Securities Regulation -- Challenging the Short Form Merger Through Rule 10b-5 and the Corporate Purpose Doctrine

Johnny Reid Edwards

Follow this and additional works at: http://scholarship.law.unc.edu/nclr
Part of the Law Commons

Recommended Citation
Available at: http://scholarship.law.unc.edu/nclr/vol55/iss1/22
defendant wishes to testify falsely and to enlist the aid of his attorney in so doing. In answer to Freedman, one commentator has aptly said:

[T]he very existence of the special rights accorded a defendant whose liberties are at stake—appointed counsel, the fifth amendment privilege, jury trial, proof beyond a reasonable doubt, and others—militates against adding the right to compel counsel to allow the client to perjure himself and even ethically require the counsel to argue the client's false story to the jury.91

Although he owes his client the duty of zealous representation, the lawyer's own values, his honesty and his integrity, are also at stake. These values should not be sacrificed to the client who, by choosing to pursue an illegal course of conduct, brings on his own prejudice.

If Freedman's solution elevates the duty of confidentiality to the client at too great an expense to the lawyer, then a compromise such as the trial court's, however flawed, that attempts to preserve the lawyer's duty both to his client and to the court, is necessary. Unless the holding in Robinson is somehow limited to the particular facts of the case or overruled, the court would seem to have foreclosed the possibility of such a compromise solution for the North Carolina attorney.

DEBORAH A. BRIAN

Securities Regulation—Challenging the Short Form Merger Through Rule 10b-5 and the Corporate Purpose Doctrine

In the wake of the depressed securities markets of the 1970's, a corporate phenomenon known as "going private" has become increasingly prevalent.1 "Going private" usually entails the buying out of public minority shareholders of a corporation by a few majority shareholders so as to take the corporation outside the scope of the Securities Exchange Act of 1934 and its attendant reporting requirements.2 The danger inherent in this mechanism, and one of the reasons it has drawn increasingly close judicial scrutiny, is that in many cases it allows a few

91. Rotunda, supra note 86, at 627.
2. See Note, Going Private, 84 YALE L.J. 903, 904 (1975).
shareholders who took the corporation public during the stock boom of the 1960's to force minority shareholders to sell their shares at a fraction of the original purchase price.\(^3\)

A number of devices serve as vehicles for "going private," one of the most utilized of which is the short form merger.\(^4\) However, a recent series of cases originating in New York\(^5\) has caused a re-evaluation of the elements essential to a valid short form merger. In *Green v. Santa Fe Industries, Inc.*,\(^6\) the Second Circuit Court of Appeals accepted an expansive reading of rule 10b-5\(^7\) and invalidated a short form merger that complied in every respect with state law on the ground that the majority shareholders did not come forward with any "justifiable corporate purpose" for the merger other than the elimination of the public minority shareholders. But a later New York Supreme Court case, *Tanzer Economic Associates, Inc. Profit Sharing Plan v. Universal Food Specialties, Inc.*,\(^8\) in interpreting fiduciary obligations of majority shareholders in a short form merger appeared to eviscerate the corporate purpose standard enunciated in *Green* by expressing receptivity to any stated corporate purpose. The Second Circuit Court of Appeals then applied the same broad corporate purpose analysis when the same merger came before it on charges of rule 10b-5 violations in *Merrit v. Libby, McNeill & Libby*.\(^9\) This note will suggest that a limited application of the "corporate purpose doctrine," as applied through rule 10b-5, would keep use of rule 10b-5 outside the regulation of fiduciary obligations to shareholders,\(^10\) traditionally the prerogative of state law, and would limit its operation to situations that more directly involve

