There were at least two cases—decided early in the twentieth century—that took the different approach of validating a sale of assets under post-incorporation enabling legislation simply on the basis of an expansive reading of the reserved power. In *Allen v. Ajax Mining Co.*,[1193] the court refused to enjoin a proposed sale by a prosperous corporation of all of its assets to another corporation, when the only authorization for such sale was found in post-incorporation legislation authorizing such transactions with the approval of two-thirds of the outstanding stock. While the enabling statute accorded appraisal rights to dissenters,[1194] that was not the basis of the decision; rather, the decision was based on an expansive reading of a pre-incorporation reserved power.[1195] Similarly, in *Germer v. Triple-State Natural Gas & Oil Co.*,[1196] it was held that a corporation could sell all of its assets under the terms of a post-incorporation enabling statute enacted pursuant to a pre-incorporation reserved power. There was no mention in the decision

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1192. *See* Allen v. Francisco Sugar Co., 112 A. 887, 888-89 (N.J. 1921); *supra* text accompanying notes 1178-80 (discussing *Allen*).

1193. 77 P. 47 (Mont. 1904).

1194. *See id.* at 48.

1195. *See id.* at 48-50. The court said:

> [T]he plaintiff [minority shareholder], when he subscribed for stock in this company, did so, charged with the full knowledge of the constitutional and statutory provisions then existing, under which the Legislature might at any time alter, amend, or repeal the provisions of the law which was made a part of its charter; and he must therefore be treated as having given his tacit consent that such changes might be made at any time as in the wisdom of the Legislature might be necessary, and this as fully as if he had signified such consent by a writing duly subscribed by himself.
>
> It cannot be said, then, that the enforcement of the provisions of [the post-incorporation statute authorizing a sale of assets] will impair the obligation of any contract which the plaintiff entered into when he became a stockholder of this company, for the reason that the reservation of this authority to alter, amend, or repeal the law under which the company was organized became as much a part of the law of its creation as any other provision respecting it, and became a part of the charter, modifying what would otherwise have been an absolute grant.

Id. at 49.

1196. 54 S.E. 509 (W. Va. 1906).

of a right of appraisal; the outcome was based entirely on an expansive reading of the reserved power.[1197]

c. Special Problem That Arises Under Statutes of Delaware

As noted above, the current statutes of both New Jersey and North Carolina provide appraisal rights for shareholders dissenting from a sale-of-assets transaction[1198]—with exceptions[1199] discussed earlier.[1200] Delaware, on the other hand, has never provided a statutory right of appraisal for shareholders dissenting from a sale-of-assets transaction.[1201]

The question arises, therefore, whether a Delaware corporation organized prior to 1917—when that state first enacted its sale-of-assets legislation[1202]—could lawfully avail itself of such post-incorporation enabling legislation.[1203] Two years before that

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1197. *See id.* at 513. The court said:

> When the Triple-State stock was subscribed for by the stockholders, they did so charged with a full knowledge of the statutory provisions then existing under which the Legislature might, at any time, alter, amend, or repeal the provisions of the law which were made a part of the charter. The powers reserved to the Legislature are plain and distinct, and any amendment or alteration made subsequent to the formation of the corporation, and made within the scope of the reserved powers, were written into the charter as certainly as the restrictions and rights and powers of the stockholders and the corporation itself existing at the time of the incorporation....
>
> ....
>
> The broad reservation to the Legislature to "amend, alter or repeal" the provisions of the statute under which corporations operate are as though written into every charter issued thereunder, and every subscriber to the stock of any such corporation is charged with full knowledge of the provisions of the law then existing, under which the Legislature might, at any time, amend, alter, or repeal the provisions of the law which were so made a part of the charter, and such subscriber must be held to have given his consent that such change might at any time be made by the Legislature. This being true, it cannot be claimed, with good reason, that by such action the Legislature would be impairing the obligation of any contract the subscriber entered into when he became a stockholder.

Id. at 513.

1198. *See* N.J. STAT. ANN. § 14A:11-1(1)(b) (West Supp. 1997) (quoted and discussed *supra* in note 858 and accompanying text); N.C. GEN. STAT. § 55-13-02(a)(3) (Supp. 1996) (quoted and discussed *supra* in note 841 (first paragraph) and accompanying text).

1199. *See supra* text accompanying notes 841-42 (North Carolina) and 859-60 (New Jersey).

1200. *See supra* text accompanying notes 773-76 and 884-85.

1201. *See supra* text accompanying notes 880-83.

1202. *See supra* notes 810-11 and accompanying text.

1203. This question was raised on appeal in *Cottrell v. Pawcatuck Co.*, 128 A.2d 225 (Del. 1956); however, the court declined to consider the question because it had not been raised in the court below. *See id.* at 233.

legislation was enacted, a Delaware court, in *Butler v. New Keystone Copper Co.*,[1204] had said that, in the absence of charter or statutory authorization, a prosperous corporation could not sell all of its assets over the dissent of a single shareholder.[1205] Could this veto power be taken away by applying Delaware's 1917 enabling statute to a pre-existing corporation without violating the Impairment Clause of the Constitution? The decisions in *Allen v. Ajax Mining Co.*[1206] and *Germer v. Triple-State Natural Gas & Oil Co.*[1207] would answer this question in the affirmative—on the ground that the reserved power became part of the charter contract of all corporations organized after reservation of the power and, therefore, no action taken under enabling legislation enacted pursuant to that reserved power could have the effect of unconstitutionally violating rights of shareholders of corporations in existence at the time of enactment of such legislation. But query whether this applies in the case of Delaware's reserved power statute.

When the Delaware sale-of-assets statute was enacted in 1917, that state's reserved power statute contained a provision that "this Act and all amendments thereof shall be a part of the charter of every such corporation except so far as the same are inapplicable and inappropriate to the objects of such corporation."[1208] The obvious question is whether a statutory amendment authorizing a corporation to sell all of its assets upon approval by less than all of its shareholders—something that could not be done in the absence of an enabling statute—is "inapplicable and inappropriate to the objects of such corporation."[1209]

1204. 93 A. 380 (Del. Ch. 1915).

1205. *See id.* at 383; *supra* notes 11 (first paragraph) (quoting *Butler*) and 810 (discussing *Butler*).

1206. 77 P. 47 (Mont. 1904); *see supra* notes 1193-95 and accompanying text (discussing *Allen*).

1207. 54 S.E. 509 (W. Va. 1906); *see supra* notes 1196-97 and accompanying text (discussing *Germer*).

1208. Act of Mar. 7, 1901, ch. 167, § 140, 22 Del. Laws 286, 353; *see supra* note 53 (second and third paragraphs).

1209. In 1917, the Delaware corporation statute provided: "The Certificate of Incorporation shall set forth: ... (3) The nature of the business, or objects or purposes proposed to be transacted, promoted or carried on." DEL. REV. CODE § 1919 (1915). The same provision (except for the comma after the word "business") appeared in section 7 of the 1899 Delaware corporation statute. *See supra* note 251 (first paragraph). It was not until Act of July 3, 1967, ch. 50, 56 Del. Laws 151, that the statute provided: "It shall be sufficient to state, either alone or with other businesses or purposes, that the purpose of the corporation is to engage in any lawful act or activity for which corporations may be organized under the General Corporation Law of Delaware...." *Id.* sec. 1, § 102(a)(3), 56 Del. Laws at 153.

In a number of cases, it has been held or stated that the reason why (absent charter or statutory authorization) all of a prosperous corporation's assets could not be sold over the dissent of a single shareholder was that such a transaction would be contrary to accomplishment of the objects of the corporation.[1210] This truism would seem to lead to the conclusion that Delaware's 1917 sale-of-assets statute would be "inapplicable and inappropriate to the objects" of a pre-existing corporation. And this, in turn, would seem to mean that Delaware's reserved power would not (by itself) sustain the utilization by a pre-1917 corporation of that post-incorporation sale-of-assets legislation.

The lesson to be derived from this seems clear. Any Delaware

1210. In *Kean v. Johnson*, 9 N.J. Eq. 401 (Ch. 1853), the defendants argued that a sale of the corporation's assets was valid, notwithstanding the dissent of minority shareholders, because the corporation's charter provided that it " 'shall be capable of purchasing, holding and *conveying* any lands, tenements, goods and chattels whatever, necessary and expedient to the objects of this incorporation.' " *Id.* at 417 (quoting the charter). In rejecting this argument, the master said:

> [T]he whole argument falls by simply restating, in terms, the propositions contained in the words cited. They are these: ... when it is necessary or expedient to *the objects of the incorporation* that it should convey any particular property, it can do so. So that it is only when the objects of the incorporation require it that any lawful conveyance can be made. Can it be pretended that the objects of the incorporation require that the necessary source of its profitable existence should be sold and conveyed away?

Id. at 418.

In *Abbot v. American Hard Rubber Co.*, 33 Barb. 578 (N.Y. App. Div. 1861), it was held, as to the complaining shareholder, that the sale of a corporation's operating assets for promissory notes was ultra vires. *See id.* at 588-93. The court said:

> An act which, to all intents, terminates the corporation, by taking from it its power to fulfill the purposes of its organization, is not consistent with the purposes of its constitution. That which changes the nature and business of a corporation from that for which it was created, does effectually destroy it for all the purposes for which it was formed.

Id. at 592.

In *Geddes v. Anaconda Copper Mining Co.*, 254 U.S. 590 (1921), the Court said:

> The rule that owners of a majority of the stock may not authorize the sale of all of the property of a going and not unprofitable company, rests upon the principle that exercise of such power would defeat the implied contract among the stockholders to pursue the purpose for which it was chartered.

Id. at 596.

In *Allied Chemical & Dye Corp. v. Steel & Tube Co.*, 120 A. 486 (Del. Ch. 1923), the court said:

> It is doubtless generally true of any going, money-making corporation that it would be not to its best interests to sell all of its assets. Indeed, is not this the consideration underlying the old rule ... that the assets of a going, prosperous concern could not be sold except by the consent of all the stockholders?

Id. at 490.

corporation organized before 1917 should, prior to entering into a sale-of-assets transaction, take steps to provide in its charter that shareholders dissenting from such a transaction would have appraisal rights.[1211]

3. Decisions in Share Exchange Cases

Reference has been made above to the relatively new share exchange statutes of New Jersey and North Carolina.[1212] Action under those statutes could certainly affect shareholder rights, because they enable one's fellow shareholders (through action by holders of the prescribed majority of shares) to determine that one's stock is to be disposed of regardless of the holder's wishes in the matter.

No case has been found on the question whether a dissenting holder of shares of a class as to which a share exchange is attempted could enjoin such transaction on the ground that the dissenter's class of shares was outstanding prior to enactment of the share exchange statute and that application of such statute to those shares would unconstitutionally impair the obligation of his charter contract. However, if there is validity to the appraisal right argument advanced above,[1213] the constitutional question would be disposed of by the fact that the share exchange statutes of both states accord a right of appraisal to dissenting shareholders.[1214]

B. Post-Incorporation Changes in Requirements for Combinations

The twentieth-century changes in the requirements for effecting a corporate combination have been outlined above under the headings of director action, shareholder approval, permissible consideration, and right of appraisal. Whenever a change in those requirements could lead to an adverse alteration of the rights of a shareholder, the question would arise whether permissive legislation authorizing such a change could be utilized by a pre-existing

1211. *See* DEL. CODE ANN. tit. 8, § 262(c) (1991) (quoted *supra* in note 766).

1212. *See* N.J. STAT. ANN. § 14A:10-9 (West Supp. 1997) (discussed *supra* in text accompanying notes 920-25); N.C. GEN. STAT. § 55-11-02 (1990) (discussed *supra* in text accompanying notes 926-33).

1213. *See supra* text accompanying notes 1121-39.

1214. *See* N.J. STAT. ANN. §§ 14A:11-1(2), 14A:11-2(5) (West Supp. 1997) (quoted *supra* in note 925 (second paragraph)); N.C. GEN. STAT. § 55-13-02(a)(2) (Supp. 1996) (quoted *supra* in note 932 (first paragraph)). However, for an exception in North Carolina with respect to marketable shares, see Act of June 9, 1997, ch. 202, § 1 (effective Oct. 1, 1997) (to be codified at N.C. GEN. STAT. § 55-13-02(c)) (quoted *supra* in note 759 (first paragraph)). It appears that, in a New Jersey share exchange, there is no denial of appraisal rights with respect to marketable shares.

corporation notwithstanding the Constitution's Impairment Clause.

1. Changes Concerning Director Action

As noted above, director action is a prerequisite for a corporation to be merged into another[1215] (except in the case of the subsidiary involved in an upstream short-form merger[1216]), for it to sell all or substantially all of its assets,[1217] or (in North Carolina) for a class of its shares to be acquired in a share exchange.[1218] As also noted above, directors are normally subject to fiduciary duties when acting on such transactions.[1219]

The most significant change made in this context has been the adoption of statutes authorizing the inclusion in corporate charters of exculpatory provisions.[1220] And the most far-reaching of those statutes in the three subject states is the one now contained in North Carolina's Business Corporation Act.[1221] That, then, will be the focus of attention in what follows.

If a person had become a minority shareholder of a North Carolina corporation organized under that state's 1955 Business Corporation Act (in effect from July 1, 1957, through June 30, 1990), one of the terms of the shareholder's charter contract (embodying all applicable statutes in effect at the time of incorporation) would have been that "[o]fficers and directors shall be deemed to stand in a fiduciary relation to the corporation and to its shareholders."[1222] Moreover, if such incorporation had occurred prior to October 1, 1987,[1223] there would have been no statutory authorization for

1215. *See supra* text accompanying notes 390 (North Carolina), 392 (Delaware), and 394 (New Jersey).

1216. *See* DEL. CODE ANN. tit. 8, § 253(a) (Supp. 1996) (quoted *supra* in note 457); N.J. STAT. ANN. § 14A:10-5.1(1) (West Supp. 1997) (quoted *supra* in note 482 (first paragraph)); N.C. GEN. STAT. § 55-11-04(b) (1990) (as amended in 1997) (quoted *supra* in note 496).

1217. *See* DEL. CODE ANN. tit. 8, § 271(a) (1991) (quoted *supra* in note 813); N.J. STAT. ANN. § 14A:10-11(1)(a) (West Supp. 1997) (quoted *supra* in note 845); N.C. GEN. STAT. § 55-12-02(a) (1990) (quoted *supra* in note 826 (first paragraph)).

1218. *See* N.C. GEN. STAT. § 55-11-02(a) (1990) (quoted *supra* in note 927 (first paragraph)).

1219. *See supra* text accompanying notes 405-32.

1220. *See supra* text accompanying notes 433-43.

1221. *See* N.C. GEN. STAT. § 55-2-02(b)(3) (Supp. 1996) (quoted *supra* in note 437).

1222. Former N.C. GEN. STAT. § 55-35 (1982); *see supra* text accompanying notes 412-13. Under then-established judicial doctrine, such "fiduciary relation" meant that directors owed duties of both care and loyalty to the shareholders as well as to the corporation. *See supra* text accompanying notes 414-15.

1223. This was the effective date of Act of July 22, 1987, ch. 626, § 1, 1987 N.C. Sess.

inclusion in the corporate charter of an exculpatory provision "eliminating the personal liability of each director arising out of an action ... for monetary damages for breach of his duty as a director."[1224] If, thereafter, such a provision were to be added to the charter (pursuant to the 1987 enabling statute), not only would it eliminate director liability for monetary damages for breach of duty but, in the process, a basic deterrent to director wrongdoing would be removed.

If those in control of the hypothetical North Carolina corporation (organized between 1957 and 1987) should now propose to amend the corporate charter to include such an exculpatory provision, could the minority shareholder enjoin adoption of such an amendment on the ground that action under this post-incorporation legislation would violate the Impairment Clause of the Constitution? This question would be especially pertinent in a situation in which the directors were themselves the majority shareholders and therefore in possession of the votes needed to approve the charter amendment.[1225] No case has been found on this point; however, if such a charter amendment were about to be submitted to a shareholder vote with no provision of an appraisal remedy for dissenters,[1226] a shareholder

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Laws 1113, 1113—the predecessor to section 55-2-02(b)(3) of the North Carolina General Statutes. *See* N.C. GEN. STAT. § 55-2-02(b)(3) (Supp. 1996) (quoted *supra* in note 437).

1224. Former N.C. GEN. STAT. § 55-7(11) (Supp. 1989). This provision, derived from the 1987 statute, was virtually the same as the comparable provision now contained in section 55-2-02(b)(3). *See* N.C. GEN. STAT. § 55-2-02(b)(3) (Supp. 1996) (quoted *supra* in note 437). The phrase "breach of his duty as a director" was changed to read "breach of any duty as a director" when the new Business Corporation Act was enacted by Act of June 8, 1989, ch. 265, sec. 1, § 55-2-02(b)(3), 1989 N.C. Sess. Laws 566, 576 (effective July 1, 1990). The phrase "personal liability of each director" was changed to read "personal liability of any director" by Act of July 24, 1993, ch. 552, § 6, 1993 N.C. Sess. Laws 2912, 2915 (effective Oct. 1, 1993).

1225. *See supra* text accompanying note 443.

1226. The North Carolina statute permits a voluntary granting of appraisal rights. *See* N.C. GEN. STAT. § 55-13-02(a)(5) (Supp. 1996) (quoted *supra* in note 768 (first paragraph)). However, the statute does not mandate a right of appraisal for the kind of charter amendment now under consideration; it provides as follows:

> (a) In addition to any rights granted under Article 9 [the North Carolina Shareholder Protection Act], a shareholder is entitled to dissent from, and obtain payment of the fair value of his shares in the event of, any of the following corporate actions:
>
> ....
>
> (4) An amendment of the articles of incorporation that materially and adversely affects rights in respect of a dissenter's shares because it (i) alters or abolishes a preferential right of the shares; (ii) creates, alters, or abolishes a right in respect of redemption, including a provision respecting a sinking fund for the redemption or repurchase, of the shares; (iii) alters or abolishes a preemptive right of the holder of the shares to acquire shares or

opposed to the amendment should be able to bring suit in a state court or a U.S. district court to enjoin consummation of the amendment.[1227]

2. Changes Concerning Shareholder Approval

As noted above, earlier statutes requiring a two-thirds vote of shareholders to approve (in New Jersey and Delaware) a long-form merger,[1228] or (in North Carolina) a sale of assets,[1229] have been amended to require only a majority vote.[1230] If a pre-existing corporation sought to avail itself of the amended statute when a vote of only 60% of the shares supported a particular corporate combination, could a complaining shareholder successfully enjoin consummation of the transaction?

a. Under Restrictive Reading of Reserved Power

If this question arose in a state whose highest court had adopted the restrictive reading of the state's reserved power, the complaining shareholder would be able to obtain injunctive relief. There were two nineteenth-century decisions in which the New Jersey courts held—under that state's restrictive reading—that voting rights of shareholders could not be altered pursuant to post-incorporation legislation.[1231] Moreover, in *Berger v. United States Steel Corp.*[1232]

> other securities; (iv) excludes or limits the right of the shares to vote on any matter, or to cumulate votes; (v) reduces the number of shares owned by the shareholder to a fraction of a share if the fractional share so created is to be acquired for cash under G.S. 55-6-04; or (vi) changes the corporation into a nonprofit corporation or cooperative organization;
>
> ....

Id. § 55-13-02(a).

1227. Such a suit would bring into question the constitutional efficacy of the broad provisions of the reserved powers contained in North Carolina's 1955 Business Corporation Act. *See supra* note 969 (fourth paragraph).

The U.S. Code provides as follows: "The district courts shall have original jurisdiction of all civil actions arising under the Constitution ... of the United States." 28 U.S.C. § 1331 (1994).

1228. For New Jersey, see *supra* notes 292-94 and accompanying text, and notes 557-58 and accompanying text. For Delaware, see *supra* notes 296-98 and accompanying text, and notes 553-54 and accompanying text. As to North Carolina, see *supra* text accompanying notes 299-301 and 565-66.

1229. *See supra* notes 824-25.

1230. *See* N.J. STAT. ANN. § 14A:10-3(2)-(3) (West Supp. 1997) (quoted *supra* in text accompanying notes 560-64) (as to mergers); N.C. GEN. STAT. § 55-12-02(e) (1990) (quoted *supra* in note 826 (first paragraph)) (as to sale-of-assets transactions); *supra* text accompanying notes 555-56 (Delaware as to mergers).

1231. *See supra* text accompanying notes 149-52.

decided in New Jersey in 1902, the court (while not required to decide the question) clearly intimated that it would not give effect to a provision of a post-incorporation statute prescribing a lesser shareholder vote for a particular kind of corporate transaction.[1233] During the period when the New Jersey courts resorted to the public interest doctrine as an antidote to that state's restrictive reading of the reserved power,[1234] it was held in *In re Collins-Doan Co.*[1235] that resort could be had to a post-incorporation statute (enacted in 1938) authorizing dissolution of a deadlocked corporation when approved by shareholders having half of the voting power, although the statute in effect when the corporation was organized (in 1916) required a two-thirds shareholder approval for dissolution.[1236] However, once it is recognized that the public interest doctrine is flawed,[1237] only one basis remains—where the restrictive reading of the reserved power has been adopted—to sustain a change in shareholder voting requirements by way of post-incorporation legislation. Only the provision of a right of appraisal would sustain the corporation's utilization of such post-incorporation legislation.[1238]

1232. 53 A. 68 (N.J. 1902); *see supra* note 950 (first paragraph) (discussing *Berger*).

1233. The court said:

> It is not necessary to discuss the validity of the provision of the [post-incorporation] act of 1902 "that two-thirds in interest of each class of the stockholders, present in person or by proxy, may authorize the retirement of shares," which is a departure from the act of 1896 [which required approval by two-thirds in interest of each class of the stockholders having voting powers, rather than just two-thirds in interest of those present]. If that provision is inimical to the supreme law, it is well settled in this court that it does not taint the entire act. It may be rejected, and the remainder of the act will stand, subject to be availed of when the proposed retirement receives the vote of shareholders required by section 27 of the act of 1896, which it did receive in this case.

Id. at 75.

1234. *See supra* text accompanying notes 1058-66.

1235. 70 A.2d 159 (N.J. 1949).

1236. *See id.* at 163-66. The two-thirds requirement in the pre-1916 statute is made clear in the opinion of the court below. *See In re* Collins-Doan Co., 67 A.2d 353, 355 (N.J. App. Div.), *rev'd*, 70 A.2d 159, 167 (N.J. 1949).

The supreme court said: "If the [post-incorporation] statute has no efficacy here, then it can have no practical utility or meaning. Such interposition is justifiable in the public interest where, as here, corporate action cannot be had. Apart from other considerations, the act constitutes legislative action within the cited reserved power." *In re Collins-Doan Co.*, 70 A.2d at 165.

1237. *See supra* text accompanying notes 1067-72.

1238. *See supra* text accompanying notes 1121-39.

b. Under Expansive Reading of Reserved Power

The analysis would be different in a state whose highest court had adopted the expansive reading of the reserved power. Such a reading would mean that shareholder voting requirements could be altered pursuant to post-incorporation legislation—unless, of course, the vested right doctrine was interposed to preclude such a result.[1239]

The most pertinent case is that of *Hinckley v. Schwarzschild & Sulzberger Co.*[1240] In this case, a corporation had been organized in 1893 under a statute providing that " '[e]very domestic stock corporation may have preferred and common stock ... if the certificate of incorporation so provides or by the unanimous consent of the stockholders.' "[1241] In 1901, the statute was amended to change the requirement for shareholder approval from unanimous consent to " 'consent of the holders of record of two-thirds of the capital stock.' "[1242] The corporation proposed to issue preferred stock, and the consent of the holders of more than 90% of the corporation's outstanding stock (all common) was obtained. However, the plaintiff-shareholder sought to enjoin consummation of the transaction on the ground that the corporation could not (over his objection) avail itself of the post-incorporation enabling statute. New York's reserved power being applicable and that state having previously adopted the expansive reading of that power, the court correctly perceived that the only question requiring decision was whether the voting requirement embodied in the statute at the time of incorporation gave rise to a vested right.[1243] Expressing the wish that it could rule otherwise but believing itself bound by what it thought to be the weight of authority against the contention of the

1239. *See supra* text accompanying notes 1001-37; *see also* Bernhard von Falkenhausen, Note, *Corporations: Alteration of Voting Right by Amendment:* Faunce v. Boost Co., 15 N.J. Super. 534, 83 A.2d 649 (1951), 37 CORNELL L.Q. 768, 771-74 (1952) (discussing the vested right doctrine in the context of voting rights); Note, *Corporate Charter Amendments and the Impairment of Voting Rights*, 54 HARV. L. REV. 1368, 1369-71 (1941) (suggesting factors a court should consider when labeling voting rights as vested).

