

11-1-1990

The Exclusivity of the Appraisal Remedy under the New North Carolina Business Corporation Act: Deciding the Standard of Review for Cash-Out Mergers

Julie Gwyn Hudson

Follow this and additional works at: <http://scholarship.law.unc.edu/nclr>Part of the [Law Commons](#)

Recommended Citation

Julie G. Hudson, *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 (1990).

Available at: <http://scholarship.law.unc.edu/nclr/vol69/iss1/19>

This Comments 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 administrator of Carolina Law Scholarship Repository. For more information, please contact law_repository@unc.edu.

COMMENT

The Exclusivity of the Appraisal Remedy Under the New North Carolina Business Corporation Act: Deciding the Standard of Review for Cash-Out Mergers

The North Carolina General Assembly's recent substantial adoption¹ of the Revised Model Business Corporation Act of 1984 ("Revised Model Act")² greatly enhances the procedures³ by which a shareholder may dissent from fundamental corporate changes.⁴ While liberalizing these procedures, the language of the new North Carolina Business Corporation Act (the "new Act") simultaneously limits the shareholder's remedies under these circumstances to the right of appraisal "unless the action is unlawful or fraudulent."⁵ This change is a radical departure from North Carolina's former law, which provided that a dissenting shareholder's right of appraisal was "[i]n addition to any other right he

1. Act of June 8, 1989, ch. 265, 1989 N.C. Sess. Laws 566 (codified at N.C. GEN. STAT. §§ 55-1-01 to -17-05 (1990)).

2. The Revised Model Business Corporation Act of 1984 was adopted by the Committee on Corporate Laws of the Section of Corporation, Banking and Business Law of the American Bar Association in the Spring of 1984. It was the first complete revision of the Model Business Corporation Act since it was originally adopted in 1950. See Committee on Corporate Laws of the Section of Corporation, Banking and Business Law of the American Bar Association, REV. MODEL BUSINESS CORP. ACT xvii (1985).

3. N.C. GEN. STAT. §§ 55-13-01 to -31 (1990); Minutes, North Carolina Senate Judiciary II Committee, March 16, 1989, appendix, Summary of Major Provisions of Proposed New North Carolina Business Corporation Act (prepared by Russell M. Robinson, II) at 7 ("simpler and more expeditious procedures," which are "designed to reduce delay and expense" will be available under the new Act's appraisal remedy). For example, the new Act enhances the rights of a dissenting shareholder by requiring the corporation to actually pay the dissenter the full fair value of the shares plus accrued interest when the dissenter commences a judicial appraisal proceeding, thereby allowing the dissenter to challenge the contested transaction with the help of these funds. See N.C. GEN. STAT. § 55-13-30(a) (1990). In contrast, the former statute had no such "advance payment" provision, so the actual payment to the dissenting shareholder typically occurred upon the resolution of the judicial appraisal proceeding. N.C. GEN. STAT. § 55-113 (1982). For a brief summary of the new Act's right of dissent and appraisal, see Hargrove & Turlington, *The Right of Dissent and Appraisal*, published by the North Carolina Bar Association Continuing Legal Education for the November 16-17, 1989, seminar "The New North Carolina Business Corporation Act", vol. 1 (1989).

4. Regarding fundamental changes under the new Act, a shareholder may dissent and obtain the fair value of his shares in the event of a merger, share exchange, sale or exchange of all or substantially all assets, material amendment of the articles of incorporation, and "[a]ny 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)(1)-(5) (1990). Formerly, North Carolina law permitted a shareholder to dissent and demand fair value for his shares when an "amendment, charter, dissolution, merger, consolidation or sale of assets" was effected. *Id.* § 55-113(b) (1982) (replaced by N.C. GEN. STAT. § 55-13-02(a)(1)-(5) (1990)).

5. The new Act provides that:

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.

Id. § 55-13-02(b) (1990).

may have in law or equity"⁶ Whether this modification means that an appraisal proceeding is the dissenting shareholder's exclusive remedy or that he also may make a collateral attack to enjoin or rescind fundamental corporate transactions is "[o]ne of the most important and potentially controversial questions of state corporation law."⁷

The North Carolina General Assembly adopted the "unlawful or fraudulent" qualification verbatim from the Revised Model Act,⁸ which purposefully left the two exceptions to the general rule of appraisal exclusivity undefined.⁹ By adopting the Revised Model Act's general terms "unlawful or fraudulent," the North Carolina General Assembly passed the buck again, leaving these two crucial terms open to judicial interpretation. The North Carolina courts' construction and application of the "unlawful or fraudulent" qualification will determine the ultimate degree of exclusivity under the new Act's appraisal remedy.

The main issue in this context is whether a breach of fiduciary duty will constitute either unlawfulness or fraud, or both, so that a dissenting shareholder may enjoin or rescind a fundamental corporate change or, alternatively, seek monetary or rescissory damages for fiduciary breaches. The new Act clarifies only that the appraisal remedy applies "without limitation" to cash-out mergers.¹⁰ The North Carolina Commentary to the new Act adds that "in determining whether a merger [is] 'unlawful' or 'fraudulent,' the same standard applies, regardless of whether the consideration received [by the minority shareholder] was cash, other property, or shares of a surviving corporation."¹¹ Neither the statute, its comments, nor prior judicial decisions in North Carolina, however, set forth the standard for evaluating whether a cash-out merger may be enjoined.

6. Formerly, North Carolina law provided that "[i]n addition to any other right he may have in law or equity, a shareholder giving such notice 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" *Id.* § 55-113(b) (1982) (replaced by N.C. GEN. STAT. § 55-13-02(b) (1990)).

7. R. ROBINSON, ROBINSON ON NORTH CAROLINA CORPORATION LAW § 27.7, at 457 (1990).

8. See *infra* notes 44-92 and accompanying text (legislative history discussion).

9. REV. MODEL BUSINESS CORP. ACT § 13.02(b) official comment 2 (1984).

10. For a discussion of the three basic variations of cash-out mergers, see generally Brudney & Chirelstein, *A Restatement of Corporate Freezeouts*, 87 YALE L.J. 1354, 1357-76 (1978) (discussing the potential harm to minority shareholders in the two-step merger, the going private merger, and the merger of affiliates). A cash-out merger is different from the usual merger case because the acquiring corporation is also the controlling stockholder of the target corporation. Greene, *Corporate Freeze-out Mergers: A Proposed Analysis*, 28 STAN. L. REV. 487, 489 (1976). In the cash-out merger, the majority shareholders receive stock in the surviving corporation, continuing their equity interest. The minority shareholders instead receive cash, eliminating their equity interest in the corporation. Although cash-out mergers typically occur after an acquisition, they also may occur *solely* for the purpose of cashing out the minority shareholder, whereby the majority shareholders of one corporation set up a new shell corporation and vote as majority shareholders of both corporations to undergo a merger. *Id.* at 490. While a cash-out merger illustrates a direct elimination of minority shareholders, other direct and indirect methods exist by which majority shareholders "squeeze-out" or "freeze-out" minority shareholders. F. O'NEAL & R. THOMPSON, O'NEAL'S CLOSE CORPORATIONS § 8.07, at 63 (3d ed. 1988) [hereinafter O'NEAL'S CLOSE CORPORATIONS]. O'Neal compares the "direct squeeze-out" of minority shareholders via a cash-out merger to "indirect" squeeze-outs via a reduction in the minority shareholder's return on his investment through dividend reduction and/or employment termination. *Id.* at 64-65.

11. N.C. GEN. STAT. § 55-13-02(b) N.C. Commentary (1990).

In analyzing how North Carolina courts should determine what types of misconduct are encompassed by the terms "unlawful" and "fraudulent," the legislative history of this provision in the new Act, as well as other states' interpretations of the Revised Model Act's two exceptions to the general rule of appraisal exclusivity—"unlawful or fraudulent"—are instructive. States that have adopted the Revised Model Act's exclusivity language have given the two exceptions of unlawfulness and fraud a wide range of treatment, from specifically deleting the two exceptions¹² to retaining but explicitly defining them.¹³ Moreover, states that have not adopted the Revised Model Act but have addressed judicially the issue of appraisal exclusivity have followed different approaches as well.¹⁴

States that have adopted the Revised Model Act's exclusivity provision and states that have adopted a provision dealing with the exclusivity of the appraisal remedy must define the limitations of their statutory language. Typically these statutes contain the "unlawful" or "fraudulent" terms found in the Revised Model Act or some qualifying variant.¹⁵ Other states, which have no provision in their corporation statutes governing this issue, particularly Delaware, have

12. See *infra* notes 192-200 and accompanying text.

13. See *infra* notes 203-19 and accompanying text.

14. See *infra* notes 104-90, 220-30 and accompanying texts.

15. Thirty-three states expressly provide that the appraisal remedy is the exclusive remedy in some circumstances. Of these, twenty-two jurisdictions have provisions comparable to § 13.02(b) of the Revised Model Act's language providing the appraisal remedy is exclusive except where the corporation action is "unlawful [or illegal] or fraudulent." ARK. STAT. ANN. § 4-27-1302(B) (Supp. 1989); COLO. REV. STAT. § 7-4-123(4) (1986); FLA. STAT. ANN. § 607.1302(5) (West Supp. 1990); HAW. REV. STAT. § 415-80(d) (1988); IDAHO CODE § 30-1-80(d) (Supp. 1990); IOWA CODE § 490.1302(2) (1990); KY. REV. STAT. ANN. § 271B.13-020(2) (Michie 1989); MASS. ANN. LAWS ch. 156B, § 98 (Law. Co-op. 1979); MICH. COMP. LAWS ANN. § 450.1762(3) (West 1990); MISS. CODE ANN. § 79-4-13.02(b) (1989); MONT. CODE ANN. § 35-1-810-(4) (1989); NEB. REV. STAT. § 21-2079(4) (1987); N.H. REV. STAT. ANN. § 293-A:81(IV) (1987); N.M. STAT. ANN. § 53-15-3(D) (1983); N.Y. BUS. CORP. LAW § 623(k) (McKinney 1986); OR. REV. STAT. § 60.554(2) (Supp. 1990); S.D. CODIFIED LAWS ANN. § 47-6-23.3 (Supp. 1990); TENN. CODE ANN. § 48-23-102(b) (1988); VA. CODE ANN. § 13.1-730(B) (Supp. 1990); WYO. STAT. § 17-16-1302(b) (1989); Act of July 13, 1990, § 351.875(2), 1990 Mo. Legis. Serv. 1310, 1336 (Vernon); Act of April 23, 1990, No. 303, § 180.1302(d)(5), 1990 Wis. Legis. Serv. 1855, 1925 (West).

Some exclusivity provisions provide that the appraisal remedy is exclusive except in the absence of "fraud" or where the corporate action is "fraudulent" only. MINN. STAT. § 302A.471(subd. 4) (1990); N.D. CENT. CODE § 10-19.1-87(4) (1985).

Washington provides that the appraisal remedy is exclusive unless non-compliance with procedural requirements or fraud occurs. TEX. BUS. CORP. ACT ANN. art. 5.12(G) (Vernon 1990) and WASH. REV. CODE § 23B.13.020(2) (1990) (recently adopted substantial parts of the Revised Model Act which became effective July 1, 1990).

A splash of variety is illustrated by California, Georgia, Illinois, and New Jersey. California provides that a shareholder entitled to dissent has no right to attack the validity of the merger except in an action to test the sufficiency of the vote authorizing the action; California has other exceptions as well. CAL. CORP. CODE § 1312 (West Supp. 1990). Georgia recently adopted the Revised Model Act's exclusivity provision limiting the "unlawful" language to procedural non-compliance and within the year amended it to qualify the "fraudulent" language to deceptive behavior in connection with the approval vote required for the corporate action. GA. CODE ANN. § 14-2-1302(b) (1989); see *infra* notes 204-09 and accompanying text. Illinois provides that a shareholder entitled to dissent may not challenge the corporate action "unless the action is fraudulent . . . or constitutes a breach of a fiduciary duty." ILL. ANN. STAT. ch. 32, para. 11.65(b) (Smith-Hurd Supp. 1990). New Jersey provides that a dissenting shareholder shall not be excluded from filing suit on the ground that the corporate action is "ultra vires, unlawful or fraudulent." N.J. REV. STAT. ANN. § 14A:11-5(2) (West 1989). Pennsylvania, in its recent revision of its corporate code, provided that "absent fraud

relied on state court decisions to define the limitations of the appraisal remedy. In this manner, certain judicial tests have evolved for determining whether equitable relief is appropriate despite the availability of the appraisal remedy. The two major tests—the “entire fairness”¹⁶ and the “business purpose”¹⁷ tests—are creatures of case law, originating in the Delaware courts and frequently followed by several other state courts.

Given that the new Act adopts the Revised Model Act’s terms “unlawful or fraudulent,” North Carolina courts now must decide what, if any, are the limits of these broad statutory terms. In particular, North Carolina courts must determine how these terms bear upon two issues: first, whether a breach of fiduciary duty occurs when the majority shareholders freeze out the minority shareholders; and second, whether this fiduciary breach constitutes illegal or fraudulent action within the meaning of the appraisal provision. Further, North Carolina courts now must decide to what extent the new North Carolina appraisal exclusivity provision should include either or both of these judicially created tests developed in other jurisdictions.

This Comment addresses the exclusivity of the appraisal remedy from the perspective of a minority shareholder eliminated in a cash-out merger and places special emphasis on the vulnerability of the close-corporation shareholder in such a merger. After exploring the history of cash-out mergers, this Comment looks briefly at the former law in North Carolina under which the appraisal remedy was non-exclusive. The Comment then examines the current law in North Carolina, and its legislative history and official comments, which make the appraisal remedy expressly exclusive absent “unlawful or fraudulent” misconduct. The Comment next explores the appraisal exclusivity language under the Revised Model Act and considers different approaches taken by various states recently in adopting the Revised Model Act’s appraisal exclusivity provision. With this background, the Comment next considers the possible approaches and authority available to North Carolina for interpreting a cash-out

or fundamental unfairness,” dissenters’ rights and remedies at law were exclusive. 15 PA. CONS. STAT. ANN. § 1105 (Purdon Supp. 1990).

Two states have an exclusive appraisal remedy. CONN. GEN. STAT. ANN. § 33-373(f) (West 1987) (providing expressly that the remedy is “exclusive”); IND. CODE ANN. § 23-1-44-8(c) (Burns 1989) (recently adopting the Revised Model Act language providing that a “shareholder . . . may not challenge the corporate action creating . . . the shareholder’s entitlement” but omitting the “unless the corporate action is unlawful or fraudulent” clause).

Finally, Maine has a non-exclusive appraisal remedy. ME. REV. STAT. ANN. tit. 13-A, § 909(13) (1981) (“No action by a shareholder in the right of the corporation shall abate or be barred by the fact that the shareholder has filed a demand for payment of the fair value of his shares . . .”). South Carolina adopted the Revised Model Business Corporation Act § 13.02(a), providing particular corporate actions entitle a shareholder to the appraisal remedy, but South Carolina omits the exclusivity provision contained in the Revised Model Act at § 13.02(b). S.C. CODE ANN. § 33-13-102 (Law. Co-op. 1990). The South Carolina reporters’ comments explain this omission as follows:

Subsection (b) of the 1984 Model Act section contains a provision attempting to limit judicial scrutiny of corporate actions that give rise to dissenters’ rights. There was nothing similar in prior South Carolina law, and it is not included in the new provision because it would probably be largely ineffective and is undesirable.

S.C. CODE ANN. § 33-13-102 reporters’ comments 2 (Law. Co-op. 1990).

16. See *infra* notes 134-54 and accompanying text.

17. See *infra* notes 105-50 and accompanying text.

merger as a breach of the fiduciary duty owed by the controlling shareholders to the minority, and whether it is "unlawful" or "fraudulent" misconduct or both. In addition, the Comment considers the two judicial tests frequently applied in jurisdictions that have statutory language similar to that of North Carolina. Given that the business purpose test is the more controversial of the two tests, this Comment notes the influence that the business purpose test may have on the ultimate interpretation of the exclusivity provision in North Carolina.

This Comment suggests that the North Carolina courts should interpret the general statutory terms of "unlawful" and "fraudulent" misconduct to include a breach of fiduciary duty when a controlling shareholder eliminates a minority shareholder through a cash-out merger without a business purpose, where fair procedures and full disclosure have not occurred, and where a fair price is not paid. This Comment concludes that all shareholders, both controlling and minority, would benefit from North Carolina's adoption of a standard of review for cash-out mergers that includes both the entire fairness and business purpose tests. Given the special plight of close corporation minority shareholders, whose investment expectations may be dramatically different from those of public investors,¹⁸ this Comment further concludes that the dual tests operating together create a standard that is particularly appropriate in the close corporation context where investors are especially vulnerable to fiduciary abuses by controlling shareholders.

I. HISTORICAL PERSPECTIVE

A. Common-Law Treatment of Minority Shareholders

Early common law required unanimous shareholder consent to effect a fundamental corporate change, such as a merger or sale of all or substantially all corporate assets.¹⁹ Thus, one shareholder could block all other shareholders from making any economically desirable fundamental change and consequently impede the economic progress of the corporation.²⁰ The basis of the one-shareholder veto developed under the vested rights doctrine.²¹ Courts viewed the corporate charter as a contract, both among the corporation's shareholders and between the corporation and the state, under which every shareholder had vested rights.²² The shareholder's vested rights included the right to maintain his equity interest in a corporation.²³

As commerce exploded with the industrial revolution, the common-law re-

18. See *infra* notes 231-59 and accompanying text.

19. Lattin, *Remedies of Dissenting Stockholders Under Appraisal Statutes*, 45 HARV. L. REV. 233, 236-37 (1931); Levy, *Rights of Dissenting Shareholders to Appraisal and Payment*, 15 CORNELL L.Q. 420, 420-22 (1930); Weiss, *The Law of Take Out Mergers, A Historical Perspective*, 56 N.Y.U. L. REV. 624, 627 (1981); Note, *Valuation of Dissenters' Stock Under Appraisal Statutes*, 79 HARV. L. REV. 1453, 1453-54 (1966).

20. Weiss, *supra* note 19, at 627.

21. *Id.*

22. *Id.*

23. *Wright v. Orville Gold Silver & Copper Mining Co.*, 40 Cal. 20 (1870); *Beloff v. Consolidated Edison Co.*, 300 N.Y. 11, 87 N.E.2d 561 (1949).

quirement of unanimity proved to be a formidable barrier to American corporate growth.²⁴ A minority shareholder who exercised his single vote unscrupulously could enjoy a tyrannical hold on a corporation.²⁵ Legislatures responded by enacting statutes liberalizing the unanimous vote requirement for fundamental corporate changes.²⁶ These laws enabled corporations to consummate fundamental changes with either a majority or supermajority shareholder vote.²⁷ Although this liberalization of corporate law foreclosed the minority shareholder's tyrannical leverage, it opened the door to his possible victimization.²⁸

B. Cash Merger Statutes: Enactment and Application

Early merger statutes contemplated that once a majority or supermajority shareholder vote approved a merger, shareholders of merged corporations would receive shares in the surviving corporation so that their equity interest would continue.²⁹ Because no state legislature had granted a corporation or its majority shareholders the express power to force the minority shareholder to relinquish his continued equity interest,³⁰ courts, at least through the late 1920s, were sympathetic to complaining minority shareholders who resisted such mergers.³¹ Liberalization of merger statutes to allow cash as permissible merger consideration³² weakened the minority shareholders' capacity to withstand mergers,

24. Schinner, *Dissenting Shareholders' Statutory Right to Fair Cash Value*: *Armstrong v. Marathon Oil Co.*, 22 AKRON L. REV. 261, 265 (1989).

25. *Id.*

26. *Id.*

27. *Id.* at 265 n.30; Weiss, *supra* note 19, at 629.

28. Schinner, *supra* note 24, at 265.

29. Weiss, *supra* note 19, at 629-30.

30. *Id.* at 629.

31. *Id.* at 631.

32. The Florida legislature enacted the first cash merger statute in 1925, which provided for "distribution of cash, notes, or bonds." Act of June 1, 1925, ch. 10096, § 36, 1925 Fla. Laws 134 (current version at FLA. STAT. ANN. § 607.1102 (West Supp. 1990)). By 1931, lawmakers in Arkansas, California, and Ohio also had enacted cash merger statutes. See Act of April 1, 1931, Act 255, ch. 1, § 61, 1931 Ark. Acts 860 (current version at ARK. STAT. ANN. § 4-26-1001 (1987)); General Corp. Law, ch. 862, § 361, 1931 Cal. Stat. 1809 (current version at CAL. CORP. CODE § 1101(d) (West 1977)); General Corp. Act § 8623-67, 1927 Ohio Laws 35 (current version at OHIO REV. CODE ANN. § 1701.78 (Anderson 1978)). In 1936, the New York legislature was the first state legislature to adopt a short-form merger statute that permitted the use of cash. Act of May 28, 1936, ch. 778, § 1(1), 1936 N.Y. Laws 1658 (current version at N.Y. BUS. CORP. LAW § 905(a)(3) (McKinney 1986)). A short-form merger statute typically allows a company that holds 90-95% of the stock of another company to merge the two corporations after only an approval vote by the acquiring company's board of directors, wherein cash may be designated as the sole consideration paid by the parent under the merger plan. See W. CARY & M. EISENBERG, CASES AND MATERIALS ON CORPORATIONS 1464 (5th ed. 1980). Long-form merger statutes typically have no threshold stock ownership requirement but require that the directors and shareholders of both corporations vote on the transaction. *Id.* at 1462. As originally enacted, New York's short-form merger statute applied only to certain limited types of corporations such as gas or electric companies but was extended in 1949 to apply to all corporations. Act of April 22, 1949, ch. 762, § 1(1), 1949 N.Y. Laws 1707 (current version at N.Y. BUS. CORP. LAW § 905(a)(3) (McKinney 1986)). In 1957, Delaware adopted a short-form merger statute that permitted cash as merger consideration, modelled after the New York law. Act of June 5, 1957, ch. 121, § 253(a), 51 Del. Laws 188 (1957) (current version at DEL. CODE ANN. tit. 8, § 253(a) (Cum. Supp. 1988)). While legislatures authorized cash as merger consideration for short-form mergers from the 1930s into the 1950s, widespread adoption of cash as

however, because the courts accepted these statutes as implicit authorization of cash-out mergers.³³

With the passage of merger statutes that allowed cash as permissible merger consideration, the concept of the "cash-out merger" was born. Frequently employed as a method of eliminating the minority shareholder, the cash-out merger derived its name from the distribution of cash to shareholders of an acquired corporation in exchange for their stock. As a result, the minority shareholders who received cash were forced out, while the majority shareholder continued his equity interest in the surviving corporation.

Commentators offer evidence that, in enacting the first cash merger statutes, legislatures did not intend either explicitly or implicitly to authorize the use of the cash-out merger to eliminate minority shareholders.³⁴ Courts, however, interpreted the cash merger statutes to permit this result. The earliest³⁵ case reaching this conclusion was *Beloff v. Consolidated Edison Co.*,³⁶ decided by the New York Court of Appeals in 1949. This case transformed the shareholder's vested rights in a corporation. No longer did a shareholder have a vested, constitutional right to continue his shareholder status. Rather, according to the court in *Beloff*, "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

permissible consideration in long-form mergers did not occur until the 1960s. In 1961, the New York legislature permitted the use of "cash and other consideration" in long-form mergers. See Act of April 24, 1961, ch. 855, § 902(a)(3), 1961 N.Y. Laws 1629 (current version at N.Y. BUS. CORP. LAW § 902(a)(3) (McKinney 1986)). The "and" was changed to "or" in 1962. Act of April 24, 1962, ch. 834, § 61, 1962 N.Y. Laws 2947. In 1967, Delaware amended its long-form merger statute to include cash. General Corp. Law, ch. 50, § 251(b)(4), 56 Del. Laws 206 (1967) (current version at DEL. CODE ANN. tit. 8, § 251(b)(5) (Cum. Supp. 1988)). North Carolina, which allowed short-form and long-form mergers initially in 1955, amended its procedure in 1969 to permit cash as consideration. Act of June 11, 1969, ch. 751, § 37, 1969 N.C. Sess. Law 780 (codified as amended at N.C. GEN. STAT. § 55-106(b)(4) (1982) and replaced by N.C. GEN. STAT. § 55-11-01(b)(3) (1990)). The long-form merger provision under the original Model Business Corporation Act was amended in 1969 to allow cash as well. Robinson, *Elimination of Minority Shareholders*, 61 N.C.L. REV. 515, 517 n.7 (1983). For an excellent in-depth review of the history of cash-out mergers, see Weiss, *supra* note 19, at 626-657; see also Thompson, *Squeeze-Out Mergers and the "New" Appraisal Remedy*, 62 WASH. U.L.Q. 415, 416-18 (1984); Note, *Corporation Law—Weinberger v. UOP, Inc.: Delaware Reevaluates State-Law Limitations on Take Out Mergers*, 62 N.C.L. REV. 812, 812 n.3 (1984) (summarizing the three types of cash-out mergers and giving a brief synopsis of the development of these transactions).

33. Weiss, *supra* note 19, at 633. Professor Weiss notes that some commentators have argued that lawmakers enacted the first cash merger statutes to implicitly authorize and facilitate cash-out mergers. *Id.*; see Borden, *Going Private—Old Tort, New Tort or No Tort?*, 49 N.Y.U. L. REV. 987, 1026-27 (1974) (such statutes reflected a preference for flexibility and corporate democracy over vested shareholder rights). Weiss argues that a "better explanation for the enactment of cash merger statutes is that they were designed to provide corporate managers with additional flexibility in structuring clearly permissible transactions" such as the sale of assets. Weiss, *supra* note 19, at 637.

34. See Weiss, *supra* note 19, at 632-41.

35. Robinson, *supra* note 32, at 517; Weiss, *supra* note 19, at 643.

36. 300 N.Y. 11, 87 N.E.2d 561 (1949); see also *Stauffer v. Standard Brands, Inc.*, 41 Del. Ch. 7, 11, 187 A.2d 78, 80 (1962) (court observed that the real purpose of the short-form merger statute was giving the parent corporation an easy means of eliminating minority shareholders), *overruled by* *Roland Int'l Corp. v. Najjar*, 407 A.2d 1032, 1036 (Del. 1978), *overruled*, *Weinberger v. UOP, Inc.*, 457 A.2d 701, 715 (Del. 1983); *David J. Green & Co. v. Schenley Indus.*, 281 A.2d 30, 35 (Del. Ch. 1971) (approving long-form cash-out merger in Delaware); *Wilcox v. Stern*, 18 N.Y.2d 195, 202, 219 N.E.2d 401, 404, 273 N.Y.S.2d 38, 44 (1966) (approving long-form cash-out merger in New York).

right to an appraisal."³⁷

Indeed, courts have viewed appraisal rights as the quid pro quo for the dissenting shareholder's loss of his common-law veto right over fundamental corporate transactions.³⁸ A critical issue is whether this remedy of requesting judicial review of the price offered to the dissenting shareholders is the shareholder's exclusive remedy or whether equitable actions such as seeking an injunction against or rescission from consummation of the merger are available as well.³⁹ Because current statutes⁴⁰ permit mergers where stock is exchanged solely for cash, the majority shareholders and corporation should have broad powers to achieve this end. However, this power is juxtaposed against the common-law fiduciary duty owed by a controlling shareholder to a minority shareholder to treat him fairly.⁴¹ The tension between the majority shareholder's power and his fiduciary duty,⁴² pervasive in the historical development of cash-out mergers, is equally prominent today. Indeed, the continuing goal of permissive merger statutes is to achieve a proper balance between the rights and interests of majority shareholders and the rights and interests of the minority shareholders.⁴³

37. *Beloff*, 300 N.Y. at 19, 87 N.E.2d at 564 (citation omitted). The court continued:

He has no right to stay in the picture, to go along into the merger, or to share in its future benefits. He has no constitutional right to deliberate, consult or vote on the merger, to have prior notice thereof or prior opportunity to object thereto . . . In none of this do we see any deprivation of due process, or of contract rights.

Id.

38. Note, *Rejecting the Minority Discount*, 1989 DUKE L.J. 258, 266-67.

39. This issue did not come to the forefront of state corporation law until 1952 with the decision in *Matteson v. Ziebarth*, 40 Wash. 2d 286, 242 P.2d 1025 (1952). The "Delaware cases have provided the lead" in this area starting with *Stauffer*, through the *Singer* trilogy and the later *Weinberger* progeny. Robinson, *supra* note 32, at 518.

40. DEL. CODE ANN. tit. 8, § 253(a) (Cum. Supp. 1988), (short-form merger) and § 251(b), (c) (Cum. Supp. 1988) (long-form merger); N.Y. BUS. CORP. LAW § 905 (McKinney 1986) (short-form merger) and § 903 (McKinney 1986) (long-form merger); N.C. GEN. STAT. § 55-11-04(b)(2) (1990) (short-form merger) and § 55-11-03 (1990) (long-form merger). But see *Alpert v. 28 Williams St. Corp.*, 63 N.Y.2d 557, 568, 473 N.E.2d 19, 25, 483 N.Y.S.2d 667, 673 (1984) (stating that "technical compliance with the Business Corporation Law's requirements alone will not necessarily exempt a merger from further judicial review" prior to discussing fiduciary duty vested in directors and majority shareholders).

41. See *Alpert*, 63 N.Y.2d at 568-73, 473 N.E.2d at 25-28, 483 N.Y.S.2d at 673-77 (discussing the fiduciary duty of the corporation and majority shareholders in the face of a "freeze-out merger").

42. See *infra* notes 245-47 and accompanying text. Initially, state courts ignored enforcing majority shareholders' fiduciary duties, forcing minority shareholders to seek injunctive relief under claims of securities fraud for breach of fiduciary duty in federal courts. See Note, *Suits for Breach of Fiduciary Duty under Rule 10b-5 After Santa Fe Industries, Inc. v. Green*, 91 HARV. L. REV. 1874, 1876-77 (1978). Although the United States Supreme Court in *Santa Fe Industries v. Green*, 430 U.S. 462 (1977), held that breach of fiduciary duty was by itself not fraudulent under the full disclosure purpose and "deceptive or manipulative" language of rule 10b-5, the Court articulated the "need for uniform federal fiduciary standards to govern mergers." *Id.* at 480. The Delaware court was quick to respond to the United States Supreme Court's inherent criticism of the states' lack of governance in this area by strengthening the standards of review pertaining to fiduciary breaches arising in the cash-out merger. See *Singer v. Magnavox Co.*, 380 A.2d 969 (Del. 1977) overruled by *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983); Weiss, *Balancing Interests in Cash-Out Mergers: The Promise of Weinberger v. UOP, Inc.*, 8 DEL. J. CORP. L. 1, 27 (1983).

43. See Weiss, *supra* note 42, at 1-2.

II. NORTH CAROLINA REVISION

A. *Adopting the Revised Model Act's Appraisal Exclusivity Provision*⁴⁴

In its former dissenters' rights statute, North Carolina provided that the appraisal remedy was non-exclusive.⁴⁵ Upon recent revision of the corporate code, however, the North Carolina General Assembly adopted virtually verbatim the language of the Revised Model Act, making the appraisal remedy expressly exclusive absent "unlawful or fraudulent" conduct. The only significant modification to the Revised Model Act language is that the new North Carolina Act applies the provision explicitly to cash-out mergers⁴⁶ whereas the Revised Model Act makes no such clear indication.⁴⁷

Although the final provision adopted by the North Carolina General Assembly closely resembles the Revised Model Act's appraisal exclusivity provision, the section as initially introduced⁴⁸ underwent significant statutory surgery in the legislative process, practically all of which was eventually disregarded in the final passage of the bill. The appraisal exclusivity provision was "hotly debated"⁴⁹ over the several months that the North Carolina Business Corporation Act Drafting Committee ("Drafting Committee"),⁵⁰ appointed by the North Carolina General Statutes Commission ("Statutes Commission")⁵¹ to assist in

44. N.C. GEN. STAT. § 55-13-02(b) (1990) (as adopted and modified from the REV. MODEL BUSINESS CORP. ACT § 13.02(b) (1984)).

45. See *supra* note 6.

46. N.C. GEN. STAT. § 55-13-02(b) (1990) ("including without limitation a merger solely or partly in exchange for cash or other property").

47. See REV. MODEL BUSINESS CORP. ACT § 13.02(b) (1984) (contains no such express language) and § 13.02 official comment 2 (1984) (refers generally to "corporate change").

48. S. 280, 139th N.C. Gen. Assembly (1989).

49. General Statutes Commission Minutes at 7 (February 2, 1988) (reporting on the North Carolina Business Corporation Act Drafting Committee's activity on the provision).

50. The North Carolina Business Corporation Act Drafting Committee [hereinafter Drafting Committee] was composed of Chairman Russell M. Robinson, II, of the Charlotte firm of Robinson, Bradshaw & Hinson, P.A.; Professor Thomas L. Hazen of the University of North Carolina School of Law; Doris R. Bray and Michael R. Abel of the Greensboro firm of Schell Bray Aycock Abel & Livingston; Professor James D. Cox of the Duke University School of Law; and Clarence W. Walker of the Charlotte firm of Kennedy, Covington, Lobbell & Hickman. (William L. Bondurant of the Mary Reynolds Babcock Foundation was appointed but later resigned).

51. In 1945, the North Carolina General Assembly established the General Statutes Commission [hereinafter Statutes Commission]. Act of February 16, 1945, ch. 157, 1945 N.C. Sess. Laws 167 (codified at N.C. GEN. STAT. § 164-12 (1987)). One of its primary purposes is "[t]o recommend to the General Assembly the enactment of such substantive changes in the law as the Commission may deem advisable." N.C. GEN. STAT. § 164-13(a)(4) (1987). In 1985, the Statutes Commission undertook to revise the corporate code and appointed the Drafting Committee to assist in this task. Telephone conversation with Bly Hall, Assistant Revisor of Statutes, Statutes Commission (May 23, 1990) [hereinafter Conversation with Hall]; Robinson, Report to Corporate Counsel Committee of North Carolina Bar Association at 1 (March 18, 1988). As the Drafting Committee completed its work on each article, it reported its proposal and underlying supportive theories to the Statutes Commission. Typically the two bodies would debate back and forth about the proposed provisions to reach mutually satisfactory language. The Statutes Commission, established by the Legislature, however, had the final power to overrule the Drafting Committee's choice of language, but seldom exercised this power. Conversation with Hall, *supra*. The Drafting Committee first met on December 20, 1985, to discuss an overview of the needed changes and "decided not to change the basic philosophy of Chapter 55 [the North Carolina Business Corporation Act] which is pro shareholder." Business Corporation Drafting Committee Minutes at 4 (December 29, 1985). The Drafting Committee intended to revise the current statute by adopting only desirable new provisions from the

studying and updating the former North Carolina corporate code, considered it. In the initial step, the Drafting Committee extensively discussed

the meaning, application, and policy considerations of this statutory provision, especially in connection with closely held corporations. The [Drafting] Committee attempted in several ways to clarify further the provision's liberalizing purpose and correlative liberalizing of "fair value" as the minority shareholders' normally exclusive protection. Finally, the [Drafting] Committee agreed that the most important point to establish is that in most cases the majority shareholders should be allowed to cash out the minority shareholders.⁵²

Over the months, the Drafting Committee had several discussions about the meaning of "unlawful" and "fraudulent." Early in its discussions, the Drafting Committee limited "unlawful" to include only procedural violations.⁵³ The Committee also extensively debated the more difficult matters of whether the term "fraudulent"⁵⁴ should include action that was "inequitable," "unconscionable," "breach of fiduciary duty" or some variation thereon⁵⁵ and whether the business purpose test⁵⁶ should be a factor.⁵⁷

In its initial discussions, the Drafting Committee believed that Delaware's

Revised Model Act. Robinson, Report to Corporate Counsel Committee of North Carolina Bar Association at 1 (March 18, 1988). Six months into the process, however, the Drafting Committee decided to overhaul the corporate code by substantially adopting the Revised Model Act. *Id.*; see also Business Corporation Drafting Committee Minutes at 5 (July 21, 1986) (all relevant portions of the official comments to the Revised Model Act to be included as annotations to the new Act). The Drafting Committee and the Statutes Commission originally had hoped to introduce the proposed legislation in the 1987 session of the General Assembly, but the process was delayed. Faced with the urgency in the General Assembly to finish the 1988 short session relatively early, the Drafting Committee recommended and the Statutes Commission agreed to ask the General Assembly to form the Corporate Law Study Commission to help them introduce the bill in 1988. Conversation with Hall, *supra*. However, members of the General Assembly felt that the 1988 session would be too short to fully consider such major legislation, forcing its sponsor to withdraw the bill. Finally, during the 1989 session on February 27, 1989, the bill was introduced again and ultimately ratified into law on June 8, 1989. Thus, over a three and one-half year period, the Statutes Commission, the Drafting Committee, and the Corporate Law Study Commission diligently worked to revise the new Act. Throughout this three-year process, "[i]ts provisions [were] discussed, probably cussed—massaged, modified, meditated and mediated by dedicated and brilliant North Carolina legal minds." Statement of Robert L. Strickland, Chairman, Lowe's Companies, Inc., before the North Carolina Senate Judiciary II Committee (March 30, 1989) (advocating passage of the bill).

52. R. ROBINSON, *supra* note 7, § 27.7, at 457-58 n.5 (quoting Business Corporation Act Drafting Committee Minutes at 8 (September 21, 1987) and at 14 (October 28, 1987)).

53. The Drafting Committee clarified the broad term "unlawful" by limiting "unlawful" corporate actions to violations of "this Chapter, the articles of incorporation or a shareholders' agreement valid under section 55-7-31." Business Corporation Act Drafting Committee Minutes at 14 (October 28, 1987) and at 9-10 (December 21, 1987). By this express language, the Drafting Committee arguably foreclosed the argument that by cashing out the minority shareholder, the majority shareholder breached his fiduciary duty so as to have committed an "unlawful" corporate action. By limiting the term "unlawful" to merely procedural compliance with statutory merger requirements, the Drafting Committee narrowed "unlawful" to exclude underlying substantive issues of fairness and fiduciary duty owed to the minority shareholder otherwise contained in the term. See *infra* notes 204-05 and accompanying text.

54. Business Corporation Act Drafting Committee Minutes at 12 (October 28, 1987) (concerns over "unlawful or fraudulent" language expressed).

55. *Id.* at 9-10 (December 21, 1987).

56. See *infra* notes 105-50 and accompanying text.

57. Business Corporation Act Drafting Committee Minutes at 8-9 (December 21, 1987).

"entire fairness" test set forth in *Weinberger v. UOP, Inc.*⁵⁸ should apply to closely held corporations.⁵⁹ According to the minutes, the Drafting Committee thought that under the "entire fairness" doctrine, "the minority shareholders are dealt with openly and fairly in that the majority shareholders are conscientiously trying to pay the minority shareholders a fair price for their shares and there is no oppression, injustice, trickery, monkey business, or other unusual circumstances."⁶⁰

Later, the Drafting Committee considered the *Weinberger* court's rejection of the business purpose requirement.⁶¹ The Drafting Committee agreed that it did not want to introduce the business purpose test into the Revised Model Act language, noting that some jurisdictions have been so expansive in their interpretation of the requirement that it has become "virtually meaningless."⁶² However, upon further discussion, Drafting Committee members noted that *Weinberger's* rejection of the business purpose test is probably the minority viewpoint and that even Delaware courts are retreating from the *Weinberger* rule.⁶³ Ultimately, after months of debate, the Drafting Committee chose to exclude the business purpose test by express language in the new provision, seeking to focus instead upon "fairness to the shareholders, not the presence or absence of a business purpose."⁶⁴ Thus, the Drafting Committee clearly intended that *Weinberger's* "entire fairness" test be a part of the review standard but chose expressly to exclude, as did the *Weinberger* court, the business purpose test from the standard.

One month prior to the resolution of the business purpose test issue and the Drafting Committee's adoption of its final version of the exclusivity provision,⁶⁵ concern arose among Drafting Committee members that North Carolina's provision as then drafted⁶⁶ would be even more restrictive than Delaware's judicial

58. 457 A.2d 701 (Del. 1983); see *infra* notes 134-54 and accompanying text.

59. Business Corporation Act Drafting Committee Minutes at 8 (September 21, 1987).

60. *Id.* at 8-9.

61. See *infra* text accompanying note 150.

62. Business Corporation Act Drafting Committee Minutes at 8-9 (December 21, 1987); see General Statutes Commission Minutes at 7 (February 5, 1988).

63. Business Corporation Act Drafting Committee Minutes at 8-9 (December 21, 1987); see *infra* notes 158-73 and accompanying text.

64. Business Corporation Act Drafting Committee Minutes at 7 (January 18, 1988) (draft of the exclusivity provision appearing in the January 18, 1988 minutes was the version ultimately introduced in the Senate on February 27, 1989 with only minor modifications); General Statutes Commission Minutes at 7-8 (February 5, 1988) (explaining the Committee's decision to eliminate the business purpose test from the proposed statute as a basis for attacking a merger: first, judicial interpretations of the rule have left the term with little real meaning, so that it affords little protection to minority shareholders, and second, the proper focus is the fairness to the shareholders, not the presence or absence of a business purpose).

65. Business Corporation Act Drafting Committee Minutes at 7 (January 18, 1988).

66. North Carolina General Statutes section 55-13-02(b), as proposed by the Drafting Committee and appearing in the Business Corporation Act Drafting Committee Minutes on December 21, 1987, read:

(b) A shareholder entitled to dissent and obtain payment for his shares under this Chapter 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 violates this Chapter, the articles of incorporation or a shareholders' agreement

interpretation of the exclusivity of appraisal rights.⁶⁷ Therefore, the Drafting Committee outlined five possible alternatives to address the problem. First, the Drafting Committee could adopt the Revised Model Act language unchanged. Although this alternative "appeared to afford a dissenter access to a judicial forum, [t]he primary difficulty [with this choice] lay in the interpretation of 'unlawful.'"⁶⁸ The Drafting Committee was aware that under the Revised Model Act, the term could be interpreted broadly to include acts such as self-dealing or could be restricted to actions that were "merely procedurally irregular," such as improper voting.⁶⁹ The Drafting Committee noted that adopting the Revised Model Act's exclusivity provision without modification left the interpretation to the courts.⁷⁰ The Drafting Committee felt comfortable with its clarification of "unlawful" as encompassing action that "violates this Chapter, the articles of incorporation or a shareholders' agreement valid under section 55-7-31"⁷¹ and opted to retain this language.⁷²

The other four alternatives discussed by the Drafting Committee focused on broadening the language surrounding the "fraudulent" exception. One proposed alternative was to broaden the term "fraudulent" to read: "is fraudulent or inequitable by reason of special circumstances with respect to such shareholder or the corporation."⁷³ Drafting Committee members criticized this language as too vague and uncertain.⁷⁴ Another alternative was to broaden the term "fraudulent" by adding the language: "is fraudulent or constitutes a breach of fiduciary duty."⁷⁵ While the Drafting Committee noted that the advantage of this language was the large body of law defining a fiduciary breach, it nonetheless believed that its inclusion would be "undesirably inconsistent," given the Revised Model Act's lack of reference to "fiduciary duty" in section 8.30, which sets out standards for director conduct.⁷⁶ The Drafting Committee also considered including the term "unconscionable" as an additional exception but felt "unconscionable" was not defined sufficiently.⁷⁷

Finally, the Drafting Committee adopted a fifth alternative that amended the provision by adding the words "or is established by clear, cogent and convincing evidence to be . . . grossly inequitable with respect to such shareholder"

valid under section 55-7-31, or is fraudulent with respect to such shareholder or the corporation.

Business Corporation Act Drafting Committee Minutes at 9 (December 21, 1987).

67. Business Corporation Act Drafting Committee Minutes at 9 (December 21, 1987).

68. *Id.*

69. *Id.*

70. The final adoption and enactment of the law by the Legislature adopted the Revised Model Act language, almost verbatim, leaving the ultimate interpretation of the provision to the courts.

71. See *supra* note 53 and accompanying text.

72. Business Corporation Act Drafting Committee Minutes at 9 (December 21, 1987) (this language appeared in the provision as introduced to the Senate in S. 280, 139th N.C. Gen. Assembly (1989)); see *infra* notes 82 and 88.

73. Business Corporation Act Drafting Committee Minutes at 10 (December 21, 1987) and at 12-13 (October 28, 1987).

74. *Id.* at 10 (December 21, 1987).

75. *Id.*; see *id.* at 10-14 (October 28, 1987).

76. *Id.* at 10 (December 21, 1987).

77. *Id.*

to the end of the subsection applying to "fraudulent."⁷⁸ In doing so, the Drafting Committee analogized a shareholder challenge of a completed corporate transaction under the equitable relief exception to an action to reform an instrument because of fraud. The Drafting Committee reasoned that "the same reluctance to disturb settled transactions in the latter case, in which the burden of proof is the equitable standard of 'clear, cogent and convincing' evidence, should also carry over to the former so that the same standard of proof would apply to both."⁷⁹ The Drafting Committee especially believed the higher proof standard should apply to the "grossly inequitable" language because the term was "elastic and there [was] no body of case law interpreting it, as there [was] for fraud."⁸⁰ As such, the adoption of the fifth alternative represented a "hard-won compromise" among Drafting Committee members because several members had favored limiting relief under this subsection to cases of "*outright fraud only*."⁸¹ Thus, in its final form the Committee's version modified the Revised Model Act by: 1) explicitly rejecting the business purpose test; 2) defining "unlawful" to include essentially procedural violations of the new Act, charter or shareholder agreements; 3) including "grossly inequitable" as an extension of fraud; and 4) raising the proof level for fraud and "grossly inequitable."⁸²

This final draft passed to the Statutes Commission, which made one major modification to the exclusivity provision by deleting the higher "clear, cogent, and convincing" standard of proof to be applied to fraud and the "grossly inequitable" language.⁸³ The Drafting Committee requested that the Statutes Commission reconsider its deletion.⁸⁴ The Statutes Commission eventually acquiesced⁸⁵ and agreed to all the language recommended by the Drafting Com-

78. *Id.*; *id.* at 7 (January 18, 1988); *id.* at 14 (February 24, 1988).

79. General Statutes Commission Minutes at 15 (March 4, 1988). The General Statutes Commission later deleted, then reinstated the specific phrase "by clear, cogent, and convincing evidence" after discussion of the Drafting Committee's reasoning in originally adopting this language. *See infra* notes 83-85 and accompanying text.

80. General Statutes Commission Minutes at 15 (March 4, 1988).

81. *Id.*

82. The Drafting Committee's final draft of the exclusivity provision, which eventually was introduced to the Senate, stated:

A shareholder entitled to dissent and obtain payment for his shares under this Chapter may not challenge the corporate action creating his entitlement, including without limitation a merger solely or partly in exchange for cash or other property, even if undertaken without a business purpose, unless the action (i) violates this Chapter, the articles of incorporation or a shareholders' agreement valid under section 55-7-31, or (ii) is proven by clear, cogent and convincing evidence to be either fraudulent with respect to such shareholder or the corporation or is grossly inequitable to such shareholder.

Business Corporation Act Drafting Committee Minutes at 7 (January 18, 1988); *see also* S. 280, 139th N.C. Gen. Assembly (1989) (identical substantive language with only grammatical changes).

83. General Statutes Commission Minutes at 8 (February 5 1988) (The Statutes Commission, "[a]fter some discussion, and due largely to the extreme difficulty in proving fraud in this State," voted to delete the phrase "by clear, cogent and convincing evidence.>").

84. Business Drafting Committee Minutes at 14 (February 24, 1988); General Statutes Commission Minutes at 12-13 (March 4, 1988); Corporate Law Study Commission Minutes at 8-9 (March 17, 1988) (noting the disagreement and ongoing negotiations between the Drafting Committee and the Statutes Commission over this issue).

85. General Statutes Commission Minutes at 16 (May 13, 1988). Eight months later, lobbyists asked that the "grossly inequitable to such shareholder" language be deleted, expressing concern that the phrase could be used by minority shareholders of a public corporation to impede a corporate

mittee,⁸⁶ which was ultimately adopted by the Corporation Law Study Commission⁸⁷ and introduced in the Senate.

The bill, originally introduced into the Senate on February 27, 1989, paralleled and clarified the Revised Model Act's rule of exclusivity absent "unlawful or fraudulent" conduct.⁸⁸ The bill passed the Senate without revision.⁸⁹ The House, however, eliminated the modifications. Faced with a strong minority shareholder lobby which proposed that the appraisal remedy be nonexclusive for non-public corporations,⁹⁰ the Legislature struck a compromise. As proposed by the House Judiciary Committee,⁹¹ the entire General Assembly deleted the

transaction. Business Corporation Act Drafting Committee Minutes at 9 (January 24, 1989). The Drafting Committee decided not to recommend any changes to the provision, explaining that § 55-13-02(b) represented a "hard-fought compromise" among Drafting Committee members and had been "thoroughly debated by the [General Statutes] Commission." *Id.* at 9-10. The Committee explained its position:

The phrase "grossly inequitable to such shareholder" does not address shareholders in general but is intended to address the situation where for some reason a single shareholder is impacted differently from the remaining shareholders. The phrase represents a small safety valve where, for example, a shareholder, who invests patent rights in a corporation with the firm understanding and expectation of benefiting from the success of the corporation, becomes a minority shareholder and is cashed out by the majority shareholders on the verge of the corporation's realization of the patent's economic value. Under these circumstances, the minority shareholder might be able to prove that the corporate transaction is grossly inequitable.

Id.

Thus, the "grossly inequitable" language apparently was intended as an aid for minority shareholders in a close corporation setting.

86. See *supra* note 82 and accompanying text.

87. CORPORATE LAW STUDY COMMISSION, REPORT TO THE 1988 GENERAL ASSEMBLY OF NORTH CAROLINA 7-8 (1989). The General Assembly established the Corporate Law Study Commission [hereinafter Study Commission] by House Bill 1409 and Senate Bill 950, enacted as Part XIII.A of Chapter 873 of the 1989 Session laws. *Id.* at 1. The Study Commission consisted of eight members: three members of the House, three members of the Senate, and two public members. *Id.* The Study Commission, using the previous groundwork and expertise of the General Statutes Commission and Business Drafting Committee, focused on the substantive changes and policy decisions as set forth in the revision of the North Carolina Business Corporation Act. *Id.* at 2. After meeting to review Article 13 on dissenters' rights on March 17, 1988, the Study Commission on May 25, 1988, voted to recommend the enactment of the Revised Model Act as amended by the Study Commission. *Id.* at 7-8. The Study Commission adopted North Carolina General Statutes § 55-13-02(b) as drafted and recommended by the Drafting Committee and the Statutes Commission.

88. As introduced, North Carolina General Statutes § 55-13-02(b) read 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, even if undertaken without a business purpose, unless the action (i) violates this act, the articles of incorporation or a shareholders' agreement valid under G.S. 55-7-31, or (ii) is proven by clear, cogent and convincing evidence to be either fraudulent with respect to such shareholder or the corporation or grossly inequitable to such shareholder.

S. 280, 139th N.C. Gen. Assembly (1989).

89. S. 280, Senate Judiciary II Committee Substitute, adopted May 3, 1989, 139th N. C. Gen. Assembly (1989).

90. Once the bill was referred to the House Subcommittee on Courts and Administrative Hearings, its members proposed: (1) to amend subsection (b) to apply to "shareholder[s] of any public corporation" and (2) to add a new subsection (c) after subsection (b) to read in pertinent part: "A shareholder of a corporation, that is not a public corporation . . . shall in addition to the right to dissent, have all other rights arising in law or equity." North Carolina House Subcommittee on Courts and Administrative Hearings Minutes (May 24, 1989).

91. S. 280, House Committee Substitute, reported favorable, June 1, 1989, 139th N. C. Gen. Assembly (1989). The House Judiciary Committee, sensing the whole bill would fail given the tug-

explicit rejection of the business purpose test, the procedural compliance limitation upon "unlawful," the extension of fraud to gross inequity, and the higher "clear, cogent and convincing" standard of proof for fraud and gross inequity, reinstating the Revised Model Act's "unlawful or fraudulent" language.⁹² Only the application of the exclusivity provision to cash-out mergers survived the legislative knife. As a product of this significant compromise, the final enacted version of the statute saddled the North Carolina courts with the task of determining the extent of the exclusivity by construing and applying the statute's terms "unlawful" and "fraudulent."

B. Interpreting the Appraisal Exclusivity Provision under the New Act

Interpretation of the appraisal exclusivity provision will require the courts to answer several controversial questions. Should "unlawful" include a breach of fiduciary duty or should it be limited to only procedural matters such as violations of the new Act or corporate charter? Should "fraudulent" include only actual deception or should the term also encompass constructive fraud from breach of fiduciary duty? How much protection do minority shareholders in North Carolina expect or deserve? The Revised Model Act's language, comments, and history, the treatment of the issue by leading states such as Delaware and New York, and approaches taken by other states that have adopted the Revised Model Act or dealt with the issue judicially may provide some guidance to the courts as they seek to resolve these questions.

1. Appraisal Exclusivity under the Revised Model Act

The Revised Model Act, adopted by the American Bar Association in 1984, grants a shareholder facing an impending merger a right of dissent and appraisal.⁹³ The Revised Model Act explicitly provides that a dissenting shareholder "may not challenge the corporate action creating his entitlement [to dissent] unless the action is unlawful or fraudulent."⁹⁴ Under the Revised Model Act, the appraisal remedy is the dissenting shareholder's *exclusive* remedy unless one of the two exceptions is triggered by some type of misconduct.⁹⁵

of-war on this issue, reinstated the Revised Model Act's wording: "unless the action is unlawful or fraudulent with respect to the shareholder or the corporation." North Carolina House Judiciary Committee Minutes at 1 (May 31, 1989).

92. S. 280, House Committee Substitute, reported favorable, June 1, 1989, 139th N. C. Gen. Assembly (1989). This final version was passed by the full House on June 5, 1989, concurred in by the Senate on June 7, 1989, and ratified on June 8, 1989, nearly three and one-half years after work on the new Act had begun. Act of June 8, 1989, ch. 265, § 1, 1989 N.C. Sess. Laws 648 (codified at N.C. GEN. STAT. § 55-13-02(b) (1990)).

Notably, after the bill was introduced into the Senate, "in response to even stronger concern expressed by practicing lawyers, and upon further reflection," the Drafting Committee recommended (1) deleting the "unlawful" qualification, the extension of fraud to gross inequity as well as the higher "clear, cogent and convincing evidence" requirement, and (2) retaining both the explicit reference to the cash-out merger and the explicit rejection of the business purpose test. Business Corporation Act Drafting Committee Minutes at 3-4 (April 8, 1989).

93. REV. MODEL BUSINESS CORP. ACT § 13.02(a)(1) (1984).

94. *Id.* § 13.02(b).

95. *Id.* § 13.02(b) official comment 2.

In retaining this language, the drafters of the Revised Model Act followed the language as originally set forth in New York Business Corporation Law Section 623(k) for making appraisal the dissenters' sole remedy absent fraud or unlawfulness.⁹⁶

The Revised Model Act purposefully left the terms "unlawful" and "fraudulent" undefined. The official comments to the Revised Model Act state that "[b]ecause of the variety of situations in which unlawfulness and fraud may appear, this section makes no attempt to specify particular illustrations."⁹⁷ The official comments instead offer some examples of shareholder or corporation misconduct that might come within the exceptions such as voting irregularities, shareholder deception and "violation of . . . fiduciary duty."⁹⁸

The official comments further state that, rather than specifying what types of action constitute illegality or fraud, section 13.02(b) "is designed to recognize and preserve the principles that have developed in the case law of Delaware, New York and other states with regard to the effect of dissenters' rights on other remedies of dissident shareholders."⁹⁹ The official comments then cite *Weinberger*¹⁰⁰ for the proposition that the "appraisal remedy may not be adequate 'where fraud, misrepresentation, self-dealing, deliberate waste of corporate assets, or gross or palpable overreaching are involved.'"¹⁰¹ Significantly, the Revised Model Act is silent on the issue of the business purpose test,¹⁰² a test

96. *Id.*; see Act of April 24, 1961, ch. 855, § 623(k), N.Y. Laws 1597 (codified as amended at N.Y. BUS. CORP. LAW § 623(k) (McKinney 1986)). In the early sixties, most state statutes and the Model Business Corporation Act (the "Model Act") were silent on the issue of appraisal exclusivity. Vornberg, *Exclusiveness of the Dissenting Stockholders' Appraisal Right*, 77 HARV. L. REV. 1189, 1207 (1964). Although the Model Act followed state law developments concerning the exclusivity issue in its annotations, it did not adopt an appraisal exclusivity provision until 1978. Committee on Corporate Laws, *Amendments on Model Business Corporation Act Affecting Dissenters' Rights (Sections 73, 74, 80, and 81)*, 33 BUS. LAW. 2587, 2591 (1978); see MODEL BUSINESS CORP. ACT § 80(d) (1979) (appraisal exclusivity provision originally adopted in 1978 included the "unlawful or fraudulent" exception to exclusivity); see also Committee on Corporate Laws, *Changes in the Model Business Corporation Act Affecting Dissenters' Rights*, 32 BUS. LAW. 1855 (1977) (the proposed language in 1977 was "illegal or fraudulent" based on the Massachusetts statute; other states' provisions were discussed in the comments to section 80(d), including states which listed "charter conflicts" and improper shareholder voting as exceptions to exclusivity); *infra* note 173 and accompanying text.

97. REV. MODEL BUSINESS CORP. ACT § 13.02(b) official comment 2.

98. *Id.* The official comments to the Revised Model Act state:

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' right under this chapter.

Id.

99. *Id.*

100. 457 A.2d 701 (Del. 1983); see *infra* notes 131-57 and accompanying text.

101. 457 A.2d at 714 (citation omitted).

102. See *infra* notes 105-150 and accompanying text.

The New York Court of Appeals follows the business purpose test. *Alpert v. 28 Williams St. Corp.*, 63 N.Y.2d 557, 573, 473 N.E.2d 19, 28, 483 N.Y.S.2d 667, 677 (1984). Delaware, however, rejects it. *Weinberger*, 457 A.2d at 715. Yet the Revised Model Act's exclusivity provision is designed to incorporate the principles of both these states' decisions. By (1) following the language of the New York appraisal exclusivity provision, which later was held in *Alpert* to incorporate the business purpose test, and (2) referencing specifically to Delaware's *Weinberger* decision, which expressly rejects the business purpose test, the Revised Model Act, apparently inadvertently, sets up this dichotomy.

which has been employed by many jurisdictions to evaluate the validity of cash-out mergers.¹⁰³

2. States Cited by the Revised Model Act: Delaware and New York

Delaware

Delaware General Corporation Law does not have a provision mandating the exclusivity of the appraisal remedy.¹⁰⁴ The Delaware Supreme Court, however, has addressed the issue, registering a dramatic reversal of its holdings twice in a six-year period.

In 1977 the decision in *Singer v. Magnavox Company*¹⁰⁵ gave birth to the business purpose rule and also perpetuated the "entire fairness" test first enunciated in *Sterling v. Mayflower Hotel Corporation*.¹⁰⁶ Decided on the heels of the United States Supreme Court's decision in *Santa Fe Industries, Inc. v. Green*,¹⁰⁷ the *Singer* case attempted to strengthen the standards of review for mergers under Delaware law in light of the United States Supreme Court's implicit criticism of Delaware's corporate law in *Santa Fe*.¹⁰⁸

In *Singer*, the minority shareholder sued for nullification of a proposed merger and for compensatory damages. Although the merger satisfied the long-form statutory procedural requirements,¹⁰⁹ the plaintiffs argued that the merger nevertheless was "fraudulent because it did not serve any business purpose other than the forced removal of the minority shareholders" and that the majority breached its fiduciary duty to the minority by approving the merger at a price that was grossly inadequate.¹¹⁰ The lower court dismissed the complaint on the ground that appraisal was the exclusive remedy.¹¹¹ The Delaware Supreme Court reversed, stating that a long-form merger, "made for the sole purpose of

103. See *infra* notes 177-90 and 222-30 and accompanying texts.

104. The New York corporation statute, unlike the Delaware corporate code, contains an exclusivity provision, which was the exact "formula" followed by the Revised Model Act. REV. MODEL BUSINESS CORP. ACT § 13.02(b) official comment 2 (1984).

105. 380 A.2d 969 (Del. 1977), *overruled by* Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983).

106. 33 Del. Ch. 293, 93 A.2d 107 (1952) (controlling shareholder, standing on both sides of the merger, was held to have the burden of proving the merger's entire fairness, which he met when the court reasoned that liquidation value was not the determinative factor of price in a merger, such that minority shareholder was not entitled to the higher liquidation value of the assets upon consummation of the merger).

107. 430 U.S. 462 (1977) (minority shareholder sued to set aside a short-form cash-out merger, alleging the parent majority shareholder had paid a wholly inadequate price so as to breach its fiduciary duty, which constituted securities fraud). The *Santa Fe* Court limited the application of rule 10b-5 by requiring that liability under the rule be based on deception and not on breach of fiduciary duty alone. See *infra* notes 211-18 and accompanying text.

108. *Santa Fe*, 430 U.S. at 479-80 ("There may well be a need for uniform federal fiduciary standards to govern mergers such as that challenged in this complaint."); see Weiss, *supra* note 42, at 27 n.173; see also Brudney & Chirelstein, *supra* note 10, at 1354 n.2 (suggesting *Singer* was the Delaware court's response to Cary's article, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663 (1974), which advocated comprehensive federal fiduciary standards and which was cited by the United States Supreme Court in *Santa Fe*).

109. DEL. CODE ANN. tit. 8, § 251 (1974).

110. *Singer v. Magnavox Co.*, 380 A.2d 969, 972, (Del. 1977), *overruled by* Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983).

111. *Singer v. Magnavox Co.*, 367 A.2d 1349 (Del. Ch. 1976), *modified*, 380 A.2d 969 (Del. 1977).

freezing out minority shareholders, is an abuse of corporate process; and . . . [supports] a cause of action for violation of a fiduciary duty."¹¹² After *Singer* a long-form merger accomplished without a valid business purpose¹¹³ constituted a breach of fiduciary duty under Delaware law and could be enjoined.¹¹⁴

Three months after the *Singer* decision, the Delaware Supreme Court broadened the scope of what could constitute a valid business purpose. In *Tanzer v. International General Industries, Inc.*,¹¹⁵ the court clarified whose business interest must be served and how compelling that interest must be to satisfy the business purpose test. In *Tanzer* the controlling shareholder wished to effect a merger to obtain long-term financing.¹¹⁶ The court limited its review of the controlling shareholder's purpose to its fiduciary duty as a shareholder, ignoring its fiduciary duty as a director.¹¹⁷ As a shareholder, the controlling parent had the fundamental right to vote its shares in its own interest.¹¹⁸ The court found the controlling shareholder's self-interested motive of facilitating its own debt financing to be a legitimate business purpose. Citing *Singer* and *Sterling*, however, the court remanded the case for the parent corporation as controlling shareholder to demonstrate the entire fairness of the transaction.¹¹⁹ The *Singer* and *Tanzer* decisions¹²⁰ made it clear that, although minority sharehold-

112. *Singer*, 380 A.2d at 980.

113. Moreover, the court emphasized that the majority shareholder could not discharge its fiduciary duty merely by establishing a valid business purpose. In addition, the controlling shareholder must meet its burden of proof under the "entire fairness" test first enunciated in *Sterling v. Mayflower Hotel Corp.*, 33 Del. Ch. 293, 93 A.2d 107 (1952). This test refers to the court's scrutiny of the fairness of the transaction as a whole; it was later refined in *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983), to include two aspects: "fair dealing" and "fair price." See *infra* notes 134-54 and accompanying text.

114. The court in *Singer* explained *Stauffer v. Standard Brands, Inc.*, 41 Del. Ch. 7, 187 A.2d 78 (1962), *overruled*, *Roland Int'l Corp. v. Najjar*, 407 A.2d 1032 (Del. 1978), *overruled by Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983) and *David J. Greene & Co. v. Schenley Indus., Inc.*, 281 A.2d 30 (Del. Ch. 1971). *Singer*, 380 A.2d at 980. *Stauffer* and *Schenley*, among other cases, "developed a body of law that permitted [both short- and long-form] cash out mergers, without any limitations expressed, as a valued minority elimination device." Robinson, *supra* note 32, at 518. Notably, the court in *Singer* did not find it necessary to distinguish the facts of *Stauffer* and *Schenley* from *Singer*, since neither case "involved a merger in which the minority was totally expelled via a straight 'cash-for-stock' conversion in which the only purpose of the merger was . . . to eliminate the minority." *Singer*, 380 A.2d at 978. The court pointed out that in *Stauffer*, the issue solely involved "a difference of opinion as to [the] value of the converted shares," for which the appraisal remedy was available. *Id.* Moreover, the *Singer* court noted that the *Schenley* case did not involve a cash merger "the sole purpose of which was to eliminate minority stockholders." *Id.* at 979 (emphasis in original).

115. 379 A.2d 1121 (Del. 1977) (for the purpose of facilitating long-term financing, the parent corporation effected a reverse triangular long-form cash-out merger of an 81%-owned subsidiary into a new shell subsidiary corporation formed by the parent corporation), *overruled by Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983).

116. *Id.* at 1124.

117. *Id.* at 1123. See also Weiss, *supra* note 42, at 31-32 (suggesting that under Delaware law a majority shareholder who takes action as a shareholder need not take into account other shareholders, but when a majority shareholder exercises power through the directors of a controlled corporation, he must then protect or advance the interests of all shareholders).

118. *Tanzer*, 379 A.2d at 1123.

119. *Id.* at 1124.

120. Weiss, *supra* note 19, at 666-67 n.275. *Singer* and *Tanzer* were under consideration for an "extended and substantially overlapping" time period, were decided three months apart by the same three-judge panel, and involved related issues. *Id.* Weiss suggests that the two "cases should be

ers were no longer limited to the appraisal remedy, they could be eliminated in a transaction, the only purpose of which was to further the interest of the controlling shareholder.¹²¹ By allowing such selfish action, the court in effect eviscerated the business purpose test.¹²²

The Delaware Supreme Court soon extended application of the business purpose test to short-form mergers in *Roland International Corporation v. Najjar*.¹²³ In *Najjar* the court stated that, while the 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, the merger must have a valid business purpose as required by *Singer*.¹²⁴ The court declared that the fiduciary duty of the controlling shareholder is an overriding obligation owed equally to any minority shareholder, no matter how large or small.¹²⁵ The statute permits the elimination of the minority shareholder only as an incidental cost of a merger conducted for a business purpose other than elimination of the minority shareholders.¹²⁶

Although the controlling shareholder's fiduciary obligation could not be avoided by technical compliance with merger statutes, the parties could agree contractually to eliminate any common-law fiduciary duty. In *Coleman v. Taub*,¹²⁷ the Third Circuit imposed neither the business purpose nor fairness requirements when a minority shareholder contracted away his right to remain a shareholder. In *Coleman* the minority shareholder of a close corporation had agreed earlier to a buy-back provision in his employment contract, which stated that upon termination of his employment "for any reason whatsoever," the corporation had the right to repurchase his shares at an agreed-upon price or at a price determined by three impartial appraisers.¹²⁸ The court held the *Singer/Tanzer/Najjar* reasoning did not apply because the contract altered the fiduciary duty; a freeze-out under these circumstances was not a breach of that duty.¹²⁹

analyzed as parts of a whole, rather than as sequential statements dealing with different fact patterns." *Id.*

121. *Cf. Coggins v. New England Patriots Football Club*, 397 Mass. 525, 492 N.E.2d 1112 (1986) (controlling shareholder's attempt to restructure the company through a merger so that corporate income could repay the personal debt he incurred to buy the company held to be an invalid corporate purpose). See *supra* notes 221-30 and accompanying text.

122. Weiss, *supra* note 19, at 664, 667, 671 n.300; see Robinson, *supra* note 32, at 520-21; Steinberg & Lindahl, *The New Law of Squeeze-Out Mergers*, 62 WASH. U.L.Q. 351, 359 n.37 (1984); see also Weiss, *supra* note 42, at 34 (suggesting that the *Tanzer* court's analysis was "inconsistent with traditional fiduciary doctrine" and "threatened to strip all content from the [business] purpose test").

123. 407 A.2d 1032 (Del. 1979), *overruled by* Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983).

124. *Id.* at 1036.

125. *Id.* (short-form merger statute "may not be used to short-circuit the law of fiduciary duty").

126. Comment, *Shareholders' Rights in Short-Form Mergers: The New Delaware Formula*, 64 MARQ. L. REV. 687, 709 (1981).

127. 638 F.2d 628 (3d Cir. 1981) (the 99% controlling shareholder set up a shell corporation, wholly owned by him and created solely as a merger vehicle to cash-out the 1% minority shareholder).

128. *Id.* at 636-37.

129. *Id.* at 636. The court stated:

[A] minority shareholder may bargain away the 'additional interest' in corporate participa-

After announcing the business purpose test in *Singer* in 1977, just six years later the Delaware Supreme Court summarily overruled the *Singer* trilogy "as a departure from prior case law."¹³⁰ The landmark case of *Weinberger v. UOP, Inc.*¹³¹ reinstated the "well established principles . . . mandating a stockholder's recourse to the basic [appraisal] remedy,"¹³² but excepting from this rule cases in which "fraud, misrepresentation, self-dealing, deliberate waste of corporate assets, or gross and palpable overreaching are involved."¹³³ In addition to overruling the business purpose test, *Weinberger* provided guidance for the application of the entire fairness test by further delineating its two prongs of fair dealing and fair price.¹³⁴

In *Weinberger*, Signal Companies, Inc., sought to invest its cash surplus. The company acquired fifty and one-half percent of the outstanding shares of UOP, Inc. in 1975 through a friendly tender offer for twenty-one dollars a share, with the stock trading just under fourteen dollars a share.¹³⁵ Signal controlled UOP's thirteen-member board by appointing seven of its members, including four members who were also top ranking officers of Signal and who served on Signal's board.¹³⁶ In 1978, still with surplus cash and having found no other

tion which might otherwise be the basis for a fiduciary duty on the part of the majority. Once such bargaining away is established, Delaware law has nothing to tell us regarding the need for a valid business purpose in order to justify a merger for it is only the 'additional interest' that calls for an inquiry into business purpose Thus, if such an inquiry is inappropriate because the minority's additional interest has been bargained away, the merger cannot, in itself, constitute a breach of fiduciary duty.

Id.

130. *Weinberger v. UOP, Inc.*, 457 A.2d 701, 715 (Del. 1983); Note, *Weinberger to Rabkin: Fine Tuning the Doctrine of Corporate Mergers*, 11 DEL. J. CORP. L. 839, 840-841 (1986); see also Note, *supra* note 32, at 824-25 (stating that "this flip-flopping in the Delaware Supreme Court's opinion is troublesome").

131. 457 A.2d 701 (Del. 1983).

132. *Id.* at 715 (citations omitted); see also Steinberg & Lindahl, *supra* note 122, at 365 (explaining the liberalized *Weinberger* appraisal remedy).

133. *Weinberger*, 457 A.2d at 714 (citing *Cole v. National Cash Credit Ass'n*, 18 Del. Ch. 47, 56, 156 A. 183, 187 (1931), as a basis for the five exceptions created by the *Weinberger* court in which minority shareholders are not limited to the appraisal remedy); see also Steinberg & Lindahl, *supra* note 122, at 365 n.75.

In *Cole*, the [court] discussed the concepts of actual and constructive fraud in the context of an injunction against a merger. To prove constructive fraud in the alleged undervaluation of shares, the dissenting shareholder must show that the valuation constitutes a conscious abuse of discretion, breach of trust, or mal-administration manifestly causing injury to the dissenting shareholder. Mere inadequacy of price does not equal fraud unless the undervaluation suggests bad faith or reckless indifference to the rights of the minority shareholder.

Id.

134. *Weinberger*, 457 A.2d at 711. Fair dealing "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." *Id.* Fair price "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.* Finally, *Weinberger* discarded the outmoded "Delaware block" method as the exclusive valuation method and broadened the court's review to include "all relevant factors" as determined by "generally accepted techniques used in the financial community" and used by other courts. *Id.* at 712-13.

135. *Id.* at 704.

136. *Id.* at 704-05.

suitable acquisitions, Signal decided to acquire UOP's remaining shares. It offered the same twenty-one dollars a share, representing a substantial premium over the market price at that time.

Two of Signal's officers who also sat on UOP's board conducted an internal feasibility study—for use only by Signal—of the possible acquisition.¹³⁷ This study, based on information acquired from UOP, concluded that acquisition of UOP's remaining stock at a price up to twenty-four dollars per share would return fifteen and one-half percent to Signal, which was a good investment.¹³⁸ Signal then negotiated the price with UOP's outside directors, but did not disclose the results of this study—its maximum price of twenty-four dollars—to them.¹³⁹ The parties submitted the merger to the shareholders, still without disclosing Signal's maximum price, whereby the twenty-one dollars price per share was approved.¹⁴⁰ The plaintiff, a minority shareholder of UOP, attacked the merger, initially claiming it lacked a proper business purpose under *Singer* and, unaware of the nondisclosures, that the price was unfair. The chancery court dismissed the suit.¹⁴¹ Given that Signal, owning only fifty and one-half percent of the outstanding shares, had conditioned the merger upon a vote of two-thirds of all outstanding UOP shares, the court found no self-dealing because the majority had not used its controlling position to *force* approval of the merger.¹⁴²

Having discovered the nondisclosures, plaintiffs amended their complaint to add that Signal had violated its fiduciary duty by distributing misleading proxy information that failed to disclose material facts about how the merger price was established, resulting in a tainted shareholder vote.¹⁴³ The chancery court, after evaluating the alleged misrepresentations to UOP's shareholders, the

137. *Id.* at 705.

138. *Id.* at 705, 709.

139. *Id.* at 709.

140. *Id.* at 708-09. Certain precautions were taken by UOP's board to insure that the merger transaction was fair. UOP first retained an investment banker who hurriedly concluded the transaction was fair. *Id.* at 706. With the fairness opinion in hand, the outside directors then approved the merger proposal. *Id.* at 707. Signal also conditioned the merger upon the approval of a majority of the minority shares actually voting on the issue and upon the condition that the minority shares actually voting, when coupled with Signal's 50.5% interest, would comprise at least two-thirds of all UOP's shares. *Id.* at 707. Given the holding of the case, *Weinberger* provides a "road map for the majority to avoid any serious challenge to the legality of a freeze-out" when they comply with certain special precautions involved in fair dealing and fair price. Booth, *The New Law of Freeze-Out Mergers*, 49 Mo. L. Rev. 517, 522, 542 (1984); see also Payson & Inskip, *Weinberger v. UOP, Inc.: Its Practical Significance in the Planning and Defense of Cash-Out Mergers*, 8 DEL. J. CORP. L. 83, 86-91 (1983) (discussing independent negotiation committees as a cure for the conflict of interest and nondisclosure problems cited in *Weinberger* and the special merger approval vote by a majority of the minority shares as a device to shift the burden of proving unfairness to the minority shareholders, suggesting the "easiest merger agreement to defend" will contain both). But see Weiss, *supra* note 42, at 49-53 (questioning the effectiveness of "independent" negotiating committees and fairness opinions in light of "the opportunities for formal compliance with, and substantive evasion of, judicially-mandated procedures"). In *Weinberger*, Signal's attempted special precautions of fairness were thwarted by its failure to fully disclose the maximum price it had derived with information obtained through interlocking directors. *Weinberger v. UOP, Inc.*, 457 A.2d 701, 712 (Del. 1983).

141. *Weinberger v. UOP, Inc.*, 409 A.2d 1262, 1268 (Del. Ch. 1979).

142. *Id.* at 1264-66.

143. *Weinberger v. UOP, Inc.*, 426 A.2d 1333, 1341 (Del. Ch. 1981), *rev'd*, 457 A.2d 701 (Del. 1983).

alleged breach of fiduciary duty by the interlocking directors, and the alleged inadequate price, concluded the merger was legally fair.¹⁴⁴ Regarding the special structure of the merger vote,¹⁴⁵ the chancery court held that such vote did not establish automatically that Signal had discharged its fiduciary duty, but the court did consider the special structure as another factor in evaluating entire fairness.¹⁴⁶ Concerning the business purpose, the court found that Signal had shown a legitimate business purpose, namely that "Signal itself was an investment company" and that UOP was the "best possible placement" of its surplus cash.¹⁴⁷

On appeal, the Delaware Supreme Court reversed,¹⁴⁸ holding that the majority must prove the approval vote is a fair, fully informed vote while the minority must prove unfairness resulting from the majority's specific acts of fraud or misrepresentation.¹⁴⁹ In its opinion, the court abolished *Singer's* business purpose test, stating that this test gave no "additional meaningful protection" to minority shareholders.¹⁵⁰ The court announced that the appropriate fiduciary standard is solely the entire fairness test enunciated in *Sterling*, redefining the test as having two aspects: fair dealing and fair price.¹⁵¹

Noting that fair dealing embraces the timing, initiation, structure, disclosure and means of obtaining director and stockholder approval of the merger, the court found that the majority failed to disclose fully material information, thereby breaching its fiduciary duty to the minority shareholders.¹⁵² Moreover, the parent's non-disclosure and the cursory preparation of its fairness opinion tainted the vote so that the transaction failed the "fair dealing" aspect of the entire fairness test.¹⁵³ Thus, through the fair dealing aspect of the entire fairness test, the court evaluated and enforced the majority shareholder's fiduciary obligation to the minority shareholder.¹⁵⁴

After *Weinberger*, Delaware operated under the rule that, absent fraud, misrepresentation, and other limited circumstances, a minority shareholder's ex-

144. *Id.* at 1362-63.

145. For the merger to be approved, two things were required. First, a majority of the UOP minority shareholders actually voting on the transaction had to approve. Second, at least two-thirds of all outstanding shares had to approve. Signal owned only 50.5% of the outstanding shares. *Id.* at 1361.

146. *Id.* at 1362.

147. *Id.* at 1350. Commentators noted the decision "rendered the business purpose test utterly meaningless." See, e.g., Booth, *supra* note 140, at 521.

148. *Weinberger v. UOP, Inc.*, 457 A.2d 701, 715 (Del. 1983).

149. *Id.* at 703.

150. *Id.* at 715.

151. *Id.*; see also *supra* note 134. See generally Steinberg & Lindahl, *supra* note 122, at 366-89 (discussing fair dealing and fair price).

152. *Weinberger*, 457 A.2d at 703.

153. *Id.* at 711-12. Concerning fair price, the court abolished the rigid "Delaware block" method as out-dated, extending fair price considerations to include all relevant factors—assets, market value, earnings future prospects, dividends—evaluated under any generally accepted financial technique. *Id.* at 711-13. The court remanded the case to allow the lower court to apply the new liberalized valuation standard. *Id.* at 715.

154. Weiss, *supra* note 42, at 49; see Coleman, *The Appraisal Remedy in Corporate Freeze-Outs: Questions of Valuation and Exclusivity*, 38 Sw. L.J. 775, 790 (1984).

clusive remedy was the right to demand a liberalized appraisal proceeding where both fair dealing and a fair price were mandated.¹⁵⁵ This result stemmed from the court's conviction that the overriding concern of minority shareholders is to be paid a fair price for their stock.¹⁵⁶ *Weinberger* left unanswered the question of what circumstances would render the liberalized appraisal proceeding "inadequate" so as to allow the minority shareholder "any form of equitable and monetary relief."¹⁵⁷

In *Rabkin v. Philip A. Hunt Chemical Corporation*,¹⁵⁸ the Delaware Supreme Court addressed this question. For the first time since *Weinberger*, the court focused upon the exclusivity issue, holding that the plaintiffs' specific allegations—that defendants breached their fiduciary duty by deliberately manipulating the timing of the merger—stated a claim for equitable relief, despite the absence of claims of nondisclosure or misrepresentation.¹⁵⁹ In *Rabkin* the minority shareholder challenged a cash-out merger on the grounds that the price offered was grossly inadequate because the acquiring corporation unfairly and purposefully manipulated the timing¹⁶⁰ of the merger to avoid a one-year commitment to the minority at a higher price per share.¹⁶¹ The plaintiffs claimed that the entire fairness test entitled them to relief broader than an appraisal.¹⁶²

155. See *supra* note 134.

156. *Weinberger*, 457 A.2d at 711.

157. *Id.* at 714. Another issue left unanswered by *Weinberger* but analyzed extensively by legal commentators was the question of how a minority shareholder procedurally should pursue equitable relief: in a separate action or within the appraisal proceeding itself. *E.g.*, Weiss, *The Law of Take Out Mergers: Weinberger v. UOP, Inc. Ushers in Phase Six*, 4 CARDOZO L. REV. 245, 256-60 (1983); Payson & Inskip, *supra* note 140, at 95; Note, *supra* note 130, at 847-49. The Delaware Supreme Court in 1988 handed down *Cede & Co. v. Technicolor, Inc.*, 542 A.2d 1182 (Del. 1988), which gave some guidance on this issue. In *Cede & Co.*, the court held that a minority shareholder who had begun an appraisal proceeding after dissenting from a cash-out merger could still bring an action for fraud discovered after the appraisal proceeding had begun. *Id.* at 1189. Plaintiffs may file a separate action alleging fraud, fiduciary breach or other misconduct and then consolidate the two actions in one proceeding, instead of amending the complaint to enlarge the appraisal action to include the fraud or fiduciary breach allegations. *Id.* at 1189-90. During the consolidated proceeding, if the plaintiff proves misconduct by the defendant such as fraud or a fiduciary breach, then the appraisal action would be rendered moot. *Id.* at 1191. However, if fraud is not proven, then the plaintiff is entitled to collect the fair value of its shares pursuant to the statutory appraisal provision. *Id.*

158. 498 A.2d 1099 (Del. 1985).

159. *Id.* at 1104-05.

160. The *Weinberger* court suggested that the timing of the transaction was a critical factor in procedural fairness. 457 A.2d at 711.

161. 498 A.2d at 1101, 1103. On March 1, 1983, defendant purchased 63.4% of Hunt's outstanding common stock at \$25 per share pursuant to a stock purchase agreement that also required defendant to pay \$25 per share if it acquired the remaining Hunt stock within one year thereafter. *Id.* at 1101. While the defendant circulated interoffice memoranda disclosing its intentions to eventually acquire the minority interest, the defendant's board of directors waited to approve the transaction until one week before the one-year commitment period expired, so that the merger was consummated on July 5, 1984, after the prescribed period ended. *Id.* at 1102.

162. *Id.* at 1103. Specifically, the minority argued that an appraisal would be inadequate because:

- (1) the alleged wrongdoers are not parties to an appraisal proceeding, and thus are not personally accountable for their actions;
- (2) if such misconduct is proven, then the corporation should not have to bear the financial burden which only falls upon it in an appraisal award; and
- (3) overreaching and unfair dealing are not addressed by an appraisal.

Id. at 1104.

The lower court dismissed the complaint on the ground that absent deception, *Weinberger* mandated appraisal as the only remedy available to the minority.¹⁶³ The Delaware Supreme Court viewed the holding in *Weinberger* as "broader than the scope accorded it by the trial court."¹⁶⁴ By requiring "deception," the lower court limited the *Weinberger* exclusivity exceptions to actual fraud.¹⁶⁵ The Delaware Supreme Court read these *Weinberger* exceptions to the exclusivity rule more broadly to include certain types of fiduciary breaches, and arguably constructive fraud, stating in short, "fair dealing does not turn solely on issues of deception."¹⁶⁶ The court found that the plaintiff had alleged facts sufficient to support a claim that the parent corporation,¹⁶⁷ as controlling shareholder, had breached its duty of fair dealing.¹⁶⁸

The *Rabkin* court agreed with the plaintiffs' argument that defendants unfairly manipulated the timing of the merger to purposefully avoid a bargain due the plaintiffs. The court found this to be "bad faith go[ing] beyond issues of 'mere inadequacy of price.'" ¹⁶⁹ The Delaware Supreme Court stressed that the lower courts must take care to distinguish true fiduciary breach cases that demand equitable relief from cases involving merely price inadequacy where only an appraisal is appropriate.¹⁷⁰

In sum, the Delaware Supreme Court in *Rabkin* refined *Weinberger's* appraisal exclusivity rule¹⁷¹ to include certain types of fiduciary breaches, arguably constituting constructive fraud, in addition to actual fraud.¹⁷² The entire fair-

163. *Rabkin v. Philip A. Hunt Chemical Corp.*, 480 A.2d 655, 660 (Del. Ch. 1984) ("Where . . . there are no allegations of non-disclosures or misrepresentations, *Weinberger* mandates that plaintiffs' entire fairness claims be determined in an appraisal proceeding."), *rev'd*, 498 A.2d 1099 (Del. 1985).

164. *Rabkin*, 498 A.2d at 1100.

165. *Rabkin*, 480 A.2d at 660; *see Rabkin*, 498 A.2d at 1100, 1103; Note, *supra* note 130, at 857.

166. *Rabkin*, 498 A.2d at 1104-05 (emphasis added). Referring to the unfair timing of the cash-out merger, the court stated that "inequitable conduct will not be protected merely because it is legal." *Id.* at 1107.

167. *Id.* at 1106 (discussing that there is no "safe harbor" for interlocking directors who are charged with the duty of good faith and fairness to both corporations).

168. *Id.* at 1105-08.

169. *Id.* at 1107 (quoting *Cole v. National Cash Credit Ass'n*, 18 Del. Ch. 47, 58, 156 A. 183, 188 (1931)). *Cole* evaluated constructive fraud as requiring an injunction when a breach of trust, maladministration or conscious abuse of discretion is proven. *Cole v. National Cash Credit Ass'n*, 18 Del. Ch. 45, 57, 156 A. 183, 187 (1931).

170. *Rabkin*, 498 A.2d at 1107-1108.

Necessarily, this will require the [lower courts] to closely focus upon *Weinberger's* mandate of entire fairness based on a careful analysis of both the fair price and fair dealing aspects of a transaction Moreover, our courts are not without a degree of sophistication in such matters. A balance must be struck between sustaining complaints averring faithless acts, which taken as true would constitute breaches of fiduciary duties that are reasonably related to and have a substantial impact upon the price offered, and properly dismissing those allegations questioning judgmental factors of valuation. Otherwise, we face the anomalous result that stockholders who are eliminated without appraisal rights can bring class actions, while in other cases a squeezed-out minority is limited to an appraisal, provided there was no deception, regardless of the degree of procedural unfairness employed to take their shares. Without that balance, *Weinberger's* concern for entire fairness loses all force.

Id. (citations omitted).

171. *See supra* text accompanying notes 132-33.

172. *See Note, supra* note 130, at 858-59.

ness test continues to be the current standard of review in Delaware, under which only fair price and fair dealing are primary factors. Although *Weinberger* discarded the *Singer* trilogy's business purpose test, the Delaware Supreme Court retreated from this position under *Rabkin*, allowing breach of fiduciary duty considerations to come into play under the "fair dealing" aspect of the "entire fairness" test in *Rabkin*. Thus, under the current state of corporate law in Delaware, the courts exercise a broader scope of review under the "entire fairness" test after *Rabkin* refocused *Weinberger's* appraisal exclusivity rule.

New York

The Revised Model Act perpetuated the exclusivity "formula" found under New York law, which used the "unlawful or fraudulent" language.¹⁷³ When the Revised Model Act embraced New York's version of the appraisal exclusivity provision in 1984, the New York courts had yet to define the parameters of their rule. In late November of 1984, however, the New York Court of Appeals in *Alpert v. 28 Williams Street Corporation*¹⁷⁴ undertook to "prescribe a standard for evaluating the validity of a [cash-out] merger."¹⁷⁵ Decided just over a year after Delaware's *Weinberger* decision,¹⁷⁶ *Alpert* followed *Weinberger's* lead in perpetuating the "entire fairness" test with its two aspects of fair price and fair dealing. Significantly, however, *Alpert* disagreed with *Weinberger's* rejection of the business purpose rule.¹⁷⁷ In doing so, the court noted that a majority shareholder must treat all shareholders equally and also must provide good, prudent management of the corporation; otherwise he has breached his fiduciary duty.¹⁷⁸ "When a breach of fiduciary duty occurs, that action will be considered unlawful and the aggrieved shareholder may be entitled to equitable relief."¹⁷⁹ Based on its entire fairness analysis and its application of the business purpose test as a separate independent standard, the New York Court of Appeals found no breach of fiduciary duty by the controlling shareholder and upheld the transaction.¹⁸⁰ According to the court, full disclosure of all material information to

173. N.Y. BUS. CORP. LAW § 623(k) (McKinney 1986); see *supra* note 96.

174. 63 N.Y.2d 557, 473 N.E.2d 19, 483 N.Y.S.2d 667 (1984).

175. *Id.* at 566-67, 473 N.E.2d at 24, 483 N.Y.S.2d at 672.

176. See *supra* text accompanying notes 131-57 for a discussion of *Weinberger*.

177. *Alpert*, 63 N.Y.2d at 572-73, 473 N.E.2d at 28, 483 N.Y.S.2d at 676-77.

178. *Id.* at 572, 473 N.E.2d at 28, 483 N.Y.S.2d at 676.

179. *Id.* at 569, 473 N.E.2d at 26, 483 N.Y.S.2d at 674 (emphasis added).

180. *Id.* at 574, 473 N.E.2d at 29, 483 N.Y.S.2d at 677. In *Alpert*, the majority shareholders sold their interests in 79 Realty Corp. to the defendant for a price equal to their proportionate ownership in the corporation's major asset, a New York City office building. *Id.* at 563, 473 N.E.2d at 22, 483 N.Y.S.2d at 670. Significantly, defendants promised the former owners to purchase the minority shareholders' stock under the same terms within four months. *Id.* Defendants kept their promise, seeking to cash-out the minority shareholders at this previously negotiated arm's-length price. *Id.* at 566, 473 N.E.2d at 24, 483 N.Y.S.2d at 672. In undertaking to consummate the merger, defendants disclosed all relevant procedural and financial aspects of the merger, including their conflict of interest and their plan to cash-out plaintiffs, as well as their ultimate goal to dissolve 79 Realty Corp., the target corporation, after the merger and thereafter operate it as a partnership. *Id.* at 564, 473 N.E.2d at 22-23, 483 N.Y.S.2d at 671. Minority shareholders sued, alleging among other things, that the merger had no legitimate business purpose. *Id.* at 564-65, 473 N.E.2d at 23, 483 N.Y.S.2d at 671. The plaintiffs further contended that "essential financial information was not disclosed and that the value offered for the minority shares was understated and determined in an unfair manner." *Id.*

plaintiffs, who also had access to corporate books,¹⁸¹ satisfied the fair dealing aspect of the test. Similarly, because the stock purchase price was tied to the fair market value of the office building, which greatly exceeded the stock's book value and the corporation's past and present earnings,¹⁸² the court concluded that the plaintiffs received a fair price.¹⁸³

The court then stated that "[f]air dealing and fair price alone will not render the merger acceptable. . . . There exists a fiduciary duty to treat all shareholders equally."¹⁸⁴ The court acknowledged that in a cash-out merger the majority treats the minority differently: the majority enjoys continued equity participation in the surviving corporation, while minority shareholders must surrender their shares for cash.¹⁸⁵ Despite the fiduciary duty to treat all shareholders equally, the "majority shareholders . . . have an overriding duty to provide good and prudent management."¹⁸⁶ Thus, "'departure from precisely uniform treatment of stockholders may be justified . . . where a bona fide business purpose indicates that the best interest of the corporation would be served.'"¹⁸⁷ The New York Court of Appeals declined to follow the Delaware Supreme Court and retained the business purpose rule.¹⁸⁸ Applying the business purpose test to *Alpert*, the court found that defendants' claimed purpose of attracting additional capital to effect needed repairs to the building was sufficient.¹⁸⁹

The *Alpert* decision, handed down after *Weinberger*, is New York's interpretation of the exclusivity "formula" as followed by the Revised Model Act. Notably, the *Alpert* opinion retains the business purpose rule in its interpretation of the "unlawful or fraudulent" language. This interpretation adds more complexity to the exclusivity issue, given the dichotomy set up by the Revised Model Act's use of the New York language and its reference in commentary to *Weinberger*.¹⁹⁰ The decision also sets clear precedent that a breach of fiduciary duty,

181. *Id.* at 574, 473 N.E.2d at 29, 483 N.Y.S.2d at 677.

182. *Id.* at 566, 473 N.E.2d at 24, 483 N.Y.S.2d at 672.

183. In addition, the price offered to the plaintiffs equalled the price offered to the former majority shareholder, and, as such, represented arm's-length negotiations. *Id.*

184. *Id.* at 572, 473 N.E.2d at 27-28, 483 N.Y.S.2d at 676.

185. *Id.* at 572, 473 N.E.2d at 28, 483 N.Y.S.2d at 676.

186. *Id.*

187. *Id.* (quoting *Schwartz v. Marien*, 37 N.Y.2d 487, 492, 335 N.E.2d 334, 338, 373 N.Y.S.2d 122, 126 (1975)).

188. The *Alpert* court stated that the rule requires a finding that "some" business purpose exists that "confer[s] some general gain upon the corporation." *Id.* at 573, 473 N.E.2d at 28, 483 N.Y.S.2d at 676. However, the purpose need not be a "strong and compelling" one. *Id.* at 565, 473 N.E.2d at 23, 483 N.Y.S.2d at 671. Moreover, such a finding will not be defeated merely by the fact that the corporate objective could have been accomplished in another way. *Id.* at 573, 473 N.E.2d at 28, 483 N.Y.S.2d at 676-77; see also *Leader v. Hycor*, 395 Mass. 215, 479 N.E.2d 173 (1985) (court placed an additional burden on the minority shareholder by stating that once the majority shareholder demonstrated such a purpose, the minority shareholder must then show that the majority shareholder could have achieved the same objective through an alternative method less harmful to minority shareholders).

189. Defendant offered several business purposes behind its two-step merger and eventual dissolution of the corporation into a partnership, one of which was the tax advantage of operating the business as a partnership. *Alpert*, 63 N.Y.2d at 566, 473 N.E.2d at 23-24, 483 N.Y.S.2d at 672.

190. See *supra* note 102.

as determined by the entire fairness and business purpose rules, is "unlawful" and entitles a minority shareholder to equitable relief beyond the appraisal remedy.

3. States Adopting the Revised Model Act's Appraisal Exclusivity Provision

Since the Revised Model Act was adopted in 1984 by the American Bar Association, twelve states have adopted some version of the Revised Model Act's appraisal exclusivity provision.¹⁹¹ Nine states have incorporated verbatim the Revised Model Act's specific statutory language limiting the dissenting shareholder to an appraisal proceeding unless "unlawful or fraudulent" actions occur. An examination of how the remaining three states have treated the Revised Model Act's exclusivity provision reveals stridently different approaches.

Indiana's statute has an *absolute* exclusivity provision which omits the "unlawful or fraudulent" language found in the Revised Model Act.¹⁹² By deleting that language, the Indiana Legislature expressly rejected¹⁹³ the Indiana Supreme Court's decision in *Gabhart v. Gabhart*.¹⁹⁴ *Gabhart* had interpreted former Indiana law as allowing a merger to be attacked if done without a "valid purpose," notwithstanding the language of Indiana's former exclusivity provision.¹⁹⁵

191. To date, sixteen state legislatures have adopted the Revised Model Act's provisions regarding dissenters' rights, forcing each to consider the exclusivity provision found in § 13.02(b). Of these, twelve state legislatures adopted some form of the provision. The following state statutes contain the specific "unlawful or fraudulent" language: ARK. STAT. ANN. § 4-27-1302(B) (Supp. 1989); FLA. STAT. ANN. § 607.1302(5) (West Supp. 1990); IOWA CODE § 490.1302(2) (Supp. 1990); KY. REV. STAT. ANN. § 271B.13-020(2) (Michie 1989); MICH. COMP. LAWS ANN. § 450.1762(3) (West 1990); MISS. CODE ANN. § 79-4-13.02(b) (1989); OR. REV. STAT. § 60.554(2) (Supp. 1990); TENN. CODE ANN. § 48-23-102(b) (1988); VA. CODE ANN. § 13.1-730(B) (1989); WYO. STAT. § 17-16-1302(b) (1989). On April 23, 1990, Wisconsin enacted major revisions to its corporate laws to be effective January 1, 1991. The new Act substantially follows the Revised Model Act. In its appraisal exclusivity provision, Wisconsin follows the "unlawful or fraudulent" exception to the exclusivity found in the Revised Model Act. Wisconsin includes an additional exception, however, which references the power of the court to grant equitable relief for shareholders of statutory close corporations. See Act of April 23, 1990, No. 303, § 180.1302, 1990 Wis. Legis. Serv. 1855, 1924-25 (West). On July 13, 1990, the Missouri legislature made substantial revisions to its corporate code, one of which was to adopt the "unlawful or fraudulent" language as in the Revised Model Act's appraisal exclusivity provision. Act of July 13, 1990, § 351.875(2), 1990 Mo. Legis. Serv. 1310, 1336 (Vernon). Two state statutes contain the Revised Model Act's exclusivity provision with some variation of the "unlawful or fraudulent" language. GA. CODE ANN. § 14-2-1302(b) (1989) (unless non-compliance with "procedural requirements . . . or the vote required to obtain approval of the corporate action was obtained by fraudulent and deceptive means" (emphasis added)); WASH. REV. CODE § 23B.13.020(2) (Supp. 1990) (unless the corporate action fails to comply with "procedural requirements . . . or is fraudulent" (emphasis added)). The Indiana statute contains the Revised Model Act's exclusivity provision but omits the "unlawful or fraudulent" language, making the appraisal remedy exclusive. IND. CODE § 23-1-44-8(c) (1989). The South Carolina statute adopts the Revised Model Act's provisions on dissenters' rights that delineate which corporate actions give rise to the right of dissent and appraisal, but it omits the exclusivity provision altogether. S.C. CODE ANN. § 33-13-102 reporters' comments (Law. Co-op. 1990).

192. IND. CODE § 23-1-44-8(c) (1989). "A shareholder . . . [w]ho is entitled to dissent and obtain payment for the shareholder's shares under this chapter . . . may not challenge the corporate action creating . . . the shareholder's entitlement." *Id.*

193. *Id.*, official comment.

194. 267 Ind. 370, 370 N.E.2d 345 (1977) (holding that a minority shareholder could challenge a cash-out merger as a "de facto" dissolution if the merger lacked a "valid purpose," construed by the court to mean "a purpose intended to advance a corporate interest").

195. When *Gabhart* was decided, the exclusivity provision provided that "[e]very shareholder who did not vote in favor of such merger or exchange and who does not object in writing and

Although *Gabhart* recognized the business purpose test, it rejected the then-leading Delaware case of *Singer v. Magnavox Company*¹⁹⁶ as too expansive in its application of the entire fairness test. The court stated that "[w]e do not believe the judiciary should intrude into corporate management to that extent."¹⁹⁷ Although Indiana's judicial standard of review incorporated the business purpose test for mergers but not the entire fairness test, the new statute makes the provision absolutely exclusive. The new statute excludes both tests and absolutely prohibits an equitable injunction.¹⁹⁸

The Indiana Commission explained the statutory reversal of *Gabhart* in its official comments by stating that the *Gabhart* decision created "substantial uncertainty" and disrupted corporate transactions that otherwise were authorized by law.¹⁹⁹ Described in the official comments as a "categorical statutory rule" that dissenting shareholders may not challenge the corporate action *period*, Indiana's appraisal exclusivity provision is intended as an absolutely exclusive, non-challengeable appraisal remedy.²⁰⁰

At the other extreme is the South Carolina legislature's treatment of the appraisal exclusivity issue. Although the statute follows the Revised Model Act in providing dissenting shareholders with an appraisal remedy, it does not incorporate the Revised Model Act's exclusivity provision to limit the availability of the appraisal remedy in any way.²⁰¹ Stating in its official comments that such an inclusion was "undesirable,"²⁰² the South Carolina legislature opted for a non-exclusive appraisal remedy.

A final illustration of the differences among the jurisdictions that adopted

demand payment of the value of his shares at the time and in the manner aforesaid shall be conclusively presumed to have assented to such merger or exchange." IND. CODE § 23-1-5-7 (1972) (replaced by IND. CODE § 23-1-44-8(c) (1989)).

196. 380 A.2d 969 (Del. 1977), *overruled by* *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983).

197. *Gabhart*, 267 Ind. at 388, 370 N.E.2d at 356 (emphasis added).

198. However, one commentator argues that where the minority shareholder is an owner and employee in a closely-held corporation, the Indiana courts may be inclined to protect his active investor/employee's expectation interests when the majority has breached its fiduciary duty. Note, *Dissenting Shareholders' Rights Under the Indiana Business Corporation Act: Jurisprudential Interpretations of the Exclusivity Provision*, 21 IND. L. REV. 931, 946-54 (1988).

199. The official comments to the Indiana Code revealed that the legislators:

believed the [*Gabhart*] decision created substantial uncertainty about whether and to what extent minority shareholders could seek to enjoin or undo corporate transactions authorized by statute and approved by the majority. Given the potential for disruption of corporate transactions [under the *Gabhart*] rule, the General Assembly adopted subsection (c) as a categorical statutory rule that shareholders entitled to dissenters' rights may *not* challenge the corporate action creating that entitlement.

IND. CODE § 23-1-44-8(c) official comments (1989).

200. *But see* Note, *supra* note 198, at 948-50 ("Indiana courts place a high value upon fiduciary duty between both directors and shareholders," so that an active shareholder in a close corporation may persuade a court to protect his shareholder expectations and enjoin a cash-out merger where a majority shareholder breaches his fiduciary duty or makes misrepresentations.).

201. S.C. CODE ANN. § 33-13-102 (Law. Co-op. 1990); *see supra* text accompanying note 94.

202. The South Carolina reporters' comments state:

Subsection (b) of the 1984 Model Act section contains a provision attempting to limit judicial scrutiny of corporate actions that give rise to dissenters' rights. There was nothing similar in prior South Carolina law, and it is not included in the new provision because it would probably be largely ineffective and is undesirable.

S.C. CODE ANN. § 33-13-102 reporters' comments 2 (Law. Co-op. 1990).

the Revised Model Act's exclusivity provision is Georgia's statute, which adopts a compromise position between absolute exclusivity and non-exclusivity. Although not using the Revised Model Act's "unlawful or fraudulent" language, the Georgia provision retained these two exceptions to exclusivity by clearly specifying the meaning of these terms.²⁰³

In its original enactment of the Revised Model Act's exclusivity provision, the Georgia legislature limited the term "unlawful" to procedural violations of corporate law only.²⁰⁴ This alteration was the only material modification to the Revised Model Act language until the Georgia legislature later amended the statute to similarly limit the term "fraudulent."

In its original language, the Georgia exclusivity provision precluded minority shareholders from claiming that any action constituting a fiduciary breach was "unlawful." As emphasized in the official comments to the 1988 original enactment, the "fact that the merger might be . . . unlawful as a breach of the directors' duty of care is not ground for equitable relief at the instance of a shareholder."²⁰⁵ Thus, the Georgia lawmakers chose to limit unlawfulness explicitly to strictly procedural violations.

Although the Georgia legislature took pains to limit its original enactment of the Revised Model Act's term "unlawful" to procedural corporate violations, the term "fraudulent" remained intact. One year later, however, Georgia lawmakers amended this section²⁰⁶ by replacing the word "fraudulent" with language specifying "the nature of 'fraud' that would permit collateral challenges to the corporate action."²⁰⁷ By limiting fraud to circumstances surrounding the approval vote, Georgia legislators restricted fraud to procedural matters,

203. Georgia's exclusivity provision presently provides that:

A shareholder entitled to dissent and obtain payment for his shares under this article may not challenge the corporate action creating his entitlement unless the corporate action fails to comply with procedural requirements of this chapter or the articles of incorporation or bylaws of the corporation or the vote required to obtain approval of the corporate action was obtained by fraudulent and deceptive means, regardless of whether the shareholder has exercised dissenter's rights.

GA. CODE ANN. § 14-2-1302(b) (1989).

204. As originally enacted, the exclusivity provision provided in pertinent part that "[a] shareholder . . . may not challenge the corporate action creating his entitlement unless the action fails to comply with procedural requirements of this chapter or the articles of incorporation or bylaws of the corporation or is fraudulent with respect to the shareholder or the corporation." Act of April 7, 1988, § 14-2-1302(b), 1988 Ga. Laws 1203 (codified at GA. CODE ANN. § 14-2-1302(b) (1989)).

205. GA. CODE ANN. § 14-2-1302 official comments (Special Pamphlet 1988). The Georgia official comments elaborate:

If the corporation attempts an action in violation of the corporation law on voting, in violation of clauses in articles of incorporation prohibiting it, or by deception of shareholders—to take some examples—the court's freedom to intervene should be unaffected by the presence or absence of dissenters' rights under this article.

GA. CODE ANN. § 14-2-1302 official comments (1989).

Significantly, the official comments to the Georgia Code deleted the reference to "breach of fiduciary duty" in the official comments to the Revised Model Act. Compare REVISED MODEL ACT § 13.02(b) official comment 2 (contains reference to breach of fiduciary duty) with GA. CODE ANN. § 14-2-1302 official comments (1989) (deletes breach of fiduciary duty reference).

206. Act of April 10, 1989, § 58, 1989 Ga. Laws 998 (codified at GA. CODE ANN. § 14-2-1302(b) (1989)). For specific text of exclusivity provision, see *supra* note 203.

207. GA. CODE ANN. § 14-2-1302 official comments (1989).

as seen earlier in the "unlawful" limitation.²⁰⁸ Furthermore, by using "fraudulent and deceptive," Georgia lawmakers limited the term "fraud" to "actual fraud," thereby foreclosing the possible argument that a director's breach of fiduciary duty constitutes "constructive fraud," entitling a minority shareholder to equitable relief.²⁰⁹

By restricting the "fraudulent" language to actual deceptive fraud and thereby eliminating constructive fraud and breach of fiduciary duty arguments under the statute, Georgia's exclusivity statute parallels the *Santa Fe Industries, Inc. v. Green*²¹⁰ decision. In *Santa Fe*, the United States Supreme Court declared that a mere breach of fiduciary duty, in the absence of any misrepresentation or nondisclosure, does not constitute securities fraud actionable under rule 10b-5.²¹¹ The court held that a parent corporation, owning ninety-five percent

208. See *supra* note 204 and accompanying text.

209. The official comments explain that:

Because fraud can be 'actual fraud' that involves deception, or 'constructive fraud,' in equity, that involves some claim of a breach of a fiduciary duty, litigants in some cases have been permitted to use 'fraud' claims, which are in essence claims that a fiduciary has acted unfairly, to litigate valuation issues that are appropriately disposed of in appraisal proceedings. Accordingly, the 1989 amendment made it clear that only 'actual fraud,' involving traditional notions of deception, permits collateral attack on the corporate action.

GA. CODE ANN. § 14-2-1302(b) official comments (1989).

The official comments also explain that Georgia follows the approach, but not the language, of the California exclusivity provision, which makes appraisal exclusive "except in an action to test whether the number of shares required to authorize or approve the reorganization have been legally voted." *Id.* (quoting CAL. CORP. CODE § 1312(a) (West Supp. 1989)).

210. 430 U.S. 462 (1977). For an excellent discussion of *Santa Fe*'s significance and an overview of the cases developing its holding that constructive fraud does not constitute securities fraud under rule 10b-5, see Hazen, *Corporate Mismanagement and the Federal Securities Act's Antifraud Provisions: A Familiar Path with Some New Detours*, 20 B.C.L. REV. 819, 819-844 (1979). See also Note, *Pleading Constructive Fraud in Securities Litigation—Avoiding Dismissal for Failure to Plead Fraud With Particularity*, 33 EMORY L.J. 517 (1984); *Suits for Breach of Fiduciary Duty under Rule 10b-5 After Santa Fe Industries Inc. v. Green*, 91 HARV. L. REV. 1874 (1978); Note, *Rule 10b-5: The Circuits Debate the Exclusivity of Remedies, the Purchaser-Seller Requirement, and Constructive Deception*, 37 WASH. & LEE L. REV. 877 (1980).

211. *Santa Fe*, 430 U.S. at 474. Section 10 of the Securities Exchange Act of 1934, 15 U.S.C. § 78j (1982), provides in relevant part:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange . . .

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Id.

Rule 10b-5, 17 C.F.R. § 240.10b-5 (1990) provides in relevant part:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as fraud or deceit upon any person in connection with the purchase or sale of any security.

of its subsidiary, did not violate rule 10b-5 when it acquired the remaining five percent of the shares in a short-form, cash-out merger. The merger was accomplished in accordance with state law procedural requirements without any misrepresentation or material nondisclosure.²¹² The plaintiff minority shareholder alleged that he was paid a "wholly inadequate" price in a manner constituting fraud under rule 10b-5.²¹³ However, the court found that a transaction, in which the majority shareholder disclosed all lawfully required information, is not within the scope of rule 10b-5's prohibition of "manipulative" or "deceptive" practices, even though the transaction was unfair or might constitute constructive fraud for breach of fiduciary duty.²¹⁴ The Supreme Court declined to read rule 10b-5 more broadly so as "to regulate transactions which constitute no more than internal corporate mismanagement."²¹⁵ The Court further noted that although state law traditionally has governed internal corporate affairs, a uniform federal fiduciary standard may be needed to govern such mergers.²¹⁶

Santa Fe eliminates non-deceptive fiduciary breaches from rule 10b-5 coverage.²¹⁷ The explicit language of rule 10b-5 regulates "manipulative or deceptive" conduct and, by its narrow definition, extends only to actual fraud, not to

Id.

212. Under Delaware's short-form merger statute as interpreted in *Stauffer* (at the time of *Santa Fe*, the *Singer* trilogy had not been handed down) the minority shareholders were compelled to sell their remaining 5% of the shares back to the merged corporation and were relegated to a court review of the offered price in an appraisal proceeding as their only remedy. *Stauffer v. Standard Brands, Inc.*, 41 Del. Ch. 7, 187 A.2d 78, (1962), *overruled by* *Roland Int'l Corp. v. Najjar*, 407 A.2d 1032 (Del. 1979), *overruled by* *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983). Plaintiffs in *Santa Fe* did not pursue their appraisal remedy in the Delaware courts, but sued in federal court under a rule 10b-5 theory, seeking to have the merger set aside or to recover what they claimed to be the fair value of the shares. *Santa Fe*, 430 U.S. at 466-67. Plaintiffs attacked the merger price as "wholly inadequate" because it was based on a "fraudulent appraisal" of the stock at \$100 per share, obtained by *Santa Fe* after it knew the fair market value of the company's assets had been appraised at \$772 per share. *Id.* at 467. However, the Court found that the majority had made full and fair disclosure of these and all other relevant facts such that rule 10b-5 was not violated. *Id.* at 474.

213. *Id.* at 467.

214. *Id.* at 470-74, 477. Noting that the words "manipulative or deceptive" appear in the statute, the Court declared, with regard to "manipulative":

No doubt Congress meant to prohibit the full range of ingenious devices that might be used to manipulate securities prices. But we do not think it would have chosen this "term of art" if it had meant to bring within the scope of § 10(b) instances of corporate mismanagement such as this, in which the essence of the complaint is that shareholders were treated unfairly by a fiduciary.

Id. at 477. Regarding "deceptive," the Court stated:

To the extent that the [lower court] would rely on the use of the term "fraud" in Rule 10b-5 to bring within the ambit of the Rule all breaches of fiduciary duty in connection with a securities transaction, its interpretation would . . . 'add a gloss to the operative language of the statute quite different from its commonly accepted meaning.'

Id. at 472 (quoting *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 199 (1976)).

215. *Id.* at 479 (quoting *Superintendent of Ins. v. Bankers Life & Casualty Co.*, 404 U.S. 6, 12 (1971)).

216. *Id.* at 479-80. Commentators suggest that this comment spurred Delaware, among other states, to reevaluate its lax enforcement of directors and controlling shareholders' fiduciary duties in mergers. See authorities cited *supra* note 108.

217. *Goldberg v. Meridor*, 567 F.2d 209, 218 (2d Cir. 1977) (nondisclosure of a fiduciary breach itself constitutes a violation of rule 10b-5 if an injunction might have been obtained in state court to prevent the alleged breach, had it been disclosed), *cert. denied*, 434 U.S. 1069 (1978). See Note, *Goldberg v. Meridor: The Second Circuit's Resurrection of Rule 10b-5 Liability for Breaches of Corporate Fiduciary Duties to Minority Shareholders*, 64 VA. L. REV. 765 (1978).

constructive fraud.²¹⁸ Fiduciary breaches constituting constructive fraud are fraudulent but are not *deceptive* and cannot be outlawed under rule 10b-5.

The Georgia legislature acknowledged in its official comments that fiduciary breaches entail constructive fraud, but like the United States Supreme Court's *Santa Fe* interpretation limiting rule 10b-5 to actual deception, restricted the term "fraudulent" under the Revised Model Act's appraisal exclusivity provision to actual deception.²¹⁹ In sum, Georgia limits both exceptions to procedural matters: (1) unlawfulness is restricted to procedural violations of the corporate code, corporate charter or bylaws; (2) fraud is restricted to procedure by language requiring that the merger approval vote not be obtained by fraudulent and deceptive means. Thus, the Georgia exclusivity statute precludes a minority shareholder from enjoining a merger based on the argument that a fiduciary breach by the directors or controlling shareholder is either unlawful or fraudulent.

4. States That Have Not Adopted the Revised Model Act

Many states that have not adopted the Revised Model Act have an appraisal exclusivity provision in their corporate codes paralleling the Revised Model Act's terms. Among these, Massachusetts is noteworthy.²²⁰ The Supreme Judicial Court of Massachusetts clarified the standard of review that applies in evaluating cash-out mergers under the Massachusetts statute in *Coggins v. New England Patriots Football Club*.²²¹ The court considered this issue after *Weinberger* and rejected Delaware's deletion of the independent business purpose test but retained Delaware's delineation of the entire fairness test.²²²

218. *Schreiber v. Burlington Northern, Inc.*, 472 U.S. 1, 7-8 (1985) (By the United States Supreme Court's statement interpreting its past decisions pertaining to the term "manipulative" in rule 10b-5 as requiring "misrepresentation" or nondisclosure, the Court arguably reads the term "manipulative" out of the rule.).

219. See *supra* text accompanying notes 213-14.

220. The Massachusetts exclusivity statute provides that:

The enforcement by a stockholder of his right to receive payment for his shares . . . shall be an exclusive remedy except that this chapter shall not exclude the right of such stockholder to bring or maintain an appropriate proceeding to obtain relief on the ground that such corporate action will be or is illegal or fraudulent as to him.

MASS. GEN. L. ch. 156B, § 98 (1979).

221. 397 Mass. 525, 492 N.E.2d 1112 (1986). In *Coggins* the minority shareholder was the owner of ten shares of nonvoting common stock. *Id.* at 529, 492 N.E.2d at 1115. Being an avid Patriots fan, however, he was enraged when the 100% voting stock shareholder of the New England Patriots attempted to cash him out. *Id.* at 527, 492 N.E.2d at 1114. He desired only to void the merger nearly ten years after it was consummated. *Id.* at 529, 535, 492 N.E.2d at 1115-16, 1119. The Patriots owner, having taken on significant personal debt in acquiring 100% ownership, undertook the cash-out merger in an attempt to reorganize the Patriots so that the corporation would be devoted to the repayment of these personal loans. *Id.* at 526-28, 492 N.E.2d at 1114-15. This, in effect, was the purpose underlying the elimination of the nonvoting shares in the cash-out merger.

222. The court stated:

We note that the "fairness" test to which the Delaware court now has adhered [*in Weinberger*] is . . . closely related to the views expressed in our decisions. Unlike the Delaware court [*in Weinberger*], however, we believe that the "business-purpose" test is an additional useful means under our statutes and case law for examining a transaction in which a controlling stockholder eliminates the minority interest in a corporation. This concept of fair dealing is not limited to close corporations but applies to judicial review of cash freeze-out mergers.

Declaring that "the dangers of self-dealing and abuse of fiduciary duty are greatest in freeze-out situations,"²²³ the court held that the motives and behaviors of the controlling shareholder should be examined with closest scrutiny under the entire fairness and business purpose tests to assure that the controlling shareholder does not violate fiduciary principles governing the relationship between the majority and minority.²²⁴ Citing *Pupecki v. James Madison Corporation*²²⁵ and *Leader v. Hycor, Inc.*²²⁶ among other precedent cases, the court further held that "[t]he court is justified in exercising its equitable power when a violation of fiduciary duty is claimed."²²⁷

As to the instant case, the court found no legitimate business purpose because the owner had intended only to benefit himself personally as majority shareholder.²²⁸ Therefore, the court did not need to deliberate further over the elements of fairness for a transaction without a valid corporate purpose.²²⁹ Essentially, the business purpose test operated as a threshold hurdle that controlling shareholders had to scale in addition to the "entire fairness" test. The court awarded rescissory damages for a merger that had occurred ten years earlier.²³⁰

C. Close Corporation Minority Shareholders: A Special Breed

Under the new Act, the right of dissent and appraisal exists for shareholders who resist certain fundamental corporate changes.²³¹ As the Drafting Committee acknowledged, the predicament of the close corporation shareholder merits special consideration in evaluating the exclusiveness and appropriateness of the appraisal remedy.²³² Any legal and equitable rights given to dissenting shareholders under the new Act take on added significance in protecting the rights and interests of close corporation minority shareholders because these shareholders are particularly susceptible to being squeezed out by the controlling shareholder.²³³ Forced liquidation of the minority's shares by the control-

Id. at 531, 492 N.E.2d at 1117 (citations omitted).

223. *Id.* at 532, 492 N.E.2d at 1117.

224. *Id.* at 533, 492 N.E.2d at 1117-18.

225. 376 Mass. 212, 216-17, 382 N.E.2d 1030, 1033 (1978) (when controlling shareholder failed to assure that corporation received adequate consideration for its assets, transaction was illegal or fraudulent and appraisal exclusivity provision did not foreclose review).

226. 395 Mass. 215, 221, 479 N.E.2d 173, 177 (1985) (judicial review is appropriate for claims of breach of fiduciary duty and unfairness).

227. *Coggins*, 397 Mass. at 532, 492 N.E.2d at 1117.

228. *Id.* at 534-35, 492 N.E.2d at 1118-19.

229. *Id.* at 535, 492 N.E.2d at 1119.

230. *Id.* at 535-37, 492 N.E.2d at 1119-20.

231. N.C. GEN. STAT. § 55-13-02(a)(1)-(5) (1990).

232. See *supra* note 52 and accompanying text.

233. O'Neal, *Oppression of Minority Shareholders: Protecting Minority Rights*, 35 CLEV. ST. L. REV. 121, 121-39 (1986-87) [hereinafter *Protecting Minority Rights*]; see also O'NEAL'S CLOSE CORPORATIONS, *supra* note 10, § 8.07 (discussing various direct and indirect methods by which controlling shareholders squeeze out minority shareholders from close corporations, the disadvantage of illiquidity in a close corporation, and the fact that "relationships which often exist among participants in a close corporation increase the potential for a squeeze-out"). See generally F. O'NEAL & R. THOMPSON, O'NEAL'S OPPRESSION OF MINORITY SHAREHOLDERS, ch. 2 (2d ed. 1985) [hereinafter O'NEAL'S OPPRESSION OF MINORITY SHAREHOLDERS] (discussing various reasons underlying squeeze-outs).

ling shareholder has been characterized as "private eminent domain."²³⁴ As one commentator explained, "[t]he forced taking of one person's property by another, even at a fair price, is a substantial invasion of property ownership rights."²³⁵ Allowing the majority shareholder to elect at any time to buy out the minority shareholder may unfairly burden the minority shareholder.

Because the stock of a close corporation, by definition, is not publicly traded, the close-corporation shareholder suffers illiquidity risks that a shareholder of a public corporation does not.²³⁶ In the close corporation context when the majority shareholder forces out the minority shareholders, the close-corporation shareholder has no ready market price by which to value his shares.²³⁷ In addition to suffering from the illiquidity and valuation difficulties created by its lack of a public market, the equity investment of a close-corporation shareholder differs in nature from that of a publicly traded corporation shareholder.²³⁸ Often ownership in the corporation is not just another investment for the close-corporation shareholder but is a major commitment of his personal capital.²³⁹ A close-corporation shareholder typically will be involved heavily in the daily activities of the company as officer, employee, or director.²⁴⁰ Indeed, he may wear any or all of these hats, while the publicly traded corporation shareholder typically wears none.²⁴¹ The dividends or the salary the close

234. Vorenberg, *supra* note 96, at 1191.

235. Hetherington, *Defining the Scope of Controlling Shareholders' Fiduciary Responsibilities*, 22 WAKE FOREST L. REV. 9, 31 (1987).

236. See *Protecting Minority Rights*, *supra* note 233, at 123; O'NEAL'S OPPRESSION OF MINORITY SHAREHOLDERS, *supra* note 233, § 2:15; see also Meiselman v. Meiselman, 309 N.C. 279, 291, 307 S.E.2d 551, 559 (1983) ("[T]he illiquidity of a minority shareholder's interest in a close corporation renders him vulnerable to exploitation by the majority shareholders.").

237. O'NEAL'S CLOSE CORPORATIONS, *supra* note 10, § 1.07, at 26-27. Related to valuation difficulties is the controversial issue of whether a controlling or majority shareholder who cashes out the minority shareholder in a freeze-out merger can price the cash-out transaction at a valuation that adjusts the minority shares for the so-called "minority discount." See Note, *supra* note 38, at 280 (concluding that "[w]ithout the minority discount, the appraisal remedy more effectively safeguards against bad faith and coercion by majority shareholders"). A "minority discount" is an adjustment to the pro-rata value of shares that lowers the value of the minority block because the minority shareholders lack corporate decision-making power over corporate policy, the payment of dividends, and employment compensation, among other factors. *Id.* at 260; Harris, *Valuation of Closely Held Partnerships and Corporations: Recent Developments Concerning Minority Interests and Lack of Marketability Discounts*, 42 ARK. L. REV. 649, 660 (1989). See Comment, *Valuing Closely Held Stock: Control Premiums and Minority Discounts*, 31 EMORY L.J. 139, 145 (1982).

Because the "minority discount" issue arises in valuing both public and close corporation shares, a close corporation shareholder effectively suffers two discounts: a "minority discount," because the shares do not give the buyer a controlling interest in the enterprise, and a "marketability discount," another adjustment made specifically to closely held shares because of the illiquidity risks inherent in such stock. "The discount for lack of marketability is distinct from the minority interest discount, even though judicial decisions sometimes blur the two." Harris, *supra*, at 659.

238. Comment, *The Strict Good Faith Standard—Fiduciary Duties to Minority Shareholders in Close Corporations*, 33 MERCER L. REV. 595, 595 (1982); Note, *Oklahoma Close Corporations: A Need to Recognize Shareholder Expectations*, 11 OKLA. CITY U.L. REV. 357, 360 (1986).

239. Bulloch, *Heightened Fiduciary Duties in Closely Held Corporations: Donahue Revisited*, 16 PAC. L.J. 935, 938 (1985); see *Donahue v. Rodd Electrotype Co. of New England, Inc.*, 367 Mass. 578, 585-86, 328 N.E.2d 505, 511 (1975).

240. See Comment, *supra* note 238, at 595-96; Note, *Close Corporations: Strict Good Faith Fiduciary Duty Applied to Controlling Stockholders*, 38 LA. L. REV. 214, 215 (1977).

241. See Comment, *supra* note 238, at 596 (In a public corporation the board of directors, as management, sets the business policy and oversees daily operations of the company while the share-

corporation shareholder receives often represents his major source of income.²⁴²

Two additional concerns common to all minority shareholders generally plague the close corporation shareholder: tax liability and search costs. First, the majority shareholder in buying out the minority forces the minority to realize any tax gains or losses on the sale of his shares at possibly an unfavorable time.²⁴³ Furthermore, a cash-out merger effected by the majority forces the minority to incur the inconvenience and search costs of finding an alternative, but equally satisfying investment.²⁴⁴

Because of the vulnerability of the close corporation shareholder, general common-law principles recognize that the controlling shareholder of a close corporation owes the minority shareholder a *higher*²⁴⁵ fiduciary duty than usual. This duty requires that the majority or controlling shareholders "exercise good faith, care and diligence" to make the property of the corporation produce the largest possible amount, [and] to protect the interests of the [minority shareholder]" by securing and paying over to them "their just proportion of the

holders, as owners, have the right to vote at shareholders' meetings and potentially veto actions taken by directors on fundamental corporate matters.).

242. See Comment, *supra* note 238, at 595; Note, *supra* note 240, at 215; see also Note, *A Statutory Proposal Protecting Employment Expectations of a Close Corporation's Minority Shareholders*, 63 WASH. U. L.Q. 545, 547 (1985) [hereinafter Note, *Protecting Employment Expectations*] (The minority shareholder often expects the corporation to employ him on a full-time basis; if discharged, he may lose his means of livelihood as well as his investment in the company.).

243. Hetherington, *supra* note 235, at 31 (discussing tax liability and search costs incurred by both close and public corporation shareholders). The Drafting Committee also discussed tax liability in trying to craft the meaning of "fair value" under N.C. Gen. Stat. § 55-13-01(3) (1990). North Carolina Business Corporation Act Drafting Committee Minutes at 7 (December 21, 1987). The Drafting Committee considered providing that in a "squeeze-out, cash-out" situation the appraiser could consider . . . tax consequences and any collateral benefits the 'cashed out' shareholders derived from participation in the corporation's ownership." *Id.* However, the sentiment surfaced that "since the shareholder would eventually have to recognize a gain from the shares and be taxed on any gain, allowing for tax consequences [as a part of the fair value in a cash-out merger] would in effect overcompensate the shareholder." *Id.* Thus, the Drafting Committee finally agreed to leave the definition of "fair value" under N.C. Gen. Stat. § 55-13-01(3) as it appeared in the Revised Model Act. *Id.* at 10.

244. See Hetherington, *supra* note 235, at 31.

245. *Donahue v. Rodd Electrotypes Co. of New England, Inc.*, 367 Mass. 578, 593-94, 328 N.E.2d 505, 515-16 (1975) (contrasting the fiduciary duty that stockholders of a close corporation owe one another with the "somewhat less stringent standard of fiduciary duty to which directors and stockholders of all corporations must adhere"); see Bulloch, *supra* note 239, at 939, 955 (concluding that the *Donahue* case was "well reasoned and correctly decided because the *Donahue* court profoundly grasped the peculiarities of life in a closely held corporation" where the majority shareholders could use their power to "freeze out" the minority); see generally Comment, *supra* note 238, at 612-13 (discussing the expansion of fiduciary duty of close majority shareholders in *Donahue* to impose a fiduciary duty upon minority shareholders under *Smith v. Atlantic Properties, Inc.*, 12 Mass. App. Ct. 201, 422 N.E.2d 798 (1981) in their use of any veto power they enjoy). The North Carolina Supreme Court first applied a fiduciary duty to a majority shareholder of a close corporation in *Gaines v. Long Mfg. Co.*, 234 N.C. 340, 67 S.E.2d 350 (1951). In that case, a minority shareholder sought an injunction to prevent the proposed issuance of additional stock, which would have diluted his interest in the corporation. *Id.* at 344, 67 S.E.2d at 353. The court held that a complaint alleging that the majority shareholders failed to pay dividends to the minority shareholder to render his stock worthless and to freeze him out of the corporation stated a claim for breach of fiduciary duty, for which equitable relief was appropriate. *Id.* at 345-47, 67 S.E.2d at 354-55; see also Note, *Shareholder Agreements—Oral Agreements in Close Quarters*—Penley v. Penley, 22 WAKE FOREST L. REV. 147, 157 (1987) ("Because the by-laws and charters of many close corporations do not reflect the total business bargain, a higher standard of fiduciary duty is required to protect the minority shareholders.").

income and of the proceeds of the corporate property."²⁴⁶ In essence, the fiduciary duty proscribes self-serving conduct by controlling shareholders.²⁴⁷ The new North Carolina Business Corporation Act retains the fiduciary duty doctrine²⁴⁸ and the "reasonable expectations"²⁴⁹ doctrine the North Carolina Supreme Court adopted in *Meiselman v. Meiselman*,²⁵⁰ which both serve to protect the minority shareholder. Under the former judicial dissolution statute, the North Carolina Supreme Court in *Meiselman* held that the "rights or interests" of the minority shareholder that are protected by the court are his "reasonable expectations."²⁵¹ The court must "examin[e] the entire history of the partici-

246. *Gaines*, 234 N.C. at 338, 67 S.E.2d at 361 (quoting 13 AM. JUR. CORPORATIONS § 423 (1938)).

247. *Donahue*, 367 Mass. at 589, 328 N.E.2d at 513.

248. The express statutory mandate under former North Carolina law that "directors and officers shall be deemed to stand in a fiduciary relation to the corporation and to its shareholders" has been deleted from the new Act. See N.C. GEN. STAT. § 55-35 (1982) (replaced by N.C. GEN. STAT. § 55-8-30 (1990)). The drafters recommended that the North Carolina General Assembly follow the Revised Model Act's verbatim language on the issue of directors' standard of conduct, which has no reference to a "fiduciary" duty but instead codifies the business judgment rule. See *infra* notes 293-94 and accompanying text. The General Assembly deleted the word "fiduciary" from the new Act. However, the North Carolina Commentary to the new Act states that "there is 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." N.C. GEN. STAT. § 55-8-30 official comments. Thus, under the new Act, shareholders in a close corporation who also serve as officers or as directors of the company will continue to bear a fiduciary duty to the corporation and all its shareholders, including the minority shareholders. See *infra* text accompanying notes 293-301.

249. By deleting the Revised Model Act's "illegal, oppressive, or fraudulent" language, the general assembly retained the wording from North Carolina's former dissolution provision—"the rights or interests of the complaining shareholder"—which the North Carolina Supreme Court construed in *Meiselman v. Meiselman*, 309 N.C. 279, 307 S.E.2d 551 (1983), to mean the "reasonable expectations" of the shareholder. *Id.* at 296-300, 307 S.E.2d at 562-63. Compare N.C. GEN. STAT. § 55-125(a)(4) (1982) (replaced by N.C. GEN. STAT. § 55-14-30(2)(ii) (1990)) with N.C. GEN. STAT. § 55-14-30(2)(ii) (1990). For a good general discussion of the changes made by the general assembly to the new judicial dissolution provision and the effect upon the *Meiselman* decision, see Note, *Minority Shareholders' Rights in the Close Corporation Under the New North Carolina Business Corporation Act*, 68 N.C.L. REV. 1109, 1119-26 (1990). The Note observes that "[i]ncluding the language 'liquidation is reasonably necessary for the protection of the rights or interests of the complaining shareholder' in the new Act constitutes clear evidence of legislative intent to maintain the existing *Meiselman* standard." *Id.* at 1119.

250. 309 N.C. 279, 307 S.E.2d 551 (1983); see also Note, *Corporation Law—Meiselman v. Meiselman: "Reasonable Expectations" Determine Minority Shareholders' Rights*, 62 N.C.L. REV. 999, 1021-22 (1984) ("Like the reasonable expectations test, [the] fiduciary duty operates to protect minority interests by limiting the exercise of majority control. . . . [R]easonable expectations should include a fiduciary duty owed the minority by the majority."). Although the general assembly retained the "rights or interests" language as construed by the *Meiselman* decision, it deleted the alternate relief provision provided under the former N.C. Gen. Stat. § 125.1. This alteration may decrease the court's flexibility in giving effect to the reasonable expectations doctrine. See Note, *supra* note 249, at 1120 ("The final part of the *Meiselman* test—the requirement that the shareholder show that he 'is entitled to some form of equitable relief'—will change under the new Act.").

251. *Meiselman*, 309 N.C. at 301-06, 307 S.E.2d at 565-67. The "reasonable expectations" doctrine was followed by the New York Court of Appeals in *In re Kemp & Beatley, Inc.*, 64 N.Y.2d 63, 473 N.E.2d 1173, 484 N.Y.S.2d 799 (1984). The highest courts in Alaska, Montana, North Dakota and West Virginia also have adopted "reasonable expectations" as a guide to the meaning of "oppression" under their involuntary dissolution statutes while some states have codified judicial consideration of the shareholder's "reasonable expectations" in their dissolution statutes. O'NEAL'S CLOSE CORPORATIONS, *supra* note 10, ch. 9, § 9.30, at 142-43 (citing *Stefano v. Coppock*, 705 P.2d 443 (Alaska 1985); *Fox v. 7L Bar Ranch Co.*, 198 Mont. 201, 645 P.2d 929 (1982); *Balvik v. Sylvester*, 411 N.W.2d 383 (N.D. 1987); *Masinter v. WEBCO Co.*, 164 W. Va. 241, 262 S.E.2d 433 (1980)).

pants' relationship"²⁵² to ascertain the minority shareholder's "understandings, express or implied," as they developed and changed during the course of his dealings with the majority shareholder.²⁵³ Beyond the traditional expectation of increased share value, the *Meiselman* rule arguably protects reasonable expectations of continued employment as well.²⁵⁴ Thus, under a squeeze-play tactic²⁵⁵ in *Meiselman*, where the controlling shareholder's actions forced the minority shareholder to seek judicial intervention, the North Carolina Supreme Court recognized broad protection for close corporation shareholders' rights. The precedent set in *Meiselman* illustrates the possible degree of minority protection North Carolina courts may render in the squeeze-out merger²⁵⁶ context to protect shareholders' reasonable expectations regarding their continued equity investment in an enterprise.²⁵⁷

Significantly, the General Statutes Commission originally incorporated into the North Carolina official comments a statement that "reasonable expectations" be considered in evaluating the fairness of the cash-out merger²⁵⁸ but later deleted the statement because "reasonable expectations" had "never before been considered in connection with a cash-out merger," making it "improper to tell the court what it could and could not take into account."²⁵⁹

Given the many differences between public and close corporations, the higher fiduciary duty placed upon close corporation majority shareholders, and the illiquidity and valuation difficulties of close corporations, the issue of appraisal exclusivity takes on added importance to a close-corporation shareholder.

252. *Meiselman*, 309 N.C. at 298, 307 S.E.2d at 563.

253. *Id.*

254. See Note, *supra* note 245, at 156 ("In *Meiselman*, the good-faith firing of the minority shareholder was not a defense when the minority shareholder had a reasonable expectation of employment and participation in the management of the corporation."); see Note, *Protecting Employment Expectations*, *supra* note 242, at 556-59.

255. Denied profits diverted into a corporation set up by the majority shareholder and later stripped of his employee status, the minority shareholder in *Meiselman* sought a buy-out of his shares at their fair value under the former judicial dissolution and alternative relief statutes. *Meiselman*, 309 N.C. at 283-87, 297-98, 307 S.E.2d at 554-56, 562; see N.C. GEN. STAT. §§ 125(a)(4), § 125.1 (1982) (replaced by N.C. GEN. STAT. §§ 55-14-30, 55-13-31 (1990)). A judicial dissolution arises when the minority shareholder seeks to exit his equity investment. The appraisal remedy and the extent of its exclusivity arises when the minority shareholder seeks equitable relief to enjoin a cash-out merger and retain his equity investment. Both remedies allow minority shareholders to seek judicial intervention when their rights are violated by the majority. See O'NEAL'S CLOSE CORPORATIONS, *supra* note 10, ch. 8, § 8.07, at 64 & ch. 9, § 9.02, at 5-6.

256. See *supra* note 10.

257. Business Corporation Act Drafting Committee Minutes at 11 (October 28, 1987) (Committee member "pointed out that it can be argued that a breach of fiduciary duty occurs when the majority shareholders squeeze out a minority shareholder because the minority shareholders have a reasonable expectation to remain in the corporation and to continue with their investment.").

258. General Statutes Commission Minutes at 8 (February 5, 1988). The Statutes Commission directed that a statement be included in the North Carolina official comments suggesting that "reasonable expectations" could be considered in determining whether an action was "grossly inequitable." Later, at the urging of the Drafting Committee, the Statutes Commission decided that "while it did not want to foreclose consideration of 'reasonable expectations,' it also did not want to force such consideration and agreed to the omission of a specific reference to 'reasonable expectations.'" *Id.* at 5 (December 2, 1988). The general assembly eventually deleted the "grossly inequitable" language itself from the provisions. See *supra* note 92 and accompanying text.

259. General Statutes Commission Minutes at 5 (December 2, 1988).

D. Resolution of the Appraisal Exclusivity Issue in North Carolina

Because the recently enacted North Carolina appraisal exclusivity statute left the meaning of "unlawful" and "fraudulent" open to judicial interpretation, the North Carolina courts could follow a number of approaches to decide the appropriate standard of review for evaluating cash-out mergers. In light of the special plight of close corporation minority shareholders, this standard takes on added importance when applied in the close corporation context.²⁶⁰ Whether the courts will read these terms to encompass a breach of fiduciary duty and whether the courts will incorporate the business purpose test as well as the entire fairness test into the standard of review adopted for cash-out mergers will determine the degree of protection afforded the minority shareholder facing a cash-out merger in North Carolina. For guidance, the North Carolina judiciary can rely upon North Carolina cases governing fiduciary breaches in similar contexts²⁶¹ Massachusetts²⁶² and New York²⁶³ cases that construe "unlawful" and "fraudulent" to encompass a breach of fiduciary duty and the business purpose test.

III. APPROACHES NORTH CAROLINA COURTS MAY TAKE IN CRAFTING A STANDARD OF REVIEW FOR CASH-OUT MERGERS

A. A Breach of Fiduciary Duty is "Fraudulent"

As interpreted in North Carolina case law, fraud may arise when plaintiffs have reposed a special confidence in the defendant that creates a fiduciary relationship.²⁶⁴ As the Supreme Court has stated, "[c]onstructive fraud differs from active fraud in that the intent to deceive is not an essential element, but *it is nevertheless fraud though it rests upon presumption arising from breach of fiduciary obligation rather than deception intentionally practiced.*"²⁶⁵ Constructive fraud is presumed from the breach of a fiduciary duty; it does not require intentional deception or actual dishonesty.²⁶⁶ Indeed, constructive fraud is "a breach of [fiduciary] duty which, irrespective of moral guilt, the law declares fraudulent because of its tendency to deceive, to violate confidence, or to injure public interests."²⁶⁷

North Carolina courts long have recognized that certain fiduciary relationships raise a presumption of fraud. Examples of such relationships include attorney-client, principal-agent, trustees of trust funds, and executors who are principal beneficiaries under wills.²⁶⁸ In 1951 in *Gaines v. Long Manufacturing*

260. See *supra* text accompanying notes 231-59.

261. See *infra* text accompanying notes 264-83.

262. See *supra* text accompanying notes 220-30.

263. See *supra* notes 173-90 and accompanying text.

264. *McNeill v. McNeill*, 223 N.C. 178, 25 S.E.2d 615 (1943).

265. *Miller v. First Nat'l Bank of Catawba County*, 234 N.C. 309, 316, 67 S.E.2d 362, 367 (1951) (emphasis added).

266. *Id.*

267. *Id.*

268. *McNeill*, 223 N.C. at 181, 25 S.E.2d at 616.

Co., the North Carolina Supreme Court held that majority shareholders of a close corporation owe minority shareholders a fiduciary duty, stating that "actual fraud or mismanagement . . . is not essential to the application of the rule . . . to prevent . . . a breach of the fiduciary duties owing to the minority."²⁶⁹ The court emphasized that by virtue of their majority ownership, majority shareholders have the power to direct the corporation in everything it does, placing them in the shoes of the corporation and making the majority shareholders "the actual, if not the technical, trustees" for the minority shareholders.²⁷⁰

More recently, the North Carolina Court of Appeals, in *Hajmm Company v. House of Raeford Farms, Inc.*,²⁷¹ addressed constructive fraud arising from a fiduciary breach by a corporation and its directors in refusing to redeem a revolving fund certificate. The defendant corporation bought one hundred percent of the stock of Raeford Turkey Farms, Inc., of which plaintiff owned twenty-five percent.²⁷² In exchange for plaintiff's stock, defendant corporation issued to plaintiff a revolving fund certificate.²⁷³ When plaintiff later requested that defendant corporation redeem the certificate, defendants refused.²⁷⁴ Plaintiff claimed this refusal constituted a breach of fiduciary duty.²⁷⁵ Although the corporation carried the instrument on its books as equity,²⁷⁶ defendant corporation maintained that the instrument was debt.²⁷⁷ Thus, the defendant corporation

269. 234 N.C. 340, 344, 67 S.E.2d 350, 353 (1951) (quoting 13 AM. JUR. CORPORATIONS, §§ 422-23, at 474-76 (1938)). In *Gaines* the majority attempted to squeeze out the minority by passing resolutions to decrease dividends and issuing additional common stock at a time when plaintiff was unable to purchase his pro-rata shares. This conduct amounted to a breach of fiduciary duty even though no actual fraud was shown. *Id.* at 344-45, 67 S.E.2d at 353; see *supra* note 248.

270. *Gaines*, 234 N.C. at 344, 67 S.E.2d at 353. Quoting from 13 AM. JUR. CORPORATIONS, §§ 422-23, at 474-76 (1938), the court further explained:

The devolution of unlimited power imposes on [majority shareholders] . . . the duty of a fiduciary or agent . . . to protect the interests of the minority in the management of the corporation, especially where they undertake to run the corporation without giving the minority a voice therein It is the fact of control of the common property held and exercised . . . that creates the fiduciary obligation [of the majority to the minority] Actual fraud or mismanagement, therefore, is not essential to the application of the rule.

It is well established that courts of equity will entertain jurisdiction, at the instance of minority stockholders of a private corporation who are unable to obtain redress within the corporation and have no adequate remedy at law, to restrain threatened *ultra vires* acts on the part of the majority or to prevent any other act on the part of the majority which may be denominated as a breach of trust or a breach of the fiduciary duties owing to the minority.

Gaines, 234 N.C. at 344-45, 67 S.E.2d at 353 (quoting AM. JUR. CORPORATIONS, §§ 422-23, at 474-76 (1938)).

271. 94 N.C. App. 1, 379 S.E.2d 868, *disc. rev. allowed as to unfair trade practice issue*, 325 N.C. 271, 382 S.E.2d 439 (1989).

272. *Id.* at 5, 379 S.E.2d at 870.

273. *Id.*

274. *Id.* at 5, 379 S.E.2d at 871. The defendants claimed the corporation's bylaws gave them sole discretion whether to redeem the plaintiff's certificate. *Id.*

275. *Id.* at 4, 379 S.E.2d at 870. Plaintiff also asserted that defendants' refusal to retire the revolving fund certificate violated the corporate bylaws and constituted an unfair or deceptive trade practice. *Id.*

276. *Id.* at 5, 379 S.E.2d at 871.

277. *Id.* at 11, 379 S.E.2d at 874.

claimed no fiduciary duty existed in a debtor-creditor relationship.²⁷⁸

The court found the existence of a fiduciary duty on two grounds. First, in language reminiscent of traditional fiduciary duties, the court found that a fiduciary duty "exists in all cases where there has been a special confidence reposed in one who in equity and good conscience is bound to act in good faith and with due regard to the interests of the one reposing confidence."²⁷⁹ The second important basis for finding a fiduciary duty was that the issuance of the revolving fund certificate had some characteristics of a corporation/shareholder relationship.²⁸⁰ The court cited the then applicable North Carolina statute, which provided that "[o]fficers and directors shall be deemed to stand in a fiduciary relation to the corporation and to its shareholders . . ."²⁸¹

The court further stated that once plaintiff established that defendant owed him a fiduciary duty and that duty was breached, this "amounted to constructive fraud."²⁸² Both the majority opinion and the dissenting opinion were in agreement on this point.²⁸³ It is apparent that North Carolina clearly recognizes that fiduciary breaches by corporate officers and directors constitute constructive fraud.

Although North Carolina courts have not addressed the issue of whether eliminating a minority shareholder by a cash-out merger constitutes a breach of fiduciary duty and thus constructive fraud, other jurisdictions have.²⁸⁴ The Delaware Supreme Court in *Rabkin v. Philip A. Hunt Chemical Corporation* arguably adopted a constructive fraud theory. The court reasoned that "specific acts of unfair dealing which constitut[e] breaches of fiduciary duties," regardless of the presence or absence of actual "deception," may entitle the minority shareholder to equitable relief.²⁸⁵ The supreme court overruled the lower court's opinion that "absent deception," a minority shareholder is limited to an appraisal under *Weinberger*.²⁸⁶ However, in Delaware only certain kinds of fiduciary breaches trigger equitable remedies outside of the appraisal remedy.

278. *Id.* The official comments to the new Act make it clear that no fiduciary duty governs the debtor-creditor relationship. See N.C. GEN. STAT. § 55-8-30 official comments (1990).

279. *Hajmm*, 94 N.C. App. 11, 379 S.E.2d at 874 (quoting *Abbit v. Gregory*, 210 N.C. 577, 598, 160 S.E. 896, 906 (1931)).

280. *Id.* at 11, 379 S.E.2d at 874.

281. N.C. GEN. STAT. § 55-35 (1982) (replaced by N.C. GEN. STAT. § 55-8-30 (1990)).

282. *Hajmm*, 94 N.C. App. at 12, 379 S.E.2d at 874.

283. *Id.* at 20, 379 S.E.2d at 879 (Greene, J., dissenting).

284. Under the earliest statutes authorizing cash as appropriate merger consideration, courts consistently treated take-outs as constituting constructive fraud. See *Weiss*, *supra* note 19, at 639. Drafters of earlier statutes probably did not intend to authorize fraud, either actual or constructive, in connection with the merger provision. *Id.*

285. 498 A.2d 1099, 1100, 1103 (Del. 1985). See *supra* notes 163-72 and accompanying text. *Weinberger* itself supports the ruling in *Rabkin*. In *Weinberger*, the court said the appraisal remedy is generally exclusive absent "fraud, [and] misrepresentation." *Weinberger v. UOP*, 457 A.2d 701, 714 (Del. 1983). By including "fraud" and "misrepresentation" in its list of exceptions, *Weinberger* must have intended the term "fraud" to encompass constructive fraud; otherwise, the court's lists of exclusivity exceptions is redundant. Also, the *Cole* decision, from which *Weinberger* derived its equitable exceptions to the appraisal remedy, contemplated a cause of action for constructive fraud resulting from the undervaluation of shares. *Cole v. National Cash Credit Ass'n*, 18 Del. Ch. 47, 58, 156 A. 183, 188 (1931).

286. *Rabkin*, 498 A.2d at 1100, 1108.

Because the Delaware courts no longer apply the independent business purpose test under *Weinberger*, a cash-out merger consummated by a controlling shareholder without a valid business purpose is not a fiduciary breach per se. The supreme court in *Rabkin* recognized that its opinion will "necessarily . . . require the [lower courts] to closely focus" on distinguishing and sustaining complaints that aver fiduciary breaches "that are reasonably related to and have a substantial impact upon the price offered" from those "questioning judgmental factors of valuation."²⁸⁷ The court nonetheless believed that limiting a minority shareholder to an appraisal, "provided there was no deception, regardless of the degree of procedural unfairness employed to take their shares," was unfair.²⁸⁸ The lower courts must distinguish a fiduciary breach case from a price inadequacy case, the court concluded, or otherwise "*Weinberger's* concern for entire fairness loses all force."²⁸⁹

Finally, the United States Supreme Court's decision in *Santa Fe Industries, Inc. v. Green*²⁹⁰ supports an interpretation that a breach of fiduciary duty constitutes constructive fraud. In that case the Court held that a breach of fiduciary duty for unfair dealing by a corporation, absent deception, is not a rule 10b-5 violation, given the "deceptive or manipulative" language in section 10(b) of the Securities Exchange Act of 1934.²⁹¹ Implicitly, a breach of fiduciary duty constitutes fraud absent the "manipulative or deceptive" requirement in rule 10b-5.²⁹² Although a breach of fiduciary duty fails to trigger equitable relief under rule 10b-5 in federal courts, it may still trigger equitable relief under state corporate laws if the elements of fraud are not expressly limited to deception. North Carolina's appraisal exclusivity provision limiting minority shareholders solely to an appraisal "unless the corporate action is fraudulent" is open to such an interpretation.

B. Breach of Fiduciary Duty is "Unlawful"

The issue of whether a breach of fiduciary duty is "unlawful" must over-

287. *Id.* at 1107-08; see *supra* note 134. Mere inadequacy of price does not equal fraud unless the undervaluation suggests bad faith or reckless indifference to the rights of the minority shareholders. *Cole*, 18 Del. Ch. at 58, 156 A. at 188.

288. *Rabkin*, 498 A.2d at 1108.

289. *Id.*

290. 430 U.S. 462 (1977).

291. *Id.* at 474-77.

292. *Green v. Santa Fe Indus., Inc.*, 533 F.2d 1283, 1287 (2d Cir. 1976), *rev'd*, 430 U.S. 462 (1977). The Second Circuit held that although rule 10b-5 plainly reaches both material misrepresentations and nondisclosures, neither is an essential element to proving a rule 10b-5 violation. Therefore, rule 10b-6 must reach, as the court opined, "breaches of fiduciary duty by a majority against minority shareholders without any charge of misrepresentation or lack of disclosure." *Id.* at 1287. Significantly, the court of appeals reasoned that "[w]hile the 'fraud' at which 10b-5 is aimed obviously includes the classic examples of misrepresentation and nondisclosure . . . '[f]raud, indeed, in the sense of a court of equity properly includes all acts, omissions and concealments which involve a breach of legal or equitable duty, trust, or confidence, justly reposed . . .'" *Id.* at 1289-90 (quoting *Moore v. Crawford*, 130 U.S. 122, 128 (1889)) (citations omitted).

The United States Supreme Court reversed, holding that rule 10b-5 requires actual misrepresentation or nondisclosure even in the presence of a breach of fiduciary duty. *Santa Fe*, 430 U.S. at 470-71.

come any presumption that by deleting the former provision conferring a fiduciary duty on corporate officers and directors,²⁹³ the new Act somehow dilutes corporate fiduciary duties. The North Carolina Commentary to the new Act emphasizes that the deletion "is not intended to modify in any way the duty of directors recognized under the former law."²⁹⁴ Furthermore, the North Carolina Supreme Court recognized corporate fiduciary duties owed by majority shareholders to the minority shareholders in *Gaines v. Long Manufacturing, Inc.*²⁹⁵ in 1951, long before the corporate statute codifying fiduciary duties of directors and officers took effect.²⁹⁶ Thus, based on the comments to the new Act and prior case law, corporate fiduciary duties remain in force. Breaches of these duties may represent "unlawful[ness]" under the new Act.

The legislative history of the new Act also supports the argument that fiduciary breaches are "unlawful." As originally introduced in the North Carolina General Assembly,²⁹⁷ the appraisal exclusivity provision contained language limiting unlawfulness to procedural violations under the new Act, the corporate charter, or shareholders' agreements.²⁹⁸ While under consideration in the House, however, pressure mounted until ultimately the House rejected and deleted this language.²⁹⁹ Hence, this deletion arguably indicates the General Assembly's intent not to limit unlawfulness to mere procedural violations.

Authority in other jurisdictions further supports the theory that a breach of fiduciary duty in the cash-out merger context is "unlawful." New York case law sets the leading precedent. In *Alpert v. 28 Williams Street Corporation*, the New York Supreme Court noted many fiduciary obligations imposed on a controlling shareholder.³⁰⁰ The major duties, according to the court, include treating all shareholders, majority and minority, fairly and equally, discharging corporate responsibilities in good faith, and managing the company prudently. The court summarized: "When a breach of fiduciary duty occurs, that action will be considered *unlawful* and the aggrieved shareholder may be entitled to equitable relief."³⁰¹

C. Business Purpose Test

In trying to answer the question of whether a cash-out merger constitutes a

293. N.C. GEN. STAT. § 55-35 (1982) (referenced by N.C. GEN. STAT. § 55-8-30 N.C. Commentary and replaced by N.C. GEN. STAT. § 55-8-30 (1990)).

294. *Id.* § 55-8-30 N.C. Commentary (1990). The new Act sets forth the director's standard of care for executing his corporate duties, but does not state affirmatively that he has a fiduciary duty to the corporation and its shareholders. The provision merely codifies the business judgment rule, making no reference to fiduciary duties. The official comments to the North Carolina Business Corporation Act explain that the "[r]emoval of the word 'fiduciary' was solely because of confusion in other jurisdictions between the corporate and the trust standards of fiduciary duty." *Id.*

295. 234 N.C. 340, 344-45, 67 S.E.2d 350, 353-54 (1951).

296. Act of May 26, 1955, ch. 1371, 1955 N.C. Sess. Laws 1452 (current version at N.C. GEN. STAT. § 55-8-30 (1990)).

297. See *supra* note 88.

298. See *supra* text accompanying notes 88-92.

299. See *supra* text accompanying note 92.

300. 63 N.Y.2d 557, 568-69, 473 N.E.2d 19, 25-26, 483 N.Y.S.2d 667, 673-74 (1984).

301. *Id.* at 569, 473 N.E.2d at 26, 483 N.Y.S.2d at 674 (emphasis added).

breach of fiduciary duty that is either "unlawful or fraudulent," neither the language of nor the official comments to the Revised Model Act is helpful.³⁰² The official comments to the Revised Model Act include procedural violations contravening corporation laws on voting or articles of incorporation, "deception of shareholders," and "violation of a fiduciary duty" as examples of instances when courts are free to intervene with equitable relief notwithstanding appraisal rights.³⁰³ Intentionally making "no attempt to specify particular illustrations," the Revised Model Act drafters decided not to answer the central question of what misconduct constitutes unlawfulness or fraud so that courts are free to intervene with equitable relief.³⁰⁴

Nor did the Revised Model Act drafters elaborate on particular standards for evaluating if and when certain cash-out mergers constitute fiduciary breaches. They instead "designed [the Revised Model Act language] to recognize and preserve the principles" from leading states like Delaware and New York.³⁰⁵ Courts in these two states developed certain judicial tests—namely the "entire fairness" test and the "business purpose" test—for evaluating cash-out mergers. The New York courts use both tests for evaluating whether a cash-out merger is an "unlawful or fraudulent" breach of fiduciary duty under the New York appraisal exclusivity statute. In Delaware, where the corporate statutes contain no appraisal exclusivity provision, courts use only the "entire fairness" test to evaluate whether a cash-out merger involves "fraud, misrepresentation, self-dealing, deliberate waste of corporate assets, or gross and palpable overreaching,"³⁰⁶ so that a dissenting shareholder is entitled to enjoin the merger or receive other equitable relief.

The Revised Model Act is silent on the business purpose test. By embracing the principles of Delaware and New York law that present conflicting views on the business purpose test, the Revised Model Act fuels the confusion surrounding the issue of whether a controlling shareholder can cash out a minority shareholder in a merger without a business purpose. First, the official comments expressly cite *Weinberger* as support for the proposition that an appraisal remedy may be inadequate "where fraud, misrepresentation, self-dealing, deliberate waste of corporate assets, or gross or palpable overreaching are involved."³⁰⁷ Arguably, however, *Weinberger's* deletion of the business purpose test implicitly becomes a part of the Revised Model Act standard for evaluating when these exclusivity exceptions arise. Simultaneously, the official comments note that "section 13.02(b) basically adopts the New York formula as to [appraisal] exclusivity" by using New York's "unlawful" and "fraudulent" terms expressly.³⁰⁸ One could argue that, by this adoption, the Revised Model Act implicitly should

302. See *supra* text accompanying notes 97-103.

303. REV. MODEL BUSINESS CORP. ACT § 13.02(b) official comment 2 (1984).

304. *Id.*

305. *Id.*

306. *Weinberger v. UOP, Inc.*, 457 A.2d 701, 714 (Del. 1983).

307. REV. MODEL BUSINESS CORP. ACT § 13.02(b) official comment 2 (1984) (quoting *Weinberger*, 457 A.2d at 714).

308. REV. MODEL BUSINESS CORP. ACT § 13.02(b) official comment 2 (1984); see *supra* note 96.

follow the standard later set forth by the New York courts in *Alpert*, which applies the business purpose test in evaluating the validity of cash-out mergers. Thus, the Revised Model Act itself incorporates the law from two leading states that have adopted entirely opposing standards for determining when a cash-out merger is invalid as a breach of fiduciary duty under the business purpose test. In this manner, the Revised Model Act sets up the business purpose test dichotomy.

Delaware courts, at the time of the adoption of the Revised Model Act, had abandoned the business purpose test as an independent threshold test and announced the rule that a cash-out merger was permitted only if the merger transaction could meet the entire fairness test. Although the *Weinberger* court stated that in non-fraudulent transactions fair price outweighs fair dealing such that there is no equitable relief, *Rabkin* recognized that non-fraudulent transactions may involve breaches of fiduciary duty that require equitable relief.³⁰⁹ Arguably *Weinberger*, read with *Rabkin*, implicitly recasts the business purpose test from an independent threshold test as espoused in *Singer* into a single factor of fiduciary duty the court should consider under the fair dealing aspect of the entire fairness test.

In 1984, the same year in which the Revised Model Act was completed, the New York court announced its rule in *Alpert* that a cash-out merger was governed by the business purpose test as well as by *Weinberger's* entire fairness test. By doing so, New York announced a standard for its "fraudulent or unlawful" language. Unlike the Delaware standard, proving "entire fairness" under the New York standard is not enough.³¹⁰ The New York courts enforce the fiduciary duty a majority shareholder owes the minority shareholders through the use of the business purpose test, which operates as an independent threshold³¹¹ in addition to the entire fairness test. Under New York case law, the manner of negotiations surrounding the price may be entirely fair, but if the corporation cannot justify its actions based on some corporate purpose other than minority elimination, the merger may be enjoined.³¹²

Thus, precedent exists under the Revised Model Act to interpret a standard of review governing the validity of cash-out mergers as either, following New York law, adopting the business purpose test, or following Delaware law, abolishing it. Because the North Carolina General Assembly adopted the Revised Model Act's broad, vague language verbatim, North Carolina courts must de-

309. *Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (Del. 1983); *Rabkin v. Philip A. Hunt Chemical Corp.*, 498 A.2d 1099, 1107-08 (Del. 1985).

310. *Alpert v. 28 Williams Street Corp.*, 63 N.Y.2d 557, 472 N.E.2d 19, 483 N.Y.S.2d 667 (1984).

311. *Id.* at 573, 473 N.E.2d at 28, 483 N.Y.S.2d at 676-77.

312. The *Alpert* court summarized its position as follows:

[I]n entertaining an equitable action to review a freeze-out merger, a [New York] court should view the transaction as a whole to determine whether it was tainted with fraud, illegality, or self-dealing, whether the minority shareholders were dealt with fairly, and whether there exists any independent corporate purpose for the merger.

Id. at 573, 473 N.E.2d at 28, 483 N.Y.S.2d at 677.

cide the business purpose issue.³¹³ Not only must the North Carolina judiciary address whether its standard of review will encompass the business purpose test, but if it does, it also must decide what business purpose will suffice to satisfy the test.

In analyzing whether North Carolina should embrace the business purpose test, three factors are critical: the appraisal exclusivity provision's legislative history, *Meiselman's* "reasonable expectations" impact, and the similarity of North Carolina's appraisal exclusivity statute to parallel New York and Massachusetts statutes. First, legislative history surrounding the exclusivity provision is significant. The Drafting Committee, along with the concurrence of the General Statutes Commission and the Corporate Law Study Commission, expressly excluded the business purpose test from the original language of the exclusivity provision when it was introduced into the legislature.³¹⁴ The legislature rejected and deleted this language in the final passage of the bill as a compromise to making the remedy expressly non-exclusive.³¹⁵ Notably, in the final rounds of debate, the Drafting Committee, in response to even stronger concern expressed by practicing lawyers, had recommended that the bill's proposed language, as drafted by it and introduced into the Senate, be amended.³¹⁶ Specifically, the suggested changes included deleting the procedural compliance qualification pertaining to "unlawful," the extension of "fraudulent" to include "grossly inequitable," and the "clear, cogent and convincing evidence" standard regarding proof of fraud or gross inequity.³¹⁷ Hoping to quell the political rumbling over the appraisal exclusivity issue by recommending these deletions, the Drafting Committee at the very least sought to salvage the explicit application of the provision to cash-out mergers and the express rejection of the business purpose test.³¹⁸ Instead, when it ratified into law its final version, the general assembly deleted all the recommended changes as proposed by the Drafting Committee *plus* it deleted the bill's express rejection of the business purpose test.³¹⁹ Thus, when confronted with language that it could have simply adopted, as urged by the Drafting Committee, the general assembly chose to eliminate this language, arguably a strong indication of its intention to retain the business purpose test.

Furthermore, under *Meiselman*, North Carolina protects minority shareholders' "reasonable expectations" when controlling shareholders squeeze minority shareholders out of a close corporation. Although the *Meiselman* rule

313. See Farris, *Shareholder's Rights and Liabilities*, published by the North Carolina Bar Continuing Legal Education for the November 16-17, 1989 seminar "The New North Carolina Business Corporation Act," vol. 1 (1989). Farris writes that North Carolina will not need to address the business purpose test. *Id.* This Comment argues that this statement is a misinterpretation of the new provision.

314. See *supra* note 82 and accompanying text.

315. See *supra* text at note 92.

316. Business Corporation Act Drafting Committee Minutes at 3 (April 8, 1989).

317. Russell Robinson, Chairman of the Business Corporation Act Drafting Committee, expressed concern that the "burden to establish that a cash-out merger is inequitable to minority shareholders may be too great." General Statutes Commission Minutes at 7 (April 7, 1989).

318. *Id.*

319. See *supra* note 92.

arose under the judicial dissolution provision,³²⁰ it applies by analogy to the appraisal proceeding because the action of the controlling shareholder in both situations denies the minority shareholder the benefit of his reasonable expectations. Under the *Meiselman* decision, the controlling shareholder is not allowed to deny the minority shareholder the benefit of his investment, and as such, his reasonable expectations.³²¹ In the cash-out merger situation, the controlling shareholder should not be allowed to deny the minority shareholder the benefit of his continued equity investment in the company without a business purpose. Under the new Act, the minority shareholder's reasonable expectation to continue his equity interest in the close corporation he helped build should be protected.

Like the Massachusetts and New York statutes, the new North Carolina Act has the "unlawful or fraudulent" language in its exclusivity provision. The Delaware code does not. In deciding the breadth of these two terms, the Massachusetts court in *Coggins v. New England Patriots Football Club*³²² and the New York court in *Alpert v. 28 Williams Street Corporation*³²³ both discuss Delaware's *Weinberger* decision at length, expressly adopting the entire fairness test espoused in *Weinberger* but rejecting its abandonment of the business purpose test as an independent threshold test.³²⁴

Furthermore, in discussing the meaning of the "unlawful or fraudulent" language, both the courts in Massachusetts and New York interpreted a breach of fiduciary duty as itself illegal, and, as such, an exception to the exclusivity of the appraisal remedy.³²⁵ The Delaware court did not need to face this issue

320. N.C. GEN. STAT. §§ 55-125, 125.1 (1982) (current version at N.C. GEN. STAT. §§ 55-14-30, 55-14-31 (1990)).

321. While the plaintiff contended his "rights and interests" included secure employment, fringe benefits, and management participation, the court did not decide the issue but remanded the case for further findings of fact. *Meiselman v. Meiselman*, 309 N.C. 279, 302-06, 307 S.E.2d 551, 564-67 (1983).

322. 397 Mass. 525, 492 N.E.2d 1112 (1986).

323. 63 N.Y.2d 557, 473 N.E.2d 19, 483 N.Y.S.2d 667 (1984).

324. *Coggins*, 397 Mass. at 531, 492 N.E.2d at 1116-17; *Alpert*, 63 N.Y.2d at 570-71, 473 N.E.2d at 26-27, 483 N.Y.S.2d at 675.

325. *Coggins*, 397 Mass. at 532, 492 N.E.2d at 1117 (Given that the Massachusetts statute lists "illegal or fraudulent" conduct as exceptional cases where appraisal is not exclusive, the court held that it "is justified in exercising its equitable power when a violation of fiduciary duty is claimed."); see also *Alpert*, 63 N.Y.2d at 569, 473 N.E.2d at 26, 483 N.Y.S.2d at 674 (Under New York's exclusivity statute which lists "unlawful or fraudulent" misconduct as exceptions to when the appraisal remedy should be exclusive, the court found that "[w]hen a breach of fiduciary duty occurs, that action will be considered unlawful.").

In finding that a fiduciary breach had occurred, the New York court in *Alpert* based its decision on the grounds that all shareholders of the same class are entitled to equal treatment. *Id.* at 572, 473 N.E.2d at 28, 483 N.Y.S.2d at 676. Because one was cashed out and one was left with the operating assets of the business, this different treatment resulted in a breach of fiduciary duty that could be justified only by the controlling shareholder demonstrating some valid corporate purpose. *Id.* The Massachusetts court in *Coggins* went even further. *Coggins* can be distinguished from *Alpert* in that a breach of fiduciary duty was found even though the shareholders were not members of the same class. The minority shareholders were nonvoting common shareholders, while the controlling shareholder owned 100% of the voting common stock. *Coggins*, 397 Mass. at 527, 492 N.E.2d at 1114. The court concentrated on the fact that the controlling shareholder, as the 100% controlling shareholder of both corporations in the merger, "violate[d] his fiduciary duty when he use[d] the corporation for his . . . personal benefit in a manner detrimental to the corporation." *Id.* at 534, 492 N.E.2d at 1118. Thus, a breach of fiduciary duty can exist even where equal treatment among the share-

squarably.³²⁶

Beyond noting these similarities between North Carolina's exclusivity provision and those of New York and Massachusetts, the North Carolina judiciary should note North Carolina's kindredship with New York on the "reasonable expectations" doctrine. In *Matter of Kemp & Beatley, Inc.*,³²⁷ the New York court followed North Carolina precedent by protecting the minority shareholder's "reasonable expectations" in the judicial dissolution context as set forth in *Meiselman*. Construing statutory language that provided for a judicial dissolution when "directors or those in control of the corporation have been guilty of illegal, fraudulent or oppressive action," the New York court stated that the minority shareholders' reasonable expectations should be protected.³²⁸ Thus *Meiselman* finds acceptance in other jurisdictions in the judicial dissolution context.³²⁹ However, whether New York or North Carolina will apply the reasonable expectation doctrine to the standard of review for cash-out mergers is uncertain. In drafting the official comments to the new Act, the General Statutes Commission recommended incorporating a reference to "reasonable expectations,"³³⁰ but the Drafting Committee opted to omit this reference and the General Statutes Commission later agreed.³³¹ The Drafting Committee felt that it was "improper to tell the courts in a comment what they could or could not take into account . . . [particularly since] 'reasonable expectations' have never before been considered in connection with a cash-out merger."³³² Thus, like the exclusivity issue itself, whether the business purpose test and "reasonable expectations" doctrine should apply to cash-out mergers is left to judicial interpretation.

IV. CONCLUSION

Given the legislative history of the exclusivity provision, North Carolina's *Meiselman* precedent for protecting the "reasonable expectations" of minority shareholders, the similarities of North Carolina's exclusivity statute with those of New York and Massachusetts, and North Carolina's heritage of being pro-shareholder in light of Delaware's pro-management stance,³³³ North Carolina

holders is not the central issue. Under *Coggins*, unequal treatment among different shareholder classes is not tolerated where one class uses the corporation to its benefit over other classes.

326. Delaware has no appraisal exclusivity provision. Abolished as an independent test, the business purpose arguably operates as a mere factor under fair dealing test. See *supra* note 309.

327. 64 N.Y.2d 63, 473 N.E.2d 1173, 484 N.Y.S.2d 799 (1984).

328. *Id.* at 70 n.1, 71-72, 473 N.E.2d at 1177 n.1, 1178-79, 484 N.Y.S.2d at 803 n.1, 804-05; see O'NEAL'S CLOSE CORPORATIONS, *supra* note 10, § 9.30, at 142.

329. See O'NEAL'S CLOSE CORPORATIONS, *supra* note 10, § 9.30, at 141-43 ("One of the most significant trends in the law of close corporations" is the courts' increasing willingness to look at shareholders' reasonable expectations.).

330. General Statutes Commission Minutes at 8 (February 5, 1988). The Statutes Commission recommended that the official comments include a statement directing the courts to use *Meiselman* in determining whether an action by the controlling shareholder was "grossly inequitable" such that equitable relief was available. *Id.*

331. General Statutes Commission Minutes at 5 (December 2, 1988).

332. *Id.*

333. Business Corporation Act Drafting Committee Minutes at 3 (December 20, 1985).

should adopt a standard of review that encompasses both the business purpose and entire fairness tests for evaluating cash-out mergers in the close corporation context.³³⁴ Particularly given the significant differences between close and public corporations,³³⁵ North Carolina courts should adopt these two tests for cash-out mergers in which close corporation minority shareholders are eliminated. This dual standard will give heightened protection to close corporation minority shareholders who face illiquidity and valuation difficulties, unlike public corporation minority shareholders. Most importantly, this standard will protect the unique "reasonable expectations" of close corporation minority shareholders.³³⁶

Regarding the proposed dual standard that would encompass both the en-

334. Because the issues are very different regarding public corporation minority shareholders' investments, expectations, and degree of protection needed and warranted, this Comment is limited to considerations pertaining to the appropriate standard for non-public corporations. For a discussion focusing upon the review standard for public corporation freeze-out mergers, see Note, *Freezeouts Under The 1983 Illinois Business Corporation Act: The Need for Protection of Minority Shareholders from "Going Private" Mergers*, 1985 U. ILL. L. REV. 679 (arguing that Illinois courts should expand the cause of action for breach of fiduciary duty by controlling shareholders and apply a balancing test, on a case-by-case basis, that requires the controlling shareholders to demonstrate that legitimate corporate benefits from the merger outweigh the minority's interest in continued corporate participation). The standard governing the cash-out merger of public corporation minority shareholders *may be* the same high standard as suggested by this Comment for close corporation minority shareholders. With public corporations, securities laws on both the state and federal levels regulate full disclosure of information to protect the public investor. Given the significant differences between close and public corporation minority shareholders, a more flexible standard regarding the business purpose test may be warranted for mergers where public corporation minority shareholders are cashed-out. Whether the standard advocated herein should apply as well to public corporations is not addressed.

Notably, the new Act differentiates between the close and public corporation on numerous occasions. See, e.g., N.C. GEN. STAT. §§ 55-1-40(18a), (g), 55-13-30(d) (1990).

One proposal before the House was to apply the exclusive remedy to only public corporations and to retain the former standard for non-public corporations, giving dissenting shareholders any right available "in law or equity." See *supra* note 90 and accompanying text. Members of the Drafting Committee thought this standard for non-public corporations was too uncertain, leaving the non-public corporations without any standard at all. This Comment does not advocate such a drastic measure. This Comment encourages the North Carolina judiciary to adopt the dual "entire fairness" and "business purpose" standard. In the application of this dual standard to non-public corporations, this Comment urges the judiciary to consider the special vulnerability of the close corporation minority shareholder and put teeth into the standard by interpreting "unlawful" or "fraudulent" to encompass a breach of fiduciary duty at a minimum for non-public corporations, if not for all corporations.

The North Carolina Commentary to the new Act states that the exclusivity provision covers cash-out mergers and that "in determining whether a merger was 'unlawful' or 'fraudulent,' the same standard applies regardless of whether the consideration received—cash, other property or shares of a surviving corporation." N.C. GEN. STAT. § 55-13-02 N.C. Commentary (1990). Clearly, the language in the comments contemplates a uniform standard based on the *type of consideration* involved. But arguably the courts are free to construe and apply a standard that distinguishes between the *type of corporation* involved, a public versus non-public corporation, as seen earlier in *Meiselman* in its construction and application of the judicial dissolution provision. *Meiselman*, 309 N.C. at 288-93, 307 S.E.2d at 557-59. Such a distinction is advisable in this instance, given the special vulnerability of the close corporation minority shareholder. See Note, *supra* note 198, at 950, 954. Despite the Indiana legislature's recent enactment of a slightly altered version of the Revised Model Act's exclusivity provision, making the appraisal remedy *absolutely exclusive*, the Note distinguishes a "passive investor" in a public corporation from an "owner/employee" in a close corporation. *Id.* The commentator argues that Indiana courts should "issue an injunction in situations where the shareholder of a closely held corporation risks losing both investment in financial and human capital, particularly when the risk arises from a breach of managerial duty." *Id.*

335. See *supra* text accompanying notes 231-59.

336. *Id.*; see *supra* notes 236-44 and accompanying text.

tire fairness and business purpose tests, some commentators argue that the business purpose test is ineffective.³³⁷ These comments focus predominantly on the Delaware court's decimation of the rule in *Tanzer v. International General Industries, Inc.* by its broad interpretation that the controlling shareholder can vote to satisfy his desires as a shareholder and ignore his director responsibilities. In contrast, the Massachusetts court put teeth into its business purpose test under its *Coggins v. New England Patriots Football Club* decision when it required a business purpose unrelated to the selfish personal interest of the controlling shareholder. North Carolina courts should follow the lead of the judiciary in New York and Massachusetts by adopting the business purpose test that *some* business reason, although not compelling, should support the controlling shareholders choice to cash out the minority.

This rule would make it clear that a controlling shareholder of a close corporation could not cash out a minority shareholder when doing so would benefit only the controlling shareholder. However, should the fact that business is suffering because of intense conflict between the shareholders constitute a valid business purpose? Allowing this purpose to suffice might again permit the evisceration of the business purpose test.³³⁸

North Carolina courts should adopt this dual standard, which includes both the entire fairness and business purpose tests, such that a merger not meeting these tests would be an unlawful or fraudulent breach of fiduciary duty. This standard recognizes the minority shareholder's "reasonable expectation" to continue his close corporation equity interest.³³⁹ The greatest advantage of this dual standard is that it forces the parties to enter arm's-length negotiations directly upfront to determine when one shareholder can buy out the other at any time for any reason whatsoever. As seen in the close corporation context under *Coleman v. Taub*,³⁴⁰ the controlling shareholder would benefit from negotiations resulting in a valid shareholders' agreement in that he could avoid the fiduciary obligations imposed by the dual standard of the entire fairness and business purpose tests. A valid shareholders' agreement³⁴¹ allows the parties to discuss and agree on circumstances that will trigger a buyout of any sort and devise a pricing formula in the event that such occurs. The close corporation minority shareholder would also benefit from negotiations in drawing up a shareholders' agreement; he would be able to protect himself before entering the business by gaining full knowledge of the controlling shareholder's intentions concerning buyouts and by setting forth his reasonable expectations surrounding his continued in-

337. See *supra* note 122 and accompanying text.

338. *Id.*

339. See Note, *supra* note 198, at 950 (arguing that despite an exclusive remedy which makes it possible to more equitably value shares, the difficulty in valