



UNC
SCHOOL OF LAW

NORTH CAROLINA LAW REVIEW

Volume 42 | Number 2

Article 14

2-1-1964

Corporations -- De Facto Merger -- Minority Shareholder's Appraisal Rights

Walter Rand III

Follow this and additional works at: <http://scholarship.law.unc.edu/nclr>



Part of the [Law Commons](#)

Recommended Citation

Walter Rand III, *Corporations -- De Facto Merger -- Minority Shareholder's Appraisal Rights*, 42 N.C. L. REV. 436 (1964).

Available at: <http://scholarship.law.unc.edu/nclr/vol42/iss2/14>

This Note is brought to you for free and open access by Carolina Law Scholarship Repository. It has been accepted for inclusion in North Carolina Law Review by an authorized editor of Carolina Law Scholarship Repository. For more information, please contact law_repository@unc.edu.

Corporations—De Facto Merger—Minority Shareholder's Appraisal Rights

At common law a dissenting shareholder could prevent corporate reorganization by merger,¹ consolidation,² or sale of assets³ on the theory that such a change would violate the "contract of association" to incorporate for a particular purpose⁴ or change the essential nature of the shareholder's investment.⁵ In many instances shareholders took advantage of this right by threatening to enjoin proposed sales and mergers and thus were able to command exorbitant prices for their stock.⁶ Due in part to this abuse and in part to a corporate need for more flexibility,⁷ statutes have been passed restricting the right of dissatisfied shareholders to dissent from corporate transactions and allowing them to receive fair value⁸ for their shares in specific instances.⁹

In many jurisdictions this right of dissenting shareholders is limited by statute to situations in which the proposed change in corporate form occurs by merger or consolidation.¹⁰ Other jurisdictions grant a dissenting shareholder the right to invoke judicial aid when the corporate change occurs by sale of assets,¹¹ as well as by

¹ See, e.g., *Chicago Corp. v. Munds*, 20 Del. Ch. 142, 149, 172 Atl. 452, 455 (1934) (dictum).

² See, e.g., *Spencer v. Railroad*, 137 N.C. 107, 119-20, 49 S.E. 96, 101 (1904) (dictum). See also *Carolina Coach Co. v. Hartness*, 198 N.C. 524, 528, 152 S.E. 489, 491 (1930), which distinguished between merger and consolidation stating that "merger (is) the absorption of a thing of lesser importance by a greater, whereby the lesser ceases to exist, but the greater is not increased. . . . But . . . the legal effect of consolidation is to extinguish the constituent companies and create a new corporation." For a statutory distinction see N.C. GEN. STAT. § 55-110(a) (1960).

³ See, e.g., *Geddes v. Anaconda Copper Mining Co.*, 254 U.S. 590, 598 (1921) (dictum); *Kean v. Johnson*, 9 N.J. Eq. 401, 414 (Ch. 1853).

⁴ *Lauman v. Lebanon Valley R.R.*, 30 Pa. 42 (1858).

⁵ See *Geddes v. Anaconda Copper Mining Co.*, 254 U.S. 590, 598 (1921) (dictum); *Lauman v. Lebanon Valley R.R.*, *supra* note 4.

⁶ See *Johnson v. Baldwin*, 221 S.C. 141, 154, 69 S.E.2d 585, 591 (1952) (dictum).

⁷ See Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L.J. 223, 228-30 (1962).

⁸ See, e.g., N.C. GEN. STAT. § 55-113(c), (e) (1960), which designates the time for appraisal and places a minimum limitation on "fair value."

⁹ See, e.g., N.C. GEN. STAT. § 55-113 (1960).

¹⁰ See, e.g., DEL. CODE ANN. tit. 8, § 262 (1953). Eight states provide that merger and consolidation shall be the only triggering transactions. For a list of these see Manning, *supra* note 7, at 262-63.