1240. 95 N.Y.S. 357 (App. Div. 1905), *appeal dismissed*, 86 N.E. 1125 (N.Y. 1908).

1241. *Id.* at 358 (quoting Act of May 18, 1892, ch. 688, § 47, 1892 N.Y. Laws 1824, 1837).

1242. *Id.* (quoting Act of Apr. 16, 1901, ch. 354, § 1, 1901 N.Y. Laws 961, 969 (amending § 47)).

1243. After quoting a passage from *Looker v. Maynard*, 179 U.S. 46 (1900), indicating that a reserved power would not sustain the abrogation of a vested right, *see id.* at 52, the *Hinckley* court said: "The case would therefore seem to be brought within the [reserved] legislative power in every aspect, unless its enforcement upon corporations existing prior to its passage can be said to interfere with contract or vested rights. If it does, then it would not be authorized." *Hinckley*, 95 N.Y.S. at 361.

plaintiff-shareholder, the court held that the corporation could avail itself of the post-incorporation legislation.[1244]

A similar result was reached in *French v. Cumberland Bank & Trust Co.*[1245] In this case, the plaintiff-shareholder owned slightly more than 10% of the corporation's outstanding stock, which was enough to enable him to elect one director under cumulative voting (if cumulative voting was in effect). During the 1930s, as a prerequisite to obtaining financing from the Reconstruction Finance Corporation through the sale of voting preferred stock, the corporation's charter had been amended to provide for cumulative voting; and a state statute provided that " '[n]o corporation . . . shall, without the consent of ninety per centum in interest of the class or classes of stockholders affected thereby, have the power to change the voting rights . . . of any stockholder.' "[1246] Thereafter, in 1952, a statute was enacted authorizing elimination of the cumulative voting provisions that had been adopted in connection with the RFC financing, such elimination to be effected by way of a charter amendment approved by vote of two-thirds in interest of the stockholders; and such an amendment was approved by a vote of 83% of the outstanding stock of plaintiff's corporation. Not unnaturally, the plaintiff contended that the 1952 statute was unconstitutional and void as to him; however, on the basis of an expansive reading of the reserved power, the court rejected his contention.[1247]

1244. *See Hinckley*, 95 N.Y.S. at 360, 365. It is regrettable that the appeal in this case was dismissed on the ground "that the appellant had died and that no order of substitution had been made within three months." *Hinckley*, 86 N.E. at 1125. Had the appellant not died, the appellate court might well have applied the vested right doctrine that was later applied in *Breslav v. New York & Queens Electric Light & Power Co.*, 291 N.Y.S. 932 (App. Div. 1936), *aff'd per curiam*, 7 N.E.2d 708 (N.Y. 1937). *See supra* text accompanying notes 1004-05 (discussing *Breslav*).

1245. 74 S.E.2d 265 (Va. 1953).

1246. *Id.* at 270 (second and third alterations in original) (quoting VA. CODE ANN. § 13-90 (Michie 1950)).

1247. The court said:

> The General Assembly, by enactment of [the 1952 statute] has, it is true, authorized cumulative voting for directors of the banks of the class named to be abolished by the approval of 66-2/3% in interest of shares of stock instead of 90% in interest. But appellant [plaintiff] acquired and held his stock with full knowledge that the voting rights of his shares of stock for directors might be changed by general law, with or without his consent. Section 158 of the Virginia Constitution provides that every corporation holds "its charter and franchises, and all amendments thereof, under the provisions and subject to all the requirements, terms and conditions of this Constitution and of any laws passed in pursuance thereof, so far as the same may be applicable to such corporation."

A third such case is *Miller v. Magline, Inc.*,[1248] involving a Michigan corporation. At the time of the corporation's organization in 1947, the state constitution limited the initial term of corporate existence to thirty years and provided that such term could be extended only upon the affirmative vote of the holders of two-thirds of the outstanding shares. The constitutional limitations on the duration of corporate life were eliminated in 1963; and a new corporation statute, enacted in 1972, provided that a corporation could amend its charter to change its duration by vote of a simple majority of the outstanding shares. In 1975, the corporation's charter was amended by a majority vote to extend the corporation's life to perpetuity, with two minority shareholders—owning together 41% of the outstanding shares—voting against the amendment. When the minority shareholders challenged the corporate action, the court held that, under the state's reserved power and notwithstanding the vested right doctrine, the plaintiffs had not suffered an unconstitutional impairment of a contractual right.[1249]

In all three of these cases, the shareholdings of the complainants were such that they could have vetoed the challenged transactions under the voting requirements that were embodied in their charter contracts prior to enactment of the post-incorporation enabling legislation.[1250] Moreover, in none of these three cases was a right of appraisal accorded to dissenting shareholders. It is difficult to conceive of a situation in which a right is more "vested" than the right—based on one's shareholdings—to veto a particular kind of

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Id. at 269 (quoting VA. CONST. of 1902, § 158).

1248. 306 N.W.2d 533 (Mich. Ct. App. 1981).

1249. The court concluded as follows:

> The present case is distinguished by the nature of the expectation that has allegedly been impaired. We do not characterize any belief the plaintiffs might have had that the corporation would expire, absent a two-thirds vote for extension, as a vested contractual right. The fact that plaintiffs initially had the power to prevent extension by virtue of their substantial minority holdings does not give rise to a right to have the corporation expire. The power of plaintiffs to cast their votes in opposition to an amendment to extend the corporate existence was continuously subject to the power of the Legislature to alter the rights and privileges granted in the corporate charter. Plaintiffs have not suffered an unconstitutional impairment of a contractual right.

Id.

1250. In *Hinckley*, *see supra* text accompanying notes 1240-44, a single share was enough to defeat an action requiring "unanimous consent"; in *French*, *see supra* text accompanying notes 1245-47, ownership of slightly more than 10% was enough to defeat an action requiring "consent of ninety per centum in interest"; and in *Miller*, *see supra* text accompanying notes 1248-49, ownership of 41% was enough to defeat an action requiring "two-thirds of the outstanding shares."

corporate action. And, given the many pronouncements by the Supreme Court to the effect that a reserved power does not sustain the abrogation of a vested right,[1251] one would have to conclude that these three cases were wrongly decided.

3. Changes in Permissible Consideration

If a corporation was organized under a corporation statute whose provision for mergers permitted nothing but stock of the surviving corporation to be used as merger consideration,[1252] a shareholder of such corporation would have reason to expect that, if the corporation should become the disappearing corporation in a merger, the holder at least would be assured of a continuing equity interest in the combined enterprise resulting from the merger. If, thereafter, the corporation statute was amended to permit the use of cash as merger consideration,[1253] the shareholder would face the prospect of being cashed out if a move was made to merge his corporation into a controlling corporation (or its subsidiary). If such an effort were to be launched, the question would arise whether, notwithstanding the Impairment Clause, those in control of the corporation could avail themselves of the post-incorporation enabling legislation.

This question was answered—if only incidentally—in *Beloff v. Consolidated Edison Co.*,[1254] the earliest of the reported cases involving a cash-out merger. Plaintiffs had become shareholders in Brooklyn Edison in the 1920s, and no later than the mid-1930s more than 99% of that company's stock had come to be owned by Consolidated Edison. In 1936 and 1937, legislation was enacted authorizing electric and other specified utility companies to effect a short-form merger when a parent corporation had come to own 95% or more of the stock of its subsidiary corporation. Pursuant to that post-incorporation enabling legislation, Brooklyn Edison was merged into Consolidated Edison, and the terms of the merger called for payment by Consolidated of $135 in cash for each of the minority shares of Brooklyn. Instead of pursuing their statutory right of appraisal, plaintiffs challenged the validity of the merger on constitutional grounds; but the court ruled against the plaintiffs and

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1251. *See supra* note 971 and text accompanying notes 975-78.

1252. *See supra* note 316 and accompanying text (Delaware), and note 319 and accompanying text (North Carolina).

1253. *See supra* text accompanying notes 322-23 (North Carolina), 592, and 595 (Delaware).

1254. 87 N.E.2d 561 (N.Y. 1949).

sustained the merger. While stating that New York's constitutional reserved power authorized the legislature "to make appropriate non-confiscatory statutory provisions for mergers," the court relied heavily on the statutory right of appraisal, which it stated to be the exclusive remedy.[1255]

The question was presented squarely in *Coyne v. Park & Tilford Distillers Corp.*,[1256] which also involved a short-form cash-out merger. The plaintiffs had acquired their shares prior to the 1957 adoption of Delaware's short-form merger statute, the earliest statute of that state permitting cash to be used as consideration in a merger.[1257] Each of them contended that "[t]he right to demand in a merger conversion of his shares into other shares became vested, and no subsequently enacted statute could destroy it."[1258] While the short-form merger statute gave appraisal rights to dissenting shareholders of the subsidiary corporation,[1259] the court did not make this the stated basis for its holding that the corporation could avail itself of the post-incorporation legislation permitting the use of cash as consideration in a short-form merger. Rather, the court cited *Davis v. Louisville Gas & Electric Co.*[1260] for the proposition that the state's reserved power "authorize[s] the enactment of statutes changing the rights of stockholders in respect of shares acquired prior to such enactment."[1261] Interestingly, however, when the court cited "authority elsewhere in accord with the general rule of the Davis case," the two cases cited were *Bingham v. Savings Investment & Trust Co.* and *Beloff v. Consolidated Edison Co.*[1262] And, as pointed

1255. *See id.* at 564-65; *supra* notes 1167-68 and accompanying text (discussing *Beloff*).

1256. 154 A.2d 893 (Del. 1959).

1257. *See supra* text accompanying notes 460-62.

1258. *Coyne*, 154 A.2d at 897.

1259. *See supra* text accompanying notes 469-70.

1260. 142 A. 654 (Del. Ch. 1928); *see supra* notes 970 (third paragraph) and 997 (first paragraph) (discussing *Davis*).

1261. *Coyne*, 154 A.2d at 897.

1262. The court said:

> Such provisions have been construed in our courts. They are held to authorize the enactment of statutes changing the rights of stockholders in respect of shares acquired prior to such enactment. Davis v. Louisville Gas & Electric Co. We do not read the comments on the Davis case by the Supreme Court in the Keller case as weakening its force. On the other hand, the broad holding in the Keller case was certainly modified by the Havender case.
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> For authority elsewhere in accord with the general rule of the Davis case, see Bingham v. Savings Investment & Trust Co. and Beloff v. Consolidated Edison Co. of New York.

Id. at 897-98 (citations omitted).

out above, each of those cases made the availability of appraisal rights the basis for permitting a corporation to avail itself of post-incorporation merger legislation.[1263]

Given the Supreme Court's view that the reserved power does not sustain the abrogation of vested rights,[1264] this would seem an ideal context in which to apply the doctrine. What right could be more "vested" than the right not to be cashed out—by a controlling shareholder acting under permissive post-incorporation legislation—from a corporation in whose stock one has chosen to invest a portion of his capital?

4. Changes in Right of Appraisal

When a corporation was organized under a general corporation statute that accorded a right of appraisal to shareholders dissenting from specified transactions, the provision concerning the appraisal right became part of the charter contract.[1265] If subsequent legislation took away the right of appraisal (as in Delaware in 1967,[1266] in New Jersey in 1968 and 1974,[1267] and in North Carolina in 1997[1268]) and a corporation thereafter attempted, pursuant to a post-incorporation enabling statute, to effect a transaction that previously would have given rise to appraisal rights, two questions would emerge. First, could the appraisal right—treated as a "vested" right—be validly eliminated by post-incorporation legislation? Second, with no appraisal right available for dissenters, could the corporation effect the transaction in reliance on the post-incorporation enabling statute notwithstanding the Impairment Clause?