---

3. *See id.* at 905.
4. The short form merger statute, which exists in approximately 38 states, allows a parent corporation that owns some percentage of the stock in a subsidiary, usually 90%, to merge the two corporations and buy out the public minority shares in the subsidiary. *E.g., Del. Code Ann. tit. 8, § 253 (1974).* For a list of the states that now have short form merger statutes, see *Green v. Santa Fe Indus., Inc.*, 533 F.2d 1283, 1299 n.1 (2d Cir.), *cert. granted*, 97 S. Ct. 54 (1976) (No. 75-1753).
6. 533 F.2d 1283 (2d Cir.), *cert. granted*, 97 S. Ct. 54 (1976) (No. 75-1753).
8. --- Misc. 2d ---, 383 N.Y.S.2d 472, 479 (Sup. Ct. 1976). It should be noted that the New York Supreme Court was limited to state fiduciary law since it did not have available the federal remedies under rule 10b-5.
9. 533 F.2d 1310 (2d Cir. 1976).
securities fraud, rather than venturing into the vast domain of corporate mismanagement.

The short form merger statute's fundamental objective is to allow a merger to be effectuated without the supposedly needless costs of proxy solicitations and shareholder meetings when the majority shareholders are in accord and when the minority would be powerless to block a merger anyway. A dissenting minority, under most short form merger statutes, must resort to an appraisal proceeding as its exclusive remedy. It may be argued that the exclusivity of an appraisal remedy is the only realistic approach in modern times, especially in the face of possibly obdurate and unreasonable minorities. The fallacy in this reasoning is that the majority (in many cases the same persons who took the corporation public initially) is given the power to choose when that appraisal will occur. Therefore, when the price of the corporation's stock is at its nadir, the majority shareholders can decide to effect a short form merger, thereby forcing a buy-out of the minority at a relatively low price. Although other criticisms have also been launched at the short form merger statutes, the short form merger does provide a functional tool, when used fairly, to effectuate the will of the majority in the least expensive and quickest manner possible.

It was in the context of a short form merger that the Second Circuit decided Green v. Sante Fe Industries, Inc., a case that appeared to have such far-reaching and devastating effects that Judge Moore, in dissent, described it as nullifying "not only the corporate laws of Dela-

11. See Hamilton, Corporations and Partnerships, 24 Sw. L.J. 91 (1970). But see Comment, The Short Merger Statute, 32 U. Chi. L. Rev. 596 (1965): The short merger has endured, and shows signs of flourishing, because it offers the opportunity of merger without the needless expense of holding meetings whose outcomes would be pre-determined. Such savings will be significant, however, only where the corporation is of substantial size and where the question would have to be presented at a special meeting.

12. The exclusivity of the dissenting shareholders' remedy has been the subject of much debate. For arguments in favor of exclusivity, see Vorenberg, Exclusiveness of the Dissenting Shareholder's Appraisal Right, 77 Harv. L. Rev. 1189 (1964). Many of the short form merger statutes are ambiguous on their face about the dissenting shareholders' remedy, e.g., Kan. Stat. § 17-6712 (1974); some specify that they are exclusive, e.g., Pa. Stat. Ann. tit. 15, § 1515(B) (Purdon Supp. 1974); and at least one provides that appraisal is not the exclusive remedy, N.C. Gen. Stat. § 55-113(b) (1975). For a discussion of exclusivity, see Borden, supra note 1, at 1023.

14. These criticisms include such topics as tax problems created for minority shareholders whose shares are forcibly purchased. For an excellent discussion of the criticisms, see Comment, supra note 11.
15. 533 F.2d 1283 (2d Cir.), cert. granted, 97 S. Ct. 54 (1976) (No. 75-1753).
ware with respect to short-form corporate mergers, but also, in effect, comparable laws in an additional thirty-seven states."\textsuperscript{10} The facts can be simply stated. In 1974 Santa Fe Natural Resources (Resources) owned approximately ninety-five percent of the capital stock of Kirby Lumber Company. Resources "embarked upon a plan to effect a short-form merger pursuant to Section 253 of the Delaware Corporation Law . . . .\textsuperscript{17} In furtherance of this plan Forest Products, Inc. was organized. Resources transferred its ninety-five percent interest in Kirby to Forest Products in exchange for all of Forest Products' stock. The board of Forest Products then adopted a resolution under which it would merge with Kirby, with Kirby becoming the surviving corporation. The merger became effective July 31, 1974. Plaintiffs, minority shareholders in Kirby, sued to enjoin the merger as a "manipulative and deceptive device in breach of Rule 10b-5."\textsuperscript{18} The court of appeals reversed the district court's dismissal of the complaint.\textsuperscript{10}

The first major obstacle hurdled by the court of appeals was the historically limited application of rule 10b-5 to only those transactions in which there had been misrepresentation or lack of disclosure.\textsuperscript{20} The court accomplished this task simply by utilizing sections (a) and (c) of the rule, sections that had virtually been read out of the statute by courts requiring misrepresentation or nondisclosure.\textsuperscript{21} These sections prohibit "(a) . . . any device, scheme, or artifice to defraud, . . . and (c) . . . any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person . . . ."\textsuperscript{22} Fraud, as used in these sections, is equated by the court in \textit{Green} with a breach of fiduciary duty by the majority against the minority shareholders.\textsuperscript{23} \textit{Popkin v. Bishop},\textsuperscript{24} an earlier Second Circuit case in which the complaint of the minority shareholders was dismissed because there was no showing of nondisclosure or misrepresentation, was distinguished on two grounds: (l) in \textit{Popkin} a strong corporate purpose was shown,\textsuperscript{25}

\begin{itemize}
  \item 16. \textit{Id.} at 1299 (dissenting opinion) (footnote omitted).
  \item 17. \textit{Id.} at 1288.
  \item 18. \textit{Id.}
  \item 19. \textit{Id.} at 1294.
  \item 20. The cases are not entirely clear, but on their face appear to limit the application of rule 10b-5 to non-disclosure situations. \textit{E.g.}, \textit{Popkin v. Bishop}, 464 F.2d 714 (2d Cir. 1972); \textit{Kaufmann v. Lawrence}, 386 F. Supp. 12 (S.D.N.Y. 1974), \textit{aff'd per curiam}, 514 F.2d 283 (2d Cir. 1975).
  \item 21. 533 F.2d at 1287.
  \item 22. 17 C.F.R. \textsuperscript{\$} 240.10b-5 (1976).
  \item 23. 533 F.2d at 1287.
  \item 24. 464 F.2d 714 (2d Cir. 1972).
  \item 25. 533 F.2d at 1291.
\end{itemize}
and (2) approval of the minority shareholders was sought and given. The first distinction appears valid, although it should be noted that defendants in Green were not required by state law to demonstrate a valid corporate purpose and therefore had no reason to provide one. The second distinction is almost totally without merit, especially in light of Marshel v. AFW Fabric Corp., in which the Second Circuit held, just prior to its decision in Green, that a long form merger under New York law violated rule 10b-5, even though it had been submitted for shareholder approval. Also, submission for shareholder approval would almost assuredly be a meaningless formality since in all cases involving short form mergers, the majority already controls at least ninety percent of the stock, thereby assuring passage of any motion for merger.

The finding of fraud, or breach of fiduciary duty, by the court in Green focused on five major factors: (1) defendants had shown no "justifiable corporate purpose"; (2) no prior notice of the merger was given to minority shareholders; (3) the minority shareholders had no opportunity to obtain injunctive relief; (4) the proposed price to be paid for the minority shares was excessively low; and (5) the shares of the minority were being purchased with corporate funds. The first three factors were not required by state law and therefore defendants were not on notice that they needed to comply with any of these; the lack of justifiable corporate purpose, discussed below, was heavily relied upon by the court nonetheless. The minority shareholders have a remedy for the fourth factor, excessively low purchase price, through the appraisal proceeding provided by state law. The fifth factor also does not withstand close scrutiny; from the standpoint of the majority shareholders it would seem to make little difference, in an economic sense, whether the shares were purchased with corporate funds or with private shareholders' money. If the money is taken directly from corporate funds, the corporation will simply have less money once the merger is effected and the majority shareholders become the sole