¹¹ See, e.g., N.C. GEN. STAT. § 55-113 (1960); PA. STAT. ANN. tit. 15, § 2852-311(D) (1958); N.J. STAT. ANN. § 14:3-5 (1939).

merger and consolidation.¹² Since a sale of assets may have the same end result as a merger,¹³ dissatisfied shareholders in jurisdictions which do not provide a statutory right of appraisal upon a sale of assets have contended for recognition of the judicial doctrine of *de facto* merger. That is, the shareholder contends:

that the transaction, though in form a sale of assets . . . is in substance and effect a merger, and that it is unlawful because the merger statute has not been complied with, thereby depriving (the shareholder) of his right of appraisal.¹⁴

In Delaware, where statutory appraisal rights are accorded only in instances of merger and consolidation,¹⁵ the supreme court recently rejected such a contention in *Hariton v. Arco Electronics, Inc.*¹⁶ Arco Electronics proposed to sell its assets to Loral Electronics pursuant to the Delaware sale-of-assets statute.¹⁷ Arco was to transfer its assets to Loral in exchange for Loral stock and the assumption by Loral of all Arco's liabilities. Upon closing the transaction Arco was to distribute the Loral stock to its shareholders and dissolve. A minority shareholder in the selling corporation brought suit to enjoin the proposed sale, contending that the transaction was a *de facto* merger.¹⁸

While recognizing that the sale of assets had the same effect as would have been achieved by merger, the court pointed out that this result was permitted by the overlapping scope of the merger statute and the sale-of-assets statute.¹⁹ The court made no reference to the

¹² All states except West Virginia provide for appraisal rights to dissenting shareholders upon merger or consolidation.

¹³ See text at notes 17-18 *infra*.

¹⁴ *Hariton v. Arco Electronics, Inc.*, 182 A.2d 22, 24 (Del. Ch. 1962), *aff'd*, 188 A.2d 123 (Del. 1963).

¹⁵ DEL. CODE ANN. tit. 8, § 262 (1953).

¹⁶ 188 A.2d 123 (Del. 1963), *affirming* 182 A.2d 22 (Del. Ch. 1962). For a complete discussion of the implications of this case see Folk, *De Facto Mergers In Delaware: Hariton v. Arco Electronics, Inc.*, 49 Va. L. Rev. 1261 (1963).

¹⁷ DEL. CODE ANN. tit. 8, § 271 (1953).

¹⁸ In *Heilbrun v. Sun Chemical Co.*, 38 Del. Ch. 321, 150 A.2d 755 (Sup. Ct. 1959), *affirming* 37 Del. Ch. 552, 146 A.2d 757 (Ch. 1958), the Delaware court had "expressly observed" the issue which arose in *Hariton*, but had refused to decide it because the complaining shareholder was a member of the *purchasing* corporation and was deemed not to have suffered any damage.

¹⁹ "This is so because the sale of assets statute and the merger statute are independent of each other. They are, so to speak, of equal dignity, and the framers of a reorganization plan may resort to either type of corporate

shareholder's claim that he was being forced to accept stock in a different corporation. However, the lower court had given the following answer to that contention:

The stockholder was, in contemplation of law, aware of this right (to make a sale of assets to another corporation) when he acquired the stock. He was also aware of the fact that the situation might develop whereby he would be ultimately forced to accept a new investment, . . .²⁰

On the other hand Pennsylvania, another important commercial jurisdiction, has found considerably more merit in the *de facto* merger doctrine. In *Farris v. Glen Alden Corp.*²¹ the Pennsylvania court said that the appraisal remedy was available in any case where the new corporate combination effected a change in the essential nature of the corporation, or disturbed the relationship existing between shareholders or between shareholders and the corporation. Since the reorganization changed Glen Alden from a coal mining company into a diversified company with additional holdings in the fields of entertainment, real estate, and manufacturing, the court said that its "corporate character" had been changed.²²

Before granting appraisal rights to a shareholder of the purchasing corporation, however, the Pennsylvania court still had a difficult obstacle to hurdle. Faced with statutory language granting the appraisal remedy to a seller of assets²³ but expressly denying it to a purchaser,²⁴ the court said that the statute only applied to instances in which reorganization was accomplished by a sale of assets *without*

mechanics to achieve the desired end." *Hariton v. Arco Electronics, Inc.*, 188 A.2d 123, 125 (Del. 1963), *affirming* 182 A.2d 22 (Del. Ch. 1962).