1263. *See supra* notes 1159-61 and accompanying text (discussing *Bingham*), and notes 1167-68 and accompanying text (discussing *Beloff*).

1264. *See supra* note 971 and text accompanying notes 975-78.

1265. In *In re Janssen Dairy Corp.*, 64 A.2d 652 (N.J. Super. Ct. Law Div. 1949), the court said:

> This [appraisal] proceeding flows from a contract between the parties. The dissenting stockholders and the corporation by virtue of the statute made the provisions for the appointment of appraisers, and their appraisement of the stock, a matter of contractual obligation. This is because the provisions of the statute became a part of the contract existing between the corporation and these preferred stockholders at the time of the issuance of the preferred stock involved in this matter.

Id. at 654 (citations omitted).

1266. *See supra* text accompanying notes 748 and 751-54.

1267. *See supra* text accompanying notes 749, 755-57, and 761-62.

1268. *See supra* text accompanying notes 750 and 759-60.

IV. QUESTIONS FOR SUPREME COURT

Only the U.S. Supreme Court can provide definitive answers to the questions involved in the issue of whether there is a violation of the Impairment Clause of the Constitution when shareholder rights are altered adversely by corporate action taken pursuant to permissive post-incorporation legislation.[1269] The thesis of what follows is that such an alteration of shareholder rights cannot be sustained under the reserved power analysis but can and should be sustained under the appraisal right analysis.

A. *Court's Jurisdiction and Granting of Certiorari*

For almost a century and a half, there has been a split among the highest courts of various states over the question whether the reserved power does or does not sustain a corporation's utilization of permissive post-incorporation legislation in altering the rights of shareholders. One of the most interesting aspects of this whole subject is that the Supreme Court has never squarely resolved this question.[1270]

1269. The Supreme Court has addressed the Impairment Clause in several cases in fairly recent years. *See* Keystone Bituminous Coal Ass'n v. DeBenedictis, 480 U.S. 470, 502-06 (1987); Exxon Corp. v. Eagerton, 462 U.S. 176, 187-94 (1983); Energy Reserves Group, Inc. v. Kansas Power & Light Co., 459 U.S. 400, 409-19 (1983); Allied Structural Steel Co. v. Spannaus, 438 U.S. 234, 240-44, 250-51 (1978); United States Trust Co. v. New Jersey, 431 U.S. 1, 14-17, 21-32 (1977); City of El Paso v. Simmons, 379 U.S. 497, 503-09 (1965). However, none of these cases involved any alteration of shareholder rights or any reserved power to alter or repeal a corporate charter or corporation statute. For discussion of these cases, see the following: Henry N. Butler & Larry E. Ribstein, *State Anti-Takeover Statutes and the Contract Clause*, 57 U. CIN. L. REV. 611, 628-42 (1988); Clarke, *supra* note 55, at 193-211, 238-55; Richard A. Epstein, *Toward a Revitalization of the Contract Clause*, 51 U. CHI. L. REV. 703, 717-23, 735-40, 750-51 (1984); and Note, *A Process-Oriented Approach to the Contract Clause*, 89 YALE L.J. 1623, 1639-51 (1980).

1270. This statement is made notwithstanding the case of *Polk v. Mutual Reserve Fund Life Ass'n*, 207 U.S. 310 (1907), and the following view expressed by the late Professor Dodd:

> The Supreme Court of the United States early adopted a liberal construction of the reserved power with respect to compulsory amendments even where the effect of such amendments was to change the internal structure of the corporation rather than its relations with the outside public. It has now taken a similar position with respect to statutes empowering the majority of the stockholders or directors to amend. Polk v. Mutual Reserve Fund L. Assn. of N.Y.

Dodd, *supra* note 966, at 156 n.33 (citations omitted).

With much respect for Professor Dodd, this writer (who was first exposed to corporate law in Professor Dodd's classroom) takes a different view of the Court's holding in *Polk*. While it is true that, in this case, a pre-existing insurance association was allowed to take on for itself the expanded powers permitted by modernizing legislation, the essence of the opinion was simply that no contract right of the complainants had been

1. Restrictive Reading of Reserved Power

Adoption of the restrictive reading of the reserved power by a state court led to a decision that charter rights of shareholders could not be altered through utilization of permissive post-incorporation legislation. Such a decision was based—implicitly if not explicitly—on the view that, notwithstanding the reserved power, application of such legislation in derogation of such rights would contravene the Impairment Clause of the Constitution.

Until 1914, such a decision could not be reviewed by the Supreme Court, because the enabling statute (as sought to be applied) would have been invalidated.[1271] Under 28 U.S.C. § 1257 as it existed for some years prior to 1988,[1272] a state court decision that invalidated a state statute on constitutional grounds was not reviewable by the Supreme Court by way of appeal,[1273] but such a

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impaired when the corporation availed itself of the post-incorporation enabling legislation. As the Court said: "[I]t is impossible to say that any of the contract obligations of the Association to the complainants have been impaired by the reorganization." *Polk*, 207 U.S. at 324. And the Court said further: "[I]t has been shown that the contract rights of the complainant have not been affected by the reincorporation." *Id.* at 327. Thus, the case can hardly be viewed as a holding by the Court that, notwithstanding the Impairment Clause, contractual rights of shareholders can be altered adversely pursuant to permissive post-incorporation legislation enacted under a reserved power.

Cf. von Falkenhausen, *supra* note 1239, at 772 n.24 ("The United States Supreme Court has yet to conclusively adopt one or the other [narrow or liberal] interpretation [of the reserved power].").

1271. Wright explains:

> From 1789 to 1914 the jurisdiction [of the Supreme Court] over state courts was limited to cases in which the state court had held some federal act invalid, or had upheld the validity of a state act against a claim based on the federal Constitution or laws. The Supreme Court could not review a state-court decision that upheld the federal claim and found a state act invalid.

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1272. Prior to 1988, the U.S. Code provided as follows:

> Final judgments or decrees rendered by the highest court of a State in which a decision could be had, may be reviewed by the Supreme Court as follows:
>
> . . . .
>
> (2) By appeal, where is drawn in question the validity of a statute of any state on the ground of its being repugnant to the Constitution . . . of the United States, and the decision is in favor of its validity.
>
> (3) By writ of certiorari, . . . where the validity of a State statute is drawn in question on the ground of its being repugnant to the Constitution . . . of the United States . . . .
>
> . . . .

Former 28 U.S.C. § 1257 (1982).

1273. *See id.* § 1257(2).

decision could be reviewed (and reversed) by that Court by way of a writ of certiorari.[1274] Under 28 U.S.C. § 1257(a) as it exists today, such a decision can still be reviewed via the certiorari route.[1275] However, the granting of a writ of certiorari may be less likely in a case in which a state statute has been invalidated than in a case in which a state statute has been upheld.[1276]

2. Expansive Reading of Reserved Power

Adoption of the expansive reading of the reserved power by a state court led to a decision that charter rights of shareholders could be altered through utilization of permissive post-incorporation legislation. Such a decision was based—implicitly if not explicitly—on the view that, because of the reserved power, application of such legislation in derogation of such rights would not contravene the Impairment Clause of the Constitution.

It seems clear that the Supreme Court today would have jurisdiction to review (not by appeal but by writ of certiorari) a decision by a state's highest court adopting the expansive reading of the reserved power.[1277] The complaining shareholder would be contending that a contractual right (derived from terms of the corporate charter, including applicable provisions of the corporation law under which the corporation had been organized) was being

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1274. In *Gelfert v. National City Bank*, 313 U.S. 221 (1941), on a writ of certiorari, the Supreme Court reversed a decision by New York's highest court that had held a state statute, as applied to mortgage contracts previously made, to be violative of the Impairment Clause of the Constitution. *See id.* at 228-29, 234-36. The effect of the statute was to lessen the rights of mortgagees and to enlarge the rights of mortgagors with respect to the measure of deficiency judgments following foreclosure sales. *See id.* at 230-31. The Court stated that it had granted the petition for certiorari "because of the important constitutional question which was raised." *Id.* at 229; *see also* Voeller v. Neilston Warehouse Co., 311 U.S. 531 (1941) (reversing, on a writ of certiorari, a decision by Ohio's highest court that had invalidated a state appraisal statute on the ground that it constituted a denial of procedural due process guaranteed by the Fourteenth Amendment).

1275. Currently, the U.S. Code provides as follows:

> Final judgments or decrees rendered by the highest court of a State in which a decision could be had, may be reviewed by the Supreme Court by writ of certiorari . . . where the validity of a statute of any State is drawn in question on the ground of its being repugnant to the Constitution . . . of the United States . . . .

28 U.S.C. § 1257(a) (1994).

1276. *See* Delaware v. Van Arsdall, 475 U.S. 673, 697 (1986) (Stevens, J., dissenting) ("[A]lthough this Court now has the power to review decisions defending federal constitutional rights, the claim of these cases on our docket is secondary to the need to scrutinize judgments disparaging those rights.").

1277. *See* 28 U.S.C. § 1257(a) (1994) (quoted *supra* in note 1275).

abrogated through the corporation's utilization of a post-incorporation enabling statute and that such abrogation constituted an unconstitutional impairment notwithstanding the reserved power—thereby drawing into question the validity of the enabling statute (as applied by the state court decision) on the ground of its being repugnant to the Impairment Clause of the Constitution.

Moreover, such a case would seem to be a prime candidate for a writ of certiorari under the Supreme Court's Rule 10.[1278] The question whether a reserved power can or cannot free a state legislature from the prohibition of the Impairment Clause—when it comes to permissive legislation authorizing a specified majority to alter shareholder rights, as distinguished from mandatory legislation regulating corporate behavior in the public interest—is surely "an important federal question." Moreover, as this Article makes clear, courts of last resort in various states have arrived at conflicting answers to this question; and, now that the state courts have wrestled with it—inconsistently and inconclusively—for almost a century and a half, surely the question is one that should be settled by the Supreme Court.[1279]

1278. That Rule provides as follows:

> Review on a writ of certiorari is not a matter of right, but of judicial discretion. A petition for a writ of certiorari will be granted only for compelling reasons. The following, although neither controlling nor fully measuring the Court's discretion, indicate the character of the reasons the Court considers:
>
> . . . ;
>
> (b) a state court of last resort has decided an important federal question in a way that conflicts with the decision of another state court of last resort . . . ;
>
> (c) a state court . . . has decided an important question of federal law that has not been, but should be, settled by this Court, or has decided an important federal question in a way that conflicts with relevant decisions of this Court.
>
> A petition for a writ of certiorari is rarely granted when the asserted error consists of erroneous factual findings or the misapplication of a properly stated rule of law.

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1279. In *Murray v. Charleston*, 96 U.S. 432 (1877), the Court said:

> There is no more important provision in the Federal Constitution than the one which prohibits States from passing laws impairing the obligation of contracts, and it is one of the highest duties of this court to take care the prohibition shall neither be evaded nor frittered away. Complete effect must be given to it in all its spirit. The inviolability of contracts, and the duty of performing them, as made, are foundations of all well-ordered society, and to prevent the removal or disturbance of these foundations was one of the great objects for which the Constitution was framed.

Id. at 448-49.