26. Id.
27. 533 F.2d 1277 (2d Cir. 1976).
28. Id. at 1282. For discussion see Brodsky, State Going-Private Laws—Dead or Alive?, N.Y.L.J., Feb. 27, 1976, at 1, col. 2, 14, col. 1.
30. 533 F.2d at 1290, 1292-93.
31. The doctrine is utilized extensively by the court. For a discussion, see text accompanying notes 34-38 infra.
32. See Brodsky, supra note 28.
owners; realistically the money ultimately comes from the majority’s pockets in either event.\footnote{33}

The predominant issue that prevailed in the aftermath of \textit{Green} centered around the theory of “justifiable corporate purpose.”\footnote{34} The theory appears to have its roots in the idea that “a scheme conceived solely for the benefit of controlling stockholders without regard to the welfare of the corporation or of the minority constitutes a breach of the fiduciary obligation”;\footnote{35} thus, “the requirement that there be a showing of legitimate corporate purpose.”\footnote{36} Obviously the doctrine was implemented to provide for an analysis of the motives behind the “going private” transaction.\footnote{37} It has been praised by some as providing “an equitable method of protecting the minority shareholder while at the same time giving deference to the freedom of the corporation to go private for valid business reasons.”\footnote{38} But it can also be condemned as an imprecise and vague standard with which those effecting important corporate mergers must attempt to comply.

Commissioner Sommer of the SEC, who has argued for a strict interpretation of the “justifiable business purpose” standard, has expressed the view that a corporation going public “makes a commitment that, absent the most compelling business justification, management and those in control will do nothing to interfere with the liquidity of the public investment or the protection afforded the public by the federal securities laws.”\footnote{39} But another leading authority, Professor Vorenberg, believes very little or no corporate purpose should be necessary in the context of a short form merger.\footnote{40}

Amid this controversy, the question still remained of how the Second Circuit would interpret its own standard. Finally, in \textit{Merrit v. Libby, McNeill & Libby},\footnote{41} the federal court got its chance on a complaint of securities fraud, but only after the minority shareholders had

\footnotesize{\textit{See id.}}
\footnotesize{\textit{See Brodsky, Going Private—Is It Over?, N.Y.L.J., March 3, 1976, at 1, col. 1, 2, col. 1.}}
\footnotesize{\textit{Id.}}
\footnotesize{\textit{See Note, Going Private: An Analysis of Federal and State Remedies, 44 Fordham L. Rev. 796, 806 (1976).}}
\footnotesize{\textit{Id. at 816.}}
\footnotesize{\textit{See Vorenberg, supra note 12, at 1192-93.}}
\footnotesize{\textit{533 F.2d 1310 (2d Cir. 1976).}}
been unsuccessful in an attempt to block the same merger in the New York state courts. Nestle Alimentana (Nestle), a Swiss company, had effected a short form merger between Universal Food Specialties (UFS), a wholly owned subsidiary of Nestle, and Libby, McNeill & Libby (Libby), a Maine corporation. After purchasing Libby stock for some fifteen years, Nestle and affiliates owned approximately sixty-one percent by May 1975. UFS, which controlled the Libby shares for Nestle, announced a cash tender offer for the remaining Libby shares at $8.125 per share, substantially higher than the prevailing market price. In this offer, UFS stated its intention to merge with Nestle if the former acquired at least ninety percent of the Libby stock. Just prior to the expiration of the tender offer the minority shareholders of Libby brought an abortive suit for monetary damages. Seven months later they sought injunctive relief.

The New York Supreme Court in Tanzer was the first court to confront the merger on a motion for preliminary injunction by the minority shareholders. The Tanzer court's scope of inquiry was limited to possible breaches of fiduciary obligations because the federal remedies afforded by rule 10b-5 were unavailable. The court first distinguished Green on the ground that since that decision had been on a motion to dismiss, the federal court was forced to assume the veracity of the allegation of no valid corporate purpose, whereas Tanzer involved an application for a preliminary injunction. Two additional factors that the supreme court relied upon to distinguish Green were that in the present case (1) there was no under-valuation of the minority shares, and (2) the minority shareholders had been given notice of the proposed Libby merger.