²⁰ *Hariton v. Arco Electronics, Inc.*, *supra* note 19, at 26. Although *Hariton* would seem to preclude the application of the *de facto* merger doctrine in Delaware, the court still purports to recognize the doctrine. See *Orzeck v. Englehart*, 195 A.2d 375 (Del. 1963), *affirming* 192 A.2d 36 (Del. Ch. 1963). However the court has only applied the doctrine where the parties to the reorganization failed to comply with some statutory provision pertaining to the transaction, to the prejudice of the shareholder. See *Drug, Inc. v. Hunt*, 35 Del. 339, 168 Atl. 87 (1933); *Finch v. Warrior Cement Corp.*, 16 Del. Ch. 44, 141 Atl. 54 (1928).

²¹ 393 Pa. 427, 143 A.2d 25 (1958).

²² Other Pennsylvania cases have been decided along similar lines. See *Troupiansky v. Henry Disston & Sons*, 151 F. Supp. 609 (E.D. Pa. 1957); *Marks v. Autocar Co.*, 153 F. Supp. 768 (E.D. Pa. 1954); *Bloch v. Baldwin Locomotive Works*, 75 Pa. D. & C. 24 (C.P. 1950).

²³ PA. STAT. ANN. tit. 15, § 2852-311(D) (1958).

²⁴ PA. STAT. ANN. tit. 15, § 2852-908(C) (1958).

more and that if the shareholder's common law rights were to be abrogated, a more specific statute was necessary.²⁵ Then, almost as an afterthought, the court advanced another, perhaps sounder, principle upon which the decision could be based. The court recognized that *Glen Alden* presented a situation in which the corporation designated by the parties as the seller was actually the buyer,²⁶ and said that in such a situation it would look through the nominal designation of the parties to the substance of the transaction.

Further, the New Jersey court has recognized the *de facto* merger doctrine in a similar situation. An exchange of one corporation's shares for those of another can bear as much resemblance to merger and consolidation as does a sale of assets for shares in the buying corporation.²⁷ In *Applestein v. United Board & Carton Corp.*²⁸ the New Jersey court held that a transaction intended to effect a consolidation by means of an exchange of shares and a subsequent dissolution of the smaller corporation so closely resembled a *de jure* merger that it would be treated as a merger in fact. New Jersey has a statutory scheme granting appraisal rights when there is a merger,²⁹ consolidation,³⁰ or sale of assets³¹—making no mention of exchange of shares. However, the court said that it made no difference because “every factor present in a corporate merger is

²⁵ The court reached this decision despite the express language of the statute and evidence that this interpretation was contrary to the intention of the drafters of the statute. See *Farris v. Glen Alden Corp.*, 393 Pa. 427, 436-37, 143 A.2d 25, 30-31 (1958).

²⁶ Previous to the reorganization, List (the “seller”) owned 38.5% of Glen Alden's (the “buyer”) stock. When Glen Alden acquired all the stock of List for its own stock, this gave List effective control of Glen Alden with 76.5% of Glen Alden's stock. This problem has been settled in regard to which party receives appraisal rights by PA. STAT. ANN. tit. 15, § 2852-311(F) (Supp. 1962), which denies appraisal rights to the buyer unless it makes the purchase with more than 50% of its voting shares.

²⁷ In *Orzeck v. Englehart*, 192 A.2d 36, 38 (Del. Ch. 1963), *aff'd*, 195 A.2d 375 (Del. 1963), the court said that a sale of assets and an exchange of shares are not so similar that the same reasoning should apply to both in regard to *de facto* merger. This position may be reached by distinguishing the component parts of the transactions; however, from the position of a dissenting shareholder, the end result of one may be indistinguishable from the other.