B. *Constitutional Invalidity of Expansive Reading*

The case most likely to be reviewed by the Supreme Court is one in which a state's highest court has applied an expansive reading of the state's reserved power to validate the utilization of permissive post-incorporation legislation whereby charter rights of minority shareholders have been materially altered through an action taken by a specified shareholder majority.[1280] Such a case would present the question whether a state can constitutionally reserve to its legislature the power to enact a subsequent statute that authorizes some of the parties to a private contract—already in existence (under the corporate charter) at the time of the statute's enactment—to alter the rights of other parties to that contract without their assent.[1281]

1. Reasons for Invalidity

The thrust of the Supreme Court's reserved power jurisprudence[1282] is summarized in *Coombes v. Getz*[1283] to the effect that "neither vested property rights nor the obligation of contracts of third persons may be destroyed or impaired" in reliance on a reserved power.[1284] It is against this backdrop that one should

1280. Normally, a minority shareholder would be the one complaining about an impairment of rights resulting from an expansive reading of the reserved power. However, in some circumstances, a corporation might have occasion to complain about the effect of such a reading. The case of *Schroeter v. Bartlett Syndicate Building Corp.*, 63 P.2d 824 (Cal. 1936), involved this unusual twist. When the corporation was organized, the statute permitted directors to levy assessments on stock, but this statute was later amended to permit such assessments only to the extent authorized by a corporation's charter. *See id.* at 825. Thereafter, plaintiff's stock was assessed even though the corporate charter did not then authorize such an assessment. *See id.* When plaintiff recovered the amount of the assessment, the corporation appealed, contending that the Impairment Clause precluded application of the post-incorporation legislation. *See id.* However, the court—on the basis of a pre-incorporation reserved power—held the post-incorporation legislation to be applicable and affirmed the lower court's judgment in plaintiff's favor. *See id.* at 825-26. Thus, this was a case in which an expansive reading of the reserved power was applied to uphold a statute giving a shareholder a right not previously enjoyed and depriving the corporation of a power previously held. *See id.*; *see also In re* Adair v. Orrell's Mut. Burial Ass'n, 284 N.C. 534, 537-41, 201 S.E.2d 905, 907-10 (1974) (employing an expansive reading of the reserved power to validate a post-incorporation statute that imposed new requirements on a corporation and enlarged the rights of its members).

1281. The question almost answers itself. It is tantamount to asking whether a state can reserve the power to violate the Impairment Clause.

1282. *See supra* note 971 (citing and quoting cases setting forth the Supreme Court's view of the reserved power).

1283. 285 U.S. 434 (1932); *see supra* note 1030 (discussing *Coombes*).

1284. *Coombes*, 285 U.S. at 442; *see supra* note 971 (seventh paragraph) (quoting in full the relevant passage from *Coombes*).

examine the constitutional validity of the expansive reading of the reserved power.

Since the decision in *Trustees of Dartmouth College v. Woodward*,[1285] it has come to be accepted doctrine that a corporate charter, in addition to being a contract between the state and a corporation, is a contract between the corporation and its shareholders and also a contract among the shareholders.[1286] Under these latter two aspects of the charter contract, there are numerous rights that a shareholder derives upon investing in the stock of a corporation.[1287] These are clearly contractual rights,[1288] and they arise from private contracts—the one between the corporation and its shareholders and the one among the shareholders. While the Story dicta in the *Dartmouth College* case provide the basis for a state to reserve the power to amend the charter contract between the state and a corporation organized under its laws,[1289] there appears to be no basis on which a state can reserve the power to amend (or to authorize a shareholder majority to amend) private contracts between parties other than the state.[1290] Despite authority to the

1285. 17 U.S. (4 Wheat.) 518 (1819); *see supra* text accompanying notes 33-35 (discussing *Dartmouth College*).

1286. *See supra* notes 36-38 and accompanying text.

1287. Rights derived from provisions of the statute under which a corporation was organized stand on the same footing as rights arising from terms of the corporation's articles of incorporation. *See* Somerville v. St. Louis Mining & Milling Co., 127 P. 464, 466 (Mont. 1912).

1288. *See In re* Janssen Dairy Corp., 64 A.2d 652, 654 (N.J. Super. Ct. Law Div. 1949) (quoted *supra* in note 1265); Calvert v. Capital Southwest Corp., 441 S.W.2d 247, 255 (Tex. Civ. App. 1969) (quoted *supra* in note 38 (first paragraph)); Swan v. Barnes, 184 S.E. 257, 259 (W. Va. 1936) (quoted *supra* in note 974).

1289. The reason why a state—acting under its reserved power—can validly enact post-incorporation legislation, altering terms of the charter contract existing between the state and a corporation organized under its laws, is that the state is a party to that contract and (by reason of the reserved power incorporated therein) is authorized to make unilateral changes in its terms.

1290. This, of course, was the nub of the restrictive reading of the reserved power—voiced in many state court decisions. In *Snook v. Georgia Improvement Co.*, 9 S.E. 1104 (Ga. 1889), the court said:

> It is also held that the charter of a corporation is a contract of a dual character,—*First*, a contract between the state which grants the charter and the corporation; and, *secondly*, a contract between the corporation and its members; and while the state, if it reserves the power to do so, can alter and amend the charter, and the corporation itself cannot object to the alteration or amendment, yet the state has no power to make any material or essential alteration in the contract between the members themselves and the corporation.

Id. at 1105 (quoted more fully *supra* in note 90); *accord* McKenzie v. Guaranteed Bond & Mortgage Co., 147 S.E. 102, 103-04 (Ga. 1929) ("[W]hile the state, in its reserved power to do so, can alter and amend the charter, and the corporation itself cannot object to the

contrary,[1291] it would seem appropriate—on the basis of both fact and

alteration, even the state has no power to make any material or essential alteration in the contract between the members themselves and the corporation.") (quoted more fully *supra* in note 1049); *see also* Allen v. Francisco Sugar Co., 112 A. 887, 889 (N.J. 1921) ("Nor does [the reserved power] authorize the state to authorize one part of the stockholders, for their own benefit, at their mere option, to change their contract with the other part....") (quoted more fully *supra* in note 1041 (third paragraph)). In *Garey v. St. Joe Mining Co.*, 91 P. 369 (Utah 1907), the court said:

> [T]he right [of amendment or alteration of the charter] is reserved for the benefit of the state and of the public and for public purposes. The power can only be exercised to the extent that the state is interested. It can alter or modify any right, privilege, or immunity granted by it. It cannot, however, reach out and impair the obligations of contracts existing between the corporation and its members, or among the corporators themselves, any more than it can impair the obligations of contracts existing between other individuals.

Id. at 374 (quoted more fully *supra* in note 1052); *accord* Wheatley v. A.I. Root Co., 69 N.E.2d 187, 195 (Ohio 1946) (" 'Such power is not reserved in any sense for the benefit of the corporation, or of a majority of the stockholders, upon any idea that the Legislature can alter the contract between the corporation and its stockholders, nor for the purpose of enabling it to do so.' " (quoting 13 FLETCHER, *supra* note 1053, § 5776, at 87)) (quoted more fully *supra* in note 1053 (first paragraph)); Yukon Mill & Grain Co. v. Vose, 206 P.2d 206, 209 (Okla. 1949) ("[T]he reservation of power to amend corporate charters is applicable only to those features of the contract affected with public interest, and the private rights of the stockholder as against the corporation or his fellow stockholders are protected from alteration by the inhibition against the impairment of contracts.") (quoted more fully *supra* in note 1054); Schaad v. Hotel Easton Co., 87 A.2d 227, 232 (Pa. 1952) ("[The reserved power] can properly be exercised only to amend a charter so far as it represents a contract between the corporation and the State, and not in respects as to which it constitutes a contract between the corporation and the shareholders or between the shareholders themselves.") (quoted more fully *supra* in note 1055).

In *Yoakam v. Providence Biltmore Hotel Co.*, 34 F.2d 533 (D.R.I. 1929), the court said:

> The state has no power to impair the obligation of contracts to which it is not a party. No reservation, however artfully worded, can give it that power.
>
> ....
>
> If a state were to pass an act reserving the right to alter or amend all contracts subsequently entered into, whether between individuals or corporations, would any one seriously urge its validity? Could a state by its own act invalidate the clear intendment of article 1, § 10, of the Constitution, by the theoretical reasoning that all contracts thereafter would be made with this reservation read into them as a term and condition, and would not, therefore, be impaired?

Id. at 545, 546; *see supra* notes 1036-37 and *infra* note 1305 (quoting other portions of the *Yoakam* decision). The point was made as follows in the dissenting opinion in *Miller v. State*, 82 U.S. (15 Wall.) 478 (1872):

> Whilst the legislature may reserve the right to revoke or change its own grant of chartered rights, it cannot reserve a right to invalidate contracts between third parties; as that would enable it to reserve the right to impair the validity of all contracts, and thus evade the inhibition of the Constitution of the United States.

Id. at 499 (Bradley, J., dissenting), *quoted with approval in Yoakam*, 34 F.2d at 545.

1291. In *Schroeter v. Bartlett Syndicate Building Corp.*, 63 P.2d 824 (Cal. 1936), involving post-incorporation legislation enacted under a reserved power, the court, after

logic—to consider shareholders as third persons and to treat the shareholder rights arising under the private aspects of a charter contract as "the obligation of contracts of third persons" which, according to *Coombes v. Getz*, may not be impaired in reliance on a reserved power.[1292] Because the expansive reading of the reserved power says that these private contract rights of shareholders can be abrogated pursuant to permissive post-incorporation legislation, it follows that that reading of the power is constitutionally impermissible.

Not only are the shareholder rights arising from the corporate charter contractual in nature, they are also vested rights.[1293] Moreover, it is appropriate to describe them as property rights.[1294]

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quoting from *Coombes v. Getz*, 285 U.S. 434, 441-42 (1932), made the following pronouncement: "The legislative change here considered affects only the interrelations of the corporation and its stockholders. No rights of third persons are involved." *Schroeter*, 63 P.2d at 826.

In *Stockholders v. Sterling*, 300 U.S. 175 (1937), the Court affirmed the application to shareholders of a Maryland banking corporation (organized on January 24, 1910) of a post-incorporation statute of that state, enacted (on June 1, 1910) pursuant to a reserved power contained in the banking statute of 1870 under which the corporation was organized, specifying a new remedy for the enforcement of the liability of shareholders (imposed by the Maryland Constitution of 1867 and by the banking statute of 1870) for the debts of any banking corporation to the amount of their respective shares of stock in such corporation. *See id.* at 178-84. When appellants relied upon the passage from *Coombs v. Getz*, 285 U.S. 434, 441-42 (1932), to the effect that "neither vested property rights nor the obligation of contracts of third persons may be destroyed or impaired" in reliance on a reserved power, the *Sterling* Court noted that *Coombes* involved a complaint by creditors, *see Sterling*, 300 U.S. at 184, and stated that "[t]he complaint comes to us from stockholders, who took their stock with notice that the remedies against them might be changed from time to time." *Id.* at 185. To this statement, the Court added a footnote quoting the passage from *Coombes* with the words "of third persons" italicized. *Id.* at n.*. That italicization can certainly be taken as an indication that the *Sterling* Court was expressing doubt that shareholders should be considered "third persons" as referred to in the passage from *Coombes*. However, in *Sterling*, it was of no real moment whether the Court considered shareholders to be such "third persons" or not; the basic liability for debts of the bank was imposed on the *Sterling* shareholders, not by the post-incorporation statute of 1910, but by the pre-incorporation constitution of 1867 and the banking statute of 1870. Moreover, the changes in the remedy for enforcing that liability, as wrought by the post-incorporation statute of 1910, were of little significance, given the fact that both the 1867 constitutional provision and the 1870 statute stated that shareholders " 'shall be liable to the amount of their respective share or shares of stock in such [bank] for all its debts and liabilities.' " *See Sterling*, 300 U.S. at 178, 178-79 (quoting MD. CONST. of 1867, art. III, § 39; Act of Apr. 4, 1870, ch. 206, § 11, 1870 Md. Laws 339, 349).

1292. *See supra* text accompanying notes 1282-84.

1293. Rights are vested when the right of enjoyment has become the property of a person as a present interest, and thus vested rights differ from rights that are expectant or contingent. *See* Pearsall v. Great N. Ry., 161 U.S. 646, 673 (1896).

1294. In *Pritchard v. Norton*, 106 U.S. 124 (1882), the Court said:

> Hence it is that a vested right of action is property in the same sense in

Thus, it is proper to treat these shareholder rights as "vested property rights" which, according to *Coombes v. Getz*, may not be destroyed in reliance on a reserved power.[1295] Because the expansive reading of the reserved power says that these vested rights of shareholders can be abrogated pursuant to permissive post-incorporation legislation, it follows, again, that that reading of the power is constitutionally impermissible.