43. Id. at —, 383 N.Y.S.2d at 474-75.
44. Id. at —, 383 N.Y.S.2d at 478. It should also be noted that another New York state case, Schulwolf v. Cerro Corp., — Misc. 2d —, 380 N.Y.S.2d 957 (Sup. Ct. 1976), which involved a very similar issue, was decided just prior to the Tanzer decision. In Schulwolf, business reasons were advanced for the merger and the minority shareholders were not actually being frozen out, since they would receive preferred stock in the resultant corporation; but the minority shareholders did not receive the "residual equity" benefits to which common shareholders are normally entitled. Also, Schulwolf involved a long form merger, which could have been voted down by the public shareholders. Based on these factors, the court denied an injunction against the merger.
45. — Misc. 2d at —, 383 N.Y.S.2d at 478.
46. Id. at —, 383 N.Y.S.2d at 479.
47. Id. at —, 383 N.Y.S.2d at 480.
48. Id.
The court then relied upon nine stated business purposes for the merger to assuage its suspicions of fraud. These purposes can be generally grouped into two categories: (1) the merger of the two corporations would result in more efficiently operated businesses for both while also solving possible problems of conflicts of interest; and (2) the merger would result in savings on the cost of complying with the securities laws.\textsuperscript{49} As one noted author has pointed out, the first group of purposes could be accomplished without the elimination of the minority interest since they rely only upon the combination of the two corporations.\textsuperscript{50} The second group of purposes, while depending upon the elimination of the public minority interest, has not generally been accepted as a justifiable business purpose in and of itself.\textsuperscript{51} Despite these criticisms of the stated purposes, it can at least be argued that the corporate purpose doctrine is not so much concerned with justifications for elimination of the minority as with preventing a "naked grab for power" by placing some burden on the majority to justify their actions.

After failing to obtain any relief in the state court, the minority shareholders brought an action for preliminary injunction in federal district court. Upon denial of the injunction, the case came before the Second Circuit on appeal.\textsuperscript{53} The court of appeals distinguished \textit{Green}\textsuperscript{54} in much the same manner as had the New York Supreme Court.\textsuperscript{55} But the court had somewhat more difficulty coping with \textit{Marshel v. AFW Fabric Corp.}\textsuperscript{56} Since that case was in the same procedural posture as \textit{Libby}, the court had to distinguish it factually: in contrast to \textit{Libby}, \textit{Marshel} involved a situation in which the same people who had taken the corporation public during the bull market of the 1960's were attempting to utilize the state short form merger statute to eliminate the minority at a low cost. This acquisition was being accomplished through the vehicle of a shell corporation and with the use of corporate funds.\textsuperscript{57}

\textsuperscript{49.} Brodsky, \textit{Going Private (III)}, N.Y.L.J., April 7, 1976, at 1, col. 1, 2, col. 3.
\textsuperscript{50.} \textit{Id.} at 2, col. 3.
\textsuperscript{51.} \textit{Id.}
\textsuperscript{53.} Merrit v. Libby, McNeill & Libby, 533 F.2d 1310, 1313 (2d Cir. 1976).
\textsuperscript{54.} \textit{Id.} at 1312.
\textsuperscript{55.} See text accompanying note 46 supra.
\textsuperscript{56.} 533 F.2d 1277 (2d Cir. 1976).
\textsuperscript{57.} Merrit v. Libby, McNeill & Libby, 533 F.2d 1310, 1312 (2d Cir. 1976).
The court relied upon a confidential report to the board of Nestle by its president as a valid indication of the corporate purposes for the merger.\(^{58}\) Two of the purposes were listed as follows:

(1) 70% of Libby's sales were in the United States, Canada and Puerto Rico, and it had contacts with farmers which would be useful in integrated selling to the underdeveloped countries. (2) Libby had a healthy balance sheet and a cash flow slightly higher than its future investment possibilities, and its stock was valued at only a third of book value.\(^{59}\)

Obviously these purposes are subject to the same criticisms as those discussed earlier in relation to the *Tanzer* decision.\(^{60}\) But the president's memorandum to the board also spoke of the advantages to be gained "'in the very fact of eliminating the minority stockholders.'"\(^{61}\) The court concluded that the memorandum was obviously ambiguous, but since it was not sufficient to indicate that plaintiffs would suffer "irreparable injury," they should be left to their remedy at law.\(^{62}\)

Clear from analysis of the two decisions springing from the Libby merger is that the courts will be highly receptive to any stated business purpose in the face of an action by minority shareholders. The dissent in *Green*, along with a great many other critics, attacked the use of rule 10b-5 to control corporate fiduciary obligations. Judge Moore, dissenting in *Green*, pointed out that the majority "has extended to these plaintiffs an independent, substantive right totally unrelated to the anti-fraud scheme of the federal securities laws and in complete derogation of a valid state rule regulating corporate activity."\(^{63}\) The condemnation seems credible, especially in light of *Cort v. Ash*,\(^{64}\) a 1975 United States Supreme Court opinion that "may portend the Supreme Court's increased reluctance to entertain suits claiming a breach of state law fiduciary obligations brought in the guise of a violation of federal law."\(^{65}\)

One of the most valid criticisms of *Green* is leveled at the court's utilization of rule 10b-5 to encroach upon an area traditionally left to state legislatures—the regulation of fiduciary obligations of majority shareholders.\(^{66}\) The drawing of the line between state and federal

---

58. *Id.* at 1312-13.
59. *Id.* at 1313.
60. See text accompanying notes 50 & 51 supra.
62. *Id.*
63. 533 F.2d at 1307 (footnote omitted).
64. 422 U.S. 66 (1975).
66. 533 F.2d at 1304 (dissenting opinion).
control is inherently fraught with pitfalls in this area because many corporations, almost by definition, are forced to engage in securities transactions. Thus, any regulation of securities transactions inevitably leads to some regulation of internal corporate affairs, a province traditionally left to state control. As a result it becomes necessary to ascertain the point at which these internal corporate transactions fall outside rule 10b-5's true purpose. When does a given transaction cease being primarily a securities transaction and therefore become a matter for state regulation?

One possible means of dealing with the problem, in the limited context of a short form merger, would begin with three assumptions: (1) rule 10b-5's primary concern is to enforce the credibility of the securities markets; (2) once the securities element of a transaction becomes only tangential, so that the primary concern of the minority shareholders is actually centered on corporate mismanagement, then deference should be given to state law; and (3) the corporate purpose doctrine, to have any true validity in a securities context, must be a more restrictive test, one of compelling corporate justification. The implementation would be as follows: a series of transactions and objective criteria would be identified that have a high degree of correlation

68. In order for the corporate purpose doctrine to continue as a viable force, it must be restrictive enough to prevent avoidance by intelligent pleading by any group of majority shareholders.
69. Possible criteria would include: (1) percentage decline in market price of the stock since the corporation first went public; (2) substantial identity of the parties who took the corporation public initially with those who later attempt to take it private; and (3) the amount of time elapsed since the corporation first went public. Marshel v. AFW Fabric Corp., 533 F.2d 1277 (2d Cir. 1976), provides a flagrant example of the first criterion. In 1968-69, in a public offering, 300,000 shares of Concord Fabrics stock were sold at $15 per share and 200,000 at $20 per share. In 1974, when the market price had reached a low of $1 per share, the majority shareholders decided to go private at $3 per share. The court blocked the merger. At the other end of the spectrum is Tanzer Economic Associates, Inc. Profit Sharing Plan v. Universal Food Specialties, Inc., — Misc. 2d —, 383 N.Y.S.2d 472 (Sup. Ct. 1976), in which the price offered in the attempt to go private was $8.125 per share, a price not substantially below what the public shareholders had paid. In fact, plaintiff in the case had purchased his stock in 1973 at $6.00 per share. The problem comes in delineating the point at which the market price has declined to such a degree that any forced buy-out of the public minority would be inherently suspicious. Ascertainment of this point would necessarily involve both empirical study and a survey of shareholder and management attitudes. The second criterion would serve as a strong indicator of stock manipulation. If the same people who originally took a corporation public are now attempting forcibly to take it private, the obvious inference would be that their intention all along was to take advantage of possible market fluctuations. Again, Marshel provides an excellent example; there, exactly the same people who had taken the corporation public initially were attempting to take it private. Regarding the third criterion, the shorter the time...
with the aim of rule 10b-5 as indicated above. Once a transaction came within one of the proscribed situations, or met a threshold number of objective criteria, the application of rule 10b-5 would be triggered with an attendant requirement of a showing of compelling corporate purpose by the majority shareholders. An archetypal example is the situation in which a group of shareholders who took the corporation public in a bull market are attempting to go private in a depressed market.\(^7\) Thus, once plaintiffs show defendant’s actions to fit one of the established categories, such as the one just described, the majority shareholders would be forced to come forward with a compelling corporate purpose for the merger. The objective of this type of structure would be two-fold. First, the implementation of rule 10b-5 would be limited to only those corporate activities inextricably intertwined with securities transactions, thus keeping its application outside the domain of state law. Therefore, the minority shareholders would be forced to resort to state remedies unless their allegations of fraud were primarily centered on a securities claim. Secondly, the use of the more restrictive compelling corporate purpose standard would give that doctrine viability.