²⁸ 60 N.J. Super. 333, 159 A.2d 146 (Ch.), *aff'd per curiam*, 33 N.J. 72, 161 A.2d 474 (1960).

²⁹ N.J. STAT. ANN. § 14:12-6 (Supp. 1962).

³⁰ *Ibid.*

³¹ N.J. STAT. ANN. § 14:3-5 (1939).

found in this . . . plan, except . . . a formal designation of the transaction as a 'merger.'³²

Both the Delaware and the Pennsylvania-New Jersey views on the *de facto* merger doctrine have some merit. No statute grants appraisal rights in a purchase of assets or an exchange of shares situation; therefore, if the statute is interpreted as an exclusive remedy, there can be no *de facto* merger doctrine. It is worth noting that more than half the appraisal statutes expressly grant appraisal rights for a sale of assets,³³ so that the omission of purchase of assets might be deemed intentional.³⁴ Furthermore, a shareholder could not prevent an exchange of shares at common law,³⁵ and it can, therefore, be argued that the want of an appraisal remedy in such a situation does not deprive the shareholder of any former right.³⁶ Neither the Pennsylvania nor the New Jersey court has decided the exact elements necessary to constitute a *de facto* merger, and this lack of certainty would cause litigation in practically every case,³⁷ thereby diminishing the advantage which the appraisal remedy would afford the shareholder, while still allowing the shareholder to "hold up" the corporation due to the expense of defending against claims.³⁸ Any hard and fast rule that the court would treat as a merger any sale of assets or exchange of shares which had the same effect as a merger would, in effect, remove from consideration all means of corporate reorganization except merger.³⁹

On the other hand the fact that practically all jurisdictions grant appraisal rights to all shareholders who dissent from a merger⁴⁰ would seem to indicate that courts still adhere to the theory that one should not be compelled to accept stock in a different corpora-

³² *Applestein v. United Board & Carton Corp.*, 60 N.J. Super. 333, 348, 159 A.2d 146, 154 (Ch.), *aff'd per curiam*, 33 N.J. 72, 161 A.2d 474 (1960).

³³ Thirty-seven states grant appraisal upon a sale of assets. For a list of these see Manning, *supra* note 7, at 262-65.

³⁴ This was relied on in *Hariton v. Arco Electronics, Inc.*, 182 A.2d 22, 25 (Del. Ch. 1962), *aff'd*, 188 A.2d 123 (Del. 1963).

³⁵ At common law the only check on the right of alienation was an action for fraud. Presently this right is checked by a fiduciary duty toward the minority imposed upon directors and officers. See Folk, *supra* note 16, at 1276.

³⁶ See text at notes 1-5 *supra*. Also see Note, 58 COL. L. REV. 251, 253 (1958).

³⁷ See Note, 72 HARV. L. REV. 1132, 1144 (1959).

³⁸ *Id.* at 1133 n.6.

³⁹ See Folk, *supra* note 16, at 1276.

⁴⁰ See note 11 *supra*.

tion.⁴¹ As a sale of assets or exchange of shares, when coupled with an assumption of the seller's liabilities by the buyer and compelled dissolution of the seller, places the minority shareholder in exactly the same position as does a merger, it would seem logically inconsistent to refuse the shareholder the remedy which is available in a merger.⁴² The appraisal argument is not very compelling when the business is merely changed from a coal mining company to an ice cream company;⁴³ however, when the change is from an income company to a growth company and the shareholder cannot readily dispose of his interest, the argument is more persuasive because the shareholder's investment has truly been changed.