It comes down to this. Under the Supreme Court's view of the Impairment Clause, the reserved power cannot sustain either the impairment of contractual rights of third persons, or the destruction of vested property rights, pursuant to permissive post-incorporation legislation. Shareholders are third persons enjoying contractual rights under the corporate charter, and those rights amount to vested property rights. Therefore, the reserved power does not sustain the abrogation of a shareholder's charter rights through the utilization of permissive post-incorporation legislation, and—because it says otherwise—the expansive reading of the reserved power is constitutionally impermissible.[1296]

> which tangible things are property, and is equally protected against arbitrary interference. Whether it springs from contract or from the principles of the common law, it is not competent for the legislature to take it away [because of the prohibition of the Impairment Clause].

Id. at 132.

In *Lord v. Equitable Life Assurance Society*, 87 N.E. 443 (N.Y. 1909), the court considered a shareholder's right to vote to be a property right. *See id.* at 448-49. The majority opinion on this point was characterized in the dissenting opinion as follows: "[I]t is in substance held that the power given the original stockholders to vote for all of the directors is a vested property right of which they cannot be deprived . . . ." *Id.* at 453 (Bartlett, J., dissenting); *see also* Page v. American & British Mfg. Co., 113 N.Y.S. 734, 735 (App. Div. 1908) ("[T]he right of a stockholder to a voice in the management of a corporation in which he has invested money is a property right and vested interest entitled to protection under the Constitution.").

1295. *See supra* text accompanying notes 1282-84.

1296. The most fervent espousal of this view is probably that contained in Part II of Stern's article, *The Limitations of the Power of a State Under a Reserved Right to Amend or Repeal Charters of Incorporation*, which says (in its penultimate paragraph) the following:

> What is contended, then, in this paper is, briefly summarized, this: That the reserved power clauses were inserted in the constitutions and general statutes of the states only in order that the states might retain power over corporations in so far as the grant of franchises—that is, the contract between the state and the corporation—is concerned, being intended to give to the states control over the corporation in the nature of a supervisory police power, and to prevent a legislature from giving away irrevocable property rights in the nature of exemptions from public duties. That the reserved power was not introduced to enable the state, either directly or by way of permission given to some of the corporators as against the others, to alter the contract of association existing

There are at least three decisions by federal courts[1297] that support this view of the matter.[1298] In *Mowrey v. Indianapolis & Cincinnati Railroad Co.*,[1299] a shareholder succeeded in his suit to enjoin an impending consolidation of his railroad corporation with

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> among the stockholders of the company, even though that contract might be formally expressed in the charter over which the power was reserved. That whatever, however, may have been the *intention* of the reserved power clauses, the state has not the constitutional *power* to reserve to itself a right to alter or repeal the contract of the corporator any more than it could reserve such a power over the contracts of partners, of unincorporated associations, or of private contracts in general. That, therefore, although it may be admitted that the state, without thereby releasing dissenting stockholders, can make immaterial changes, changes which are not radical or important, in regard to the charter contract even in so far as it represents the contract among the corporators, yet this power derives no additional force from the reserved power clauses, but exists independently of them; and whatever changes of this kind cannot be made where there is no reserved power of amendment or revocation of the charter cannot be made by the state where such a reserved power exists. That the state cannot gain power over a contract over which it otherwise would have none merely because such contract is, by an accident of history and legal procedure, formally embodied in an instrument over which, in a different aspect, the state can legally reserve rights of amendment or repeal; for, if it were otherwise, the states could acquire for themselves any otherwise forbidden powers, merely by having them, or the subjects which they are intended to concern, inserted in some form in the charters of incorporation thereafter granted. In short, that the stockholders are, as a group, subject in their corporate capacity to the reserved power of the state, but that their contract among themselves is as much under the protection of the Constitution forbidding the impairment of the obligation of contracts as is any other contract. Therefore the state may, under the reserved power, say to a corporation, "We enact certain amendments qualifying your original privileges;" but it cannot say, "We enact amendments changing the organization and nature of the enterprise of your company as originally determined upon by your members;" or to some of the stockholders, "We give to you the privilege, if you desire to use it, of changing the contract into which you have entered with your fellow corporators."

Stern, *supra* note 70, at 109-11.

1297. Another federal decision denied the reserved power's efficacy to sustain post-incorporation legislation limiting the power of corporations to hire certain categories of workers. *See In re* Tiburcio Parrott, 1 F. 481, 491-93, 513-14 (C.C.D. Cal. 1880) (holding, after reviewing the history of the reserved power and limitations on its use, that California's reserved power could not sustain legislation prohibiting corporations of that state from employing Chinese or Mongolian workers).

1298. Federal cases permitting corporate combinations pursuant to *pre*-incorporation legislation are not on point here. Among such cases are the following: *Hottenstein v. York Ice Machinery Corp.*, 136 F.2d 944, 953 (3d Cir. 1943) (upholding a merger with a shell subsidiary for the purpose of eliminating preferred stock and its dividend arrearage); *In re Interborough Consolidated Corp.*, 277 F. 455, 457-58 (S.D.N.Y. 1921) (upholding a consolidation); and *Dickinson v. Consolidated Traction Co.*, 114 F. 232, 250-54 (C.C.D.N.J. 1902) (upholding a 999-year lease of the properties of complainants' corporation), *aff'd*, 119 F. 871 (3d Cir. 1903).

1299. 17 F. Cas. 930 (C.C.D. Ind. 1866) (No. 9891).

another company to be effected (upon a majority vote of shareholders) pursuant to post-incorporation legislation that authorized railroad companies generally to consolidate, and this result was reached notwithstanding the fact that the corporation's special-act charter reserved to the legislature the right at any time to alter or amend it.[1300] In *Hill v. Glasgow Railway Co.*,[1301] it was held that majority shareholder/directors could be enjoined from making use of post-incorporation legislation, enacted under a reserved power,[1302] when such post-incorporation legislation, in addition to authorizing a lease of the company's railroad to another corporation, specified that rental income was to be applied toward payment of bonds executed by the majority shareholders in payment of their stock (and negotiated by the company to outside parties) with the result that minority shareholders were to receive none of the rental income until the bonds had been retired.[1303] In *Yoakam v. Providence*

1300. *See id.* at 932-33. The court said:

> We may well suppose that the only object of the reservation in ... this special charter was to retain in the legislature a power, which, without the reservation, could not be exercised,—a power to amend the charter authoritatively and without the consent of the railroad company. On the contrary, the consolidation act ... is a mere privilege, allowing—not obliging—railroad companies to consolidate if they please to do so. Such a privilege the legislature doubtless could have offered, and perhaps did offer, by the [consolidation] act ... to the [corporation involved here], just as well, and with exactly the same effect, without the said reservation in its charter, as with it. Besides, the privilege thus offered would be utterly inoperative as an amendment of the charter, till it was accepted by the company. Now the acceptance of this offered privilege would involve a fundamental change in the charter of the company accepting it,—a change which ... could not be effected in the case of a corporation subsisting under a special charter, but by the consent of every stockholder.

Id. at 933.

1301. 41 F. 610 (C.C.D. Ky. 1888).

1302. The applicable reserved power, enacted by the Kentucky legislature in 1856, was quoted by the court as follows:

> "All charters and grants of or to corporations or amendments thereof, enacted or granted since the 14th of February, 1856, and all other statutes, shall be subject to amendment or repeal, at the will of the legislature, unless a contrary intent be therein plainly expressed; provided, that, whilst privileges and franchises so granted may be changed or repealed, no amendment or repeal shall impair other rights previously vested."

Id. at 615 (quoting the then-existing statute).

1303. *See id.* at 615-17. The court said:

> The [reserved power] statute in express terms limits and confines the power of amendment or repeal to the "privileges and franchises granted" the corporation, and provides that, in dealing with such privileges and franchises, "other rights previously vested" shall not be impaired. In the absence of this clearly expressed intent of the legislature not to affect or impair other rights previously vested, in dealing with the privileges and franchises of corporations by way of

Biltmore Hotel Co.,[1304] it was held (with respect to a Delaware corporation) that, notwithstanding a pre-incorporation reserved power, a corporation could not avail itself of post-incorporation enabling legislation to sustain a charter amendment, approved by the specified vote of shareholders, to eliminate a mandatory sinking fund provision included in the charter for the benefit of preferred shareholders.[1305]

> amendment or repeal, it is well settled by the authorities that the power of the legislature, under a reservation of the right to alter, amend, or repeal charters, is not unlimited, and that under such authority changes and alterations cannot be constitutionally made by the legislature which disturb private contracts or rights acquired under such charters before the power of amendment or repeal was exercised....
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> ....
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> The principle of these [cited cases] and other decisions upon the subject of amending or repealing charters under a reservation of power so to do, is that the legislature may change or modify the privileges and franchises which the state has granted to the corporation, and which concern the interests of the public; but dealing with what it has bestowed, either by way of withdrawal or of alteration, the state may not go further, and so legislate as to disturb, affect, or impair rights either of the corporation or of its shareholders, previously acquired, while the corporate functions were being lawfully exercised. All rights thus acquired, of whatever character, are surrounded and protected by constitutional sanctions and guaranties higher and superior to the legislative power of amendment or repeal....
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> The right reserved by the General Statutes to amend or repeal privileges and franchises conferred by the charter is one thing, but the power to take from the stockholders or others rights or property interests, acquired or vested before such repeal or amendment, is another and quite a different thing. The first comes within the legislative authority; the second lies beyond the limits of such authority, because the legislature cannot defeat or impair other rights previously vested, which have sprung up or grown out of such corporate privileges and franchises while the corporation was allowed to exercise the same.

Id.

1304. 34 F.2d 533 (D.R.I. 1929).

1305. The court said:

> The case also involves a consideration of how far the Legislature of the state of Delaware may, under the reserved power in its General Corporation Law in effect when the respondent was incorporated, confer by subsequent enactment upon the majority of stockholders the power to adopt charter amendments which will be binding upon a dissenting minority....
>
> ....
>
> The decisions of the Delaware courts have been studied with the greatest deference. I am compelled, however, to the conclusion that they do not settle the point here involved.
>
> A federal court may be bound by the interpretation placed upon a state statute by a court of last resort of that state, but is not bound by the decision of the state court as to whether so interpreted there is a resulting impairment of the "obligation of contracts" or the taking of property "without due process of law," within the meaning of the Constitution of the United States....
>
> ....

There is, however, federal case law looking in the other direction. In *C.H. Venner Co. v. United States Steel Corp.*,[1306] the court—in denying a motion for a preliminary injunction—held that the reserved power sustained a New Jersey corporation's utilization of a post-incorporation statute that authorized the use of bonds (in lieu of cash) to retire preferred stock. The court based its holding on decisions of the U.S. Supreme Court in three cases to which reference has been made previously: *Sherman v. Smith*,[1307] *Miller v. State*,[1308] and *Looker v. Maynard*.[1309] While it is true that, in each of these cases, it was held that shareholder rights could be altered by post-incorporation legislation enacted pursuant to a reserved power, a close examination of the three decisions reveals that they do not undermine the thesis advanced herein. In *Sherman v. Smith*, the post-incorporation legislation imposed upon all shareholders of banking corporations liability for subsequent debts of those corporations (to the extent of the par value of their respective holdings).[1310] This was an instance of mandatory legislation enacted for the purpose of providing added security for depositors of the state's banking corporations. In *Miller v. State*, the post-incorporation legislation mandated a change in representation on the board of directors of a railroad corporation for the purpose of ensuring that the corporation would not be controlled by its minority shareholders.[1311] This was a case of the legislature rectifying by subsequent legislation what had come to be recognized as a mistake made by earlier legislation because an assumption on which the earlier legislation was based had turned out to be erroneous. In *Looker v. Maynard*, the post-incorporation legislation mandated

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> To say that a general reservation on the part of the state of a right to repeal or enact future amendments to the corporation law gave to the state a power to authorize the cancellation of this [sinking fund] agreement, is to disregard every sound principle of law and to misconstrue legal history....
>
> I am, therefore, compelled to the conclusion that the charter amendments, in so far as they purport to eliminate the sinking fund obligation, are invalid, and the complainant is entitled to have his interest therein protected.