The corporate purpose doctrine, as enunciated in *Green*, represents an attempt to balance the protection of minority interests with the need of the majority to effectuate necessary transactions in furtherance of the corporation’s business. But then, in *Libby*, the Second Circuit gave strong indications that the doctrine is little more than a shell, which can be avoided through proper pleading by any defendant. A much more pragmatic use of the doctrine would be to restrict its application, in the context of rule 10b-5, to only those situations strongly correlated with securities transactions.\(^7\) If there is to be a federal remedy

---

70. This practice is one that has caused a great deal of the fervor in the “going private” area. It appears to be one of many possible activities that would create distrust among the public in an already disfavored securities market.

71. *See Borden,* *supra* note 1.

If the federal securities laws are to be pushed so far beyond their original purpose as not only to enforce recognized standards of fiduciary obligations but to create new ones in a hotly debated area without deference to state law or empirical study or any balancing of the numerous competing social interests involved, one may suppose that one day there will again be a recognition of the “mischievous result” of judicial law-making based upon an alleged “transcendental body of law outside of any particular State” which federal courts
for minority shareholders against a short form merger it should be formulated by a legislative or an administrative body taking all the relevant and unique considerations into account, not by courts seeking to apply rule 10b-5 to an area with which it was never intended to deal, in a misguided effort to provide needed protection for minority shareholders.

JOHNNY REID EDWARDS

Truth in Lending—Failure To Disclose a Right of Acceleration Held Not a Violation

The Truth in Lending Act and Federal Reserve Board Regulation Z provide, *inter alia*, that a creditor shall disclose to its customers any “default, delinquency, or similar charges payable in the event of late payments.” Confronted with the issue whether a contractual right to accelerate total indebtedness is such a charge when state law requires a rebate of the unearned portion of the finance charge, the Third Circuit Court of Appeals in *Johnson v. McCrackin-Sturman*

in their good judgment may discern and apply. We will then have in the securities field our own *Erie v. Tompkins*. Borden, *supra* note 1, at 1039 (footnotes omitted). This argument is relied upon heavily by defendants in *Green* in their petition for certiorari to the United States Supreme Court. Petitioner's Brief for Certiorari at 11, Santa Fe Indus., Inc. v. Green, 533 F.2d 1283 (2d Cir.), cert. granted, 45 U.S.L.W. 3222 (1976) (No. 75-1753).

It should be noted that the SEC has drafted proposed rules that would deal specifically with the application of rule 10b-5 to the types of situations discussed herein. If SEC rules are to be applied to these situations at all, it would certainly appear that the better route would be through the Commission's proposed rules. Two of these rules basically place disclosure requirements and substantive limitation on those planning to carry out transactions that would result in "going private." Proposed Rules 13e-3A & 13e-3B, Securities Act Release No. 5507 (Feb. 6, 1975), *reprinted in* [1974-1975 Transfer Binder] *Fed, Sec. L. Rep. (CCH)* ¶ 80,104, at 85,091-93.