The appraisal provisions of the North Carolina Business Corporation Act are similar to those of Pennsylvania and New Jersey in that the act expressly grants appraisal rights for merger, consolidation, and sale of assets.⁴⁴ Like the statutes of all other jurisdictions, the act does not provide for appraisal rights upon a purchase of assets or exchange of shares. There are no decisions which indicate whether the court would accept the *de facto* merger doctrine; therefore the matter is open for speculation. The only indication of intent left by the drafters of the act is the statement that appraisal rights are given for sales of assets because this is "frequently nothing more than a *de factor* (sic) merger and hence should be analogized to merger as much as possible."⁴⁵

As the North Carolina court is not bound by any existing precedent, it may select either path in deciding whether to grant

⁴¹ Delaware holds to the contrary. See *Hariton v. Arco Electronics, Inc.*, 182 A.2d 23, 26 (Del. Ch. 1962), *aff'd*, 188 A.2d 123 (Del. 1963).

⁴² See Note, 72 HARV. L. REV. 1132, 1143 (1959).

⁴³ If only the type of business in which the corporation is engaged is changed, this would seem an insufficient reason to grant appraisal rights as the same results could be reached by charter amendment or a change in the "business policy" of the corporation, neither of which would trigger any appraisal statute.

⁴⁴ N.C. GEN. STAT. § 55-113 (1960) provides that the sale of assets must be for shares of the purchasing corporation before appraisal rights are granted. In addition to transactions under consideration in connection with *de facto* merger, the North Carolina act also allows appraisal rights in the event of the following: charter amendments which would change the corporation into a non-profit or cooperative organization; charter amendments or offers of exchange which would affect dividend and liquidation preferences; and liquidation by transfer of assets in kind to shareholders. See N.C. GEN. STAT. § 55-101(b) (1960); N.C. GEN. STAT. § 55-102 (1960); N.C. GEN. STAT. § 55-119(b) (1960).

⁴⁵ S. 49, N.C. Sess. 1955, § 112 (comment).

appraisal rights for transactions not specifically mentioned by statute. The case-law emphasis in other jurisdictions has been concerned with broad interpretations of legislative intent; however, the real problem is that the form of the transaction has been made the controlling factor while the pertinent question of whether there should be appraisal rights at all has been overlooked. The granting of this remedy compels a loss of mobility to the corporation⁴⁶ and reduces the speed and effectiveness with which the corporation can make decisions. It is expensive⁴⁷ and uncertain, as the corporation never knows how many dissenters to expect. The resulting flow of cash away from the corporation may frighten creditors and cause reorganization plans to be cancelled.⁴⁸ These may well be adequate reasons for refusing appraisal rights in all situations, but deciding whether or not they are to be granted on the basis of the form of the transaction alone does not meet the problem squarely. Certainly such a rule enables a corporation to avoid granting appraisal rights simply by adopting a certain form for the transaction, but even the severest critics of appraisal rights admit their utility in "no market" situations⁴⁹ which are often found when dealing with closely held corporations. To grant relief in such situations and still preserve a maximum of corporate freedom, granting the remedy should depend on the effect of the transactions, rather than their form, and this would involve a thorough revamping of the appraisal statutes.

WALTER RAND, III

Corporations—Unlawful Proxy Solicitation Under Securities Exchange Act—Rights of Shareholders—Jurisdiction of Federal Courts to Grant Retrospective Relief

Under section 14(a) of the Securities Exchange Act of 1934,¹ it is unlawful to solicit proxies in violation of the Securities Ex-

⁴⁶ See Note, 59 COL. L. REV. 366, 368 (1959).

⁴⁷ In *Farris v. Glen Alden Corp.*, 393 Pa. 427, 431 n.5, 143 A.2d 25, 28 n.5 (1958), it was conceded that the reorganization plan would fail if appraisal rights were given, due to the expense involved.

⁴⁸ For a good discussion of "the company's perspective" see Manning, *supra* note 7, at 233-39.

⁴⁹ *Id.* at 260-62.

¹ "It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce... or otherwise to solicit or permit the use of his name to solicit any proxy... in respect of any se-