Id. at 535, 544, 547.

1306. 116 F. 1012 (C.C.S.D.N.Y. 1902).

1307. 66 U.S. (1 Black) 587 (1861); *see supra* note 1000 (first paragraph) and text accompanying note 67 (discussing *Sherman*).

1308. 82 U.S. (15 Wall.) 478 (1872); *see supra* notes 69 and 1000 (second paragraph) (discussing *Miller*).

1309. 179 U.S. 46 (1900); *see supra* note 1000 (third paragraph) and text accompanying note 68 (discussing *Looker*).

1310. The case is stated more fully *supra* in note 1000 (first paragraph).

1311. The case is stated more fully *supra* in note 1000 (second paragraph).

cumulative voting for any corporation organized under a general law of the state.[1312] The statute instituted what was deemed (by that legislature at that time) to be a desirable policy of ensuring the potential for minority representation on boards of directors.

It should be noted that in none of these three cases, *Sherman*, *Miller*, and *Looker*, did the post-incorporation legislation have the effect of extending to majority shareholders the power—exercisable at their option and over the protest of minority holders—to effect a transaction not previously authorized or to effect an authorized transaction with a lesser shareholder vote than previously required. Moreover, the force of these three cases as precedents is limited at best. The *Miller* case can be put to one side as involving nothing more than the validation of a post-incorporation statute that rectified a mistake to prevent an injustice.[1313] The *Sherman* case—aside from the fact that it appears to have been wrongly decided—did not involve any alteration of the rights of shareholders vis-à-vis one another.[1314] And, while the *Looker* case did involve such an

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1312. The case is stated more fully *supra* in note 1000 (third paragraph).

1313. The Court concluded its opinion as follows:

> All parties supposed, when the charter was formed, and when the subscriptions to the stock were paid, that the capital stock would be eight hundred thousand dollars, and that the right conceded to the city to elect four out of the thirteen directors would give the city a fair proportion of the whole number, but circumstances have changed in consequence of the failure of a large class of the subscribers to the stock to make good their subscriptions. Payments being refused, the corporation found it necessary to reduce the capital stock, and to shorten the route....
>
> These changes from the original design made new legislation necessary to the ends of justice, and the amendatory act was passed to effect that object, and the court is of the opinion that the amendatory act is a valid law....

Miller, 82 U.S. (15 Wall.) at 499.

1314. The Court failed to recognize (or acknowledge) that the shareholders derived a contractual right, not just from the articles of association, but also from the provision of the 1838 banking statute (under which the corporation had been organized in 1844) stating that " '[n]o shareholder of any such association shall be liable in his individual capacity for any contract, debt, or engagement of such association.' " Sherman v. Smith, 66 U.S. (1 Black) 587, 592 (1861) (quoting Act of Apr. 18, 1838, ch. 260, § 23, 1838 N.Y. Laws 245, 250 but adding the comma after "debt"). Moreover, while the 1838 statute contained a reserved power of alteration or repeal, the Court did not directly address the question whether, under that power, the state—by its post-incorporation imposition upon shareholders of liability for bank debts—should be permitted to speak to members of the investing public with what the apocryphal Native American referred to as a "forked tongue."

In *A.C. Frost & Co. v. Coeur d'Alene Mines Corp.*, 92 P.2d 1057 (Idaho 1939), the court said:

> Assuming but not conceding the legislature, under [the state] Constitution, has reserved power to, and that it did and could, authorize

alteration of shareholder rights, the Court advanced no support for its holding beyond the thin reeds provided by *Miller* and *Sherman*, and the reach of this case as a precedent can well be limited to the reach of the Court's conclusion.[1315]

2. Mistakes Made by Proponents of Expansive Reading

a. Failure to Acknowledge Supreme Court's Vested Right Doctrine

The argument made most frequently in support of the expansive reading of the reserved power is that, because the reserved power becomes a part of the charter of every subsequently organized corporation, the charter of such a corporation can be altered pursuant to post-incorporation legislation in any respect deemed appropriate by the legislature.[1316] There may be some validity to this

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> corporations to change non-assessable to assessable stock, without impairing the obligation of a contract that the stock should be non-assessable ..., that could not possibly vest a corporation with authority to commit fraud by inducing investors to purchase its stock upon the false representation that its shares were not assessable. If so, it puts the Constitution['s reserved power] to a new and strange use.

Id. at 1061.

1315. The *Looker* Court concluded its opinion as follows:

> Remembering that the *Dartmouth College case*, (which was the cause of the general introduction into the legislation of the several States of a provision reserving the power to alter, amend or repeal acts of incorporation,) concerned the right of a legislature to make a change in the number and mode of appointment of the trustees or managers of a corporation, we cannot assent to the theory that an express reservation of the general power does not secure to the legislature the right to exercise it in this respect.

Looker v. Maynard, 179 U.S. 46, 54 (1900).

1316. Sometimes the argument goes further by saying that shareholders are put on notice by the reserved power, and thereby are even deemed to have agreed, that the charter contract can be amended pursuant to post-incorporation legislation. *See* Mobile Press Register, Inc. v. McGowin, 124 So. 2d 812, 821 (Ala. 1960) ("In legal effect, this [reserved] power to amend under general laws was consented to by the stockholders when they purchased their stock."); Allen v. Ajax Mining Co., 77 P. 47, 49 (Mont. 1904) (quoted *supra* in note 1195); Seattle Trust & Sav. Bank v. McCarthy, 617 P.2d 1023, 1026 (Wash. 1980) (en banc) ("[T]he majority of courts ... have found the reservation of the amendment power to be a part of the shareholder's contract, with the result that the shareholder is deemed to have consented in advance to the State's exercise of a power to amend the charter or to authorize the corporation to do so."); Germer v. Triple-State Natural Gas & Oil Co., 54 S.E. 509, 513 (W. Va. 1906) (quoted *supra* in note 1197).

Initially, however, the reserved power informs a shareholder of nothing more than the fact that the legislature can impose on the corporation or its shareholders post-incorporation conditions deemed to be in the public interest. Until a court in the state of incorporation has decided whether it will adopt the restrictive or the expansive reading of the reserved power, the shareholder has no way of knowing whether (by that decision) his

proposition when the post-incorporation legislation has no real impact on shareholder rights;[1317] but, when utilization of a post-incorporation enabling statute has an adverse effect on the vested contractual rights of shareholders, the Supreme Court's reserved power jurisprudence[1318] comes into play. State courts that have adopted the expansive reading appear to have proceeded on the assumption that they have a free choice in the matter.[1319] But the matter is not one of preference; it is one of constitutionality. While it lies within the province of a state's highest court to construe that state's reserved power (whether contained in the state's constitution or in its corporation statute),[1320] the Supreme Court is the final arbiter of whether that construction can stand muster under the Impairment Clause of the Constitution.[1321] What the Supreme Court has said, of course, is that "neither vested property rights nor the obligation of contracts of third persons may be destroyed or impaired" in reliance on a reserved power.[1322] And, as pointed out above,[1323] this means

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contractual rights under the corporate charter will be protected from change, or be subjected to alteration, pursuant to permissive post-incorporation legislation.

1317. In *Bigelow v. Calumet & Hecla Mining Co.*, 167 F. 721 (6th Cir. 1909) (involving Michigan corporations), it was held that a corporation could avail itself of post-incorporation legislation, enacted pursuant to a reserved power, that authorized mining corporations to acquire stock in other mining companies. *See id.* at 723-24. However, this legislation did not involve any alteration of the rights of shareholders.

1318. *See supra* note 971 and text accompanying notes 972-78.

1319. Whether or not influenced by a desire to uphold statutes enacted by the legislatures of their respective states, courts adopting the expansive reading of the reserved power have generally opted for corporate flexibility over protection of the rights of minority shareholders. *See, e.g.*, Brundage v. New Jersey Zinc Co., 226 A.2d 585, 594-96 (N.J. 1967) (disavowing the century-old *Zabriskie* doctrine in favor of the flexibility afforded by an expansive reading of the reserved power) (quoted and discussed *supra* in notes 1057 and 1072, and text accompanying notes 1075-80); *Seattle Trust & Sav. Bank*, 617 P.2d at 1026-27 (reversing an earlier adoption of the restrictive reading and embracing the expansive reading in the interest of corporate flexibility) (discussed *supra* in text accompanying notes 1081-88).

1320. *See* Sauer v. City of New York, 206 U.S. 536, 545-47 (1907). The point was made in *Mott v. Pennsylvania Railroad Co.*, 30 Pa. 9 (1858), in the following language:

> The decisions of the Supreme Court of the United States, on the construction of the constitution or laws of the United States, are binding on the state courts. The decisions of the supreme courts of the several states, on the construction of the constitution and laws of their respective states, are, in like manner, binding on the Supreme Court of the United States. That court has no more right to overrule a judgment of a state court, on a question of state law, than the state court has to overrule the United States court on a question of United States law.

Id. at 31-32.

1321. *See supra* note 1028 and accompanying text.

1322. Coombes v. Getz, 285 U.S. 434, 442 (1932); *see supra* note 971 (seventh paragraph) and text accompanying notes 1282-84.

that the expansive reading of the reserved power is constitutionally impermissible.

There certainly are those who do not like the vested right doctrine.[1324] And, in an effort to avoid the implications of that doctrine, the expansive reading of the reserved power has been pushed to its logical extreme. It has been held that a pre-incorporation reserved power makes it impossible for any shareholder right to become vested—that, because the reserved power becomes a part of any corporate charter subsequently granted, the shareholder's charter rights are necessarily subject to alteration by post-incorporation legislation.[1325] But this stands the matter on its head. What the opponents of vested rights would like to be able to say is this: If a right is subject to change under the reserved power, it cannot be vested. But what the Supreme Court has said is this: If a right is vested, it cannot be subject to change under the reserved

1323. *See supra* text accompanying notes 1282-1315.

1324. For judicial criticism of the doctrine, see the following: *Davison v. Parke, Austin & Lipscomb, Inc.*, 35 N.E.2d 618, 622 (N.Y. 1941) ("So it seems that only confusion results from saying that 'vested rights' are not within the contemplation of the [amendment] statute."); *McNulty v. W. & J. Sloane*, 54 N.Y.S.2d 253, 259 (Sup. Ct. 1945) ("Decisions in other states and scholarly ... articles pointed out that the term 'vested right' ... was ... a 'deceptive label.' To characterize dividends, accumulating through lapse of time, but never declared, as a 'vested' interest is but to argue from a conclusion."); *McCallum v. Gray*, 542 P.2d 1025, 1028-29 (Or. 1975); *Dentel v. Fidelity Savings & Loan Ass'n*, 539 P.2d 649, 651 (Or. 1975) ("The 'vested rights' terminology has been attacked as being confusing and meaningless."); and *O'Brien v. Socony Mobil Oil Co.*, 152 S.E.2d 278, 285 n.11 (Va. 1967).

For other criticism of the doctrine, see Gibson, *supra* note 943, at 605-08, and Dale W. VanWinkle, Comment, *Corporations—Charter—Change of Voting Right by Amendment*, 54 MICH. L. REV. 279, 280 (1955).

1325. An example is provided by *Mobile Press Register, Inc. v. McGowin*, 124 So. 2d 812 (Ala. 1960), in which the court said:

> We have given due consideration to appellees' contention that "a stockholder's preemptive right is a vested property right entitled to the same protection by law as other property rights and may not be taken away by the officers, directors or other stockholders without his consent." But can it be said that such right, when acquired, became "vested", that is, cannot be "destroyed, impaired, or divested" without the consent of the holder of such right, in the face of the fact that the corporation's charter and the certificates of stock contained, in legal effect, at the time such right was acquired, the mandatory constitutional prescription that it "shall be subject to amendment, alteration, or repeal under general laws"? We think not. This reserved right to amend, in such manner as the legislature may prescribe by general laws, became, as already noted, a part of each stockholder's contract. That is, the preemptive right, when acquired, was acquired subject to the express condition that it could, in effect, be "destroyed, impaired or divested by an amendment of the charter under general laws."

Id. at 823-24 (citation omitted).

power.

b. Fallacy Concerning Multiple Categories of Corporations

It has been argued that there is a practical necessity for holding that enabling legislation be available for use by pre-existing corporations as well as by those subsequently organized.[1326] The argument is that, otherwise, a state would have multiple categories of corporations—with older corporations governed by one set of rules and newer corporations governed by a different set of rules.[1327] The argument loses its force, however, when one recognizes that such a state of affairs already exists—with no discernible adverse consequences.[1328] In North Carolina, for example, there are (depending on their date of incorporation) multiple categories of corporations with respect to the right of cumulative voting[1329] and more than one category with respect to preemptive rights.[1330] Similarly, in New Jersey, there are two categories of corporations with respect to the shareholder vote required for a long-form merger[1331] or for a sale-of-assets transaction.[1332]

There is a far more compelling argument to be made. It is much more important that we not have two categories of states: those adhering to the restrictive reading of the reserved power, and those adhering to the expansive reading. If the expansive reading were to be invalidated by the Supreme Court, shareholders throughout the nation would have the satisfaction of knowing, without regard to the

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1326. *See* Gibson, *supra* note 1023, at 292 ("Since these [modernizing] statutes were enacted to keep the agencies of business healthy and adaptable to changing business conditions, it is important that the same rules apply uniformly to all corporations, without regard to the time of their organization and financing.").

1327. In *Allen v. Scott*, 135 N.E. 683 (Ohio 1922), the court said:

> The principle contended for by counsel for [shareholders of a banking corporation] would immediately create two classes of corporations, those organized between 1903 and 1913 [when there was no constitutional provision imposing double liability on shareholders of such corporations], and those organized before and after that period [when there were such constitutional provisions]. This would be conducive to the greatest confusion and would destroy the uniform operation of laws applicable to private corporations.

Id. at 685; *accord* Diamond v. Parkersburg-Aetna Corp., 122 S.E.2d 436, 445-46 (W. Va. 1961).

1328. Different rules for different categories of corporations are often the result of "grandfathering" provisions of a prior statute when a new corporation statute is adopted.

1329. *See* N.C. GEN. STAT. § 55-7-28 (Supp. 1996).

1330. *See id.* § 55-6-30.

1331. *See* N.J. STAT. ANN. § 14A:10-3(2)-(3) (West Supp. 1997) (quoted *supra* in text accompanying notes 560-64).

1332. *See id.* § 14A:10-11(1)(c)-(d) (quoted *supra* in note 845).

domiciles of the corporations whose stock they own, that their shareholder rights could not be altered pursuant to permissive post-incorporation legislation—unless dissenters were accorded a right of appraisal.

C. Sustaining Effect of Appraisal Right

Disagreements between adherents of the two readings of the reserved power involve a tension between the arguments, on the one hand, that there is a need to promote corporate flexibility and, on the other hand, that there is a need to protect shareholder rights. One can applaud the protection given to shareholder rights in cases such as *Breslav v. New York & Queens Electric Light & Power Co.*[1333] and *Yukon Mill & Grain Co. v. Vose*,[1334] which held that the reserved power did not sustain utilization of post-incorporation legislation to make non-callable preferred stock subject to redemption,[1335] *Sutton v. Globe Knitting Works*,[1336] which held that the reserved power did not sustain utilization of post-incorporation legislation to postpone the date for mandatory redemption of preferred stock,[1337] *Keller v. Wilson & Co.*[1338] and *Wheatley v. A.I. Root Co.*,[1339] which held that the reserved power did not sustain utilization of post-incorporation legislation to eliminate dividend arrearages on preferred stock,[1340] and *Yoakam v. Providence Biltmore Hotel Co.*,[1341] which held that the reserved power did not sustain utilization of post-incorporation legislation to eliminate a sinking fund for preferred stock;[1342] at the same time, however, one can regret the fact that the will of the holders of a majority of the voting stock was thwarted in each of those cases. And one can regret the alteration of shareholder rights in cases such as *Hinckley v. Schwarzschild & Sulzberger Co.*,[1343] *French v. Cumberland Bank & Trust Co.*,[1344] and *Miller v. Magline*,

1333. 291 N.Y.S. 932 (App. Div. 1936), *aff'd per curiam*, 7 N.E.2d 708 (N.Y. 1937).
1334. 206 P.2d 206 (Okla. 1949).
1335. *See supra* notes 1005 (discussing *Breslav*) and 1054 (discussing *Vose*).
1336. 267 N.W. 815 (Mich. 1936).
1337. *See supra* text accompanying notes 1010-12 (discussing *Sutton*).
1338. 190 A. 115 (Del. 1936).
1339. 69 N.E.2d 187 (Ohio 1946).
1340. *See supra* notes 1018 (discussing *Keller*) and 1053 (first paragraph) (discussing *Wheatley*).
1341. 34 F.2d 533 (D.R.I. 1929).
1342. *See supra* text accompanying notes 1033-37 and 1304-05 (discussing *Yoakam*).
1343. 95 N.Y.S. 357 (App. Div. 1905).
1344. 74 S.E.2d 265 (Va. 1953).

Inc.,[1345] which held that the reserved power sustained utilization of post-incorporation legislation to change the voting power of shareholders,[1346] and *Seattle Trust & Savings Bank v. McCarthy*[1347] and *Mobile Press Register, Inc. v. McGowin*,[1348] which held that the reserved power sustained utilization of post-incorporation legislation to eliminate preemptive rights;[1349] at the same time, however, one can applaud the fact that effect was given to the will of the holders of a majority of the voting stock in each of those cases. What is needed is a way of giving effect to the will of majority shareholders while according protection to the rights of minority shareholders.

Such a harmonizing device is to be found in the provision of appraisal rights for dissenters. With appraisal rights available, dissenters can withdraw the value of their investment from the enterprise, and effect can be given to the will of majority shareholders. As outlined above, there are two grounds on which the Supreme Court can base a decision that post-incorporation legislation can be utilized to alter shareholder rights so long as a right of appraisal is accorded to dissenters. The first of those grounds is that a state can change the remedy of a party to a contract (provision of a right of appraisal in lieu of a power to veto or enjoin) without impairing the obligation of the contract.[1350] The second ground is that statutory provision of a right of appraisal constitutes a valid exercise of the state's power of eminent domain[1351]—a sovereign power whose exercise is not precluded by the Impairment Clause.[1352]

What is needed is a decision by the Supreme Court establishing two points. The first point is that the reserved power cannot constitutionally sustain an abrogation of shareholder rights pursuant to permissive post-incorporation legislation.[1353] The second point is that, when appraisal rights are accorded to dissenters, a corporation can utilize post-incorporation legislation notwithstanding the Impairment Clause.[1354]

1345. 306 N.W.2d 533 (Mich. Ct. App. 1981).

1346. *See supra* text accompanying notes 1240-44 (discussing *Hinckley*), 1245-47 (discussing *French*), and 1248-49 (discussing *Miller*).

1347. 617 P.2d 1023 (Wash. 1980) (en banc).

1348. 124 So. 2d 812 (Ala. 1960).

1349. *See supra* text accompanying notes 1084-88 (discussing *McCarthy*) and 1095-98 (discussing *McGowin*).

1350. *See supra* text accompanying notes 1122-25.

1351. *See supra* text accompanying notes 1126-39.

1352. *See supra* text accompanying notes 62-64 and 101-06.

1353. *See supra* text accompanying notes 1280-1332.

1354. *See supra* text accompanying notes 1121-39 and 1350-52.

A double-edged holding by the Supreme Court, along these lines, would have two salutary consequences. The first desirable result would be that, whenever a corporation sought to alter shareholder rights pursuant to permissive post-incorporation legislation, appraisal rights would have to be accorded to dissenting shareholders. The other desirable result would be an end to the controversy that has swirled for almost a century and a half around the "reserved power question."

D. A Final Observation

This discussion can be concluded by examining a provision contained in the 1984 Model Business Corporation Act and in North Carolina's 1989 Business Corporation Act (based thereon). Included as part of the section authorizing charter amendments, it states: "A shareholder of the corporation does not have a vested property right resulting from any provision in the articles of incorporation, including provisions relating to management, control, capital structure, dividend entitlement, or purpose or duration of the corporation."[1355]

Because this is such a bizarre platform from which to invite members of the investing public to purchase equity securities, some comments are in order. The Model Act's Official Comment states that the quoted provision "rejects decisions by a few courts" that have applied the vested right doctrine because the effect of such decisions is to create the "tyranny of the minority" inherent in a requirement of unanimous shareholder consent.[1356] But the means of eliminating that "tyranny of the minority" should not be by way of a statutory declaration—which, incidentally, may itself entail a violation of the Impairment Clause if applied to a pre-existing corporation[1357]—that shareholders have no vested right in the terms

1355. N.C. GEN. STAT. § 55-10-01(b) (1990) (omitting comma after "dividend"); MODEL BUS. CORP. ACT ANN. § 10.01(b) (1996) (containing erroneous comma after "dividend").

1356. MODEL BUS. CORP. ACT ANN. § 10.01 commentary at 10-4 to -5 (1996).

1357. North Carolina's 1989 Business Corporation Act contains the following:

> The provisions of this Chapter shall apply to every corporation for profit ... now existing or hereafter formed, and to the outstanding and future securities thereof, except to the extent the corporation is expressly excepted by this Chapter from its operation or except to the extent that there is other specific statutory provision particularly applicable to the corporation or inconsistent with some provisions of this Chapter, in which case that other provision prevails.

N.C. GEN. STAT. § 55-17-01(a) (1990); *see also* State *ex rel.* Howes v. W.R. Peele, Sr. Trust, 876 F. Supp. 733, 738 (E.D.N.C. 1995) ("The current North Carolina Business Corporation Act [adopted June 8, 1989, effective July 1, 1990] applies to corporations

of their charter contract. Instead, the way to eliminate that "tyranny," when it is proposed that shareholder rights be altered pursuant to post-incorporation enabling legislation, is to ensure that (after the proposal has been adopted by directors subject to a rigorous fiduciary duty and approved by an appropriate vote of shareholders following full disclosure) dissenters are given the opportunity to receive the fair value of their stock through the exercise of appraisal rights.[1358]

The vice of the expansive reading of the reserved power is evident if it permits the application to a pre-existing corporation of a statutory provision that attempts to undermine the charter rights of shareholders in the cause of corporate flexibility. At the same time, the rule of unanimity, if not abated by provision of a right of appraisal for dissenters, forecloses corporate flexibility for the sake of protecting shareholder rights.

It is not necessary to approach the need for corporate flexibility and the need for shareholder protection on an either/or basis. Both needs are important, and both needs should be met. As one court said in 1925:

> [W]hile it is quite desirable that corporations organized under the laws of [the state] should have ample proper latitude in making readjustments to meet new and unexpected business conditions, it is even more important that the contractual rights of stockholders of all classes of stock shall be upheld by the courts under all circumstances.[1359]

And another court said in 1936:

> It may be conceded, as a general proposition, that the State, as a matter of public policy, is concerned in the welfare of its corporate creatures to the end that they may have reasonable powers wherewith to advance their

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existing prior to its enactment.").

1358. The Model Act's Official Comment includes the following:

> Minority shareholders are protected from the power of the majority to impose onerous or objectionable amendments by two basic devices: the right to vote on amendments by separate voting groups and the right to dissent [and appraisal]. In addition, courts have held that a decision by majority shareholders to exercise the powers granted by this section in a way that is arguably detrimental or unfair to minority interests may be examined by a court under its inherent equity power to review transactions for good faith and fair dealing.

MODEL BUS. CORP. ACT ANN. § 10.01 commentary at 10-6 to -7 (1996) (cross references omitted).

1359. General Inv. Co. v. American Hide & Leather Co., 129 A. 244, 249 (N.J. 1925).

> interests .... The State is concerned also with the welfare of those who invest their money, the very essence of generation, in corporate enterprises. Some measure of protection should be accorded them.[1360]

A decision by the Supreme Court that a change in shareholder rights pursuant to permissive post-incorporation legislation can stand constitutional muster, not on the basis of a reserved power but only through the provision of appraisal rights for dissenters, would help to achieve both objectives.

1360. Keller v. Wilson & Co., 190 A. 115, 124 (Del. 1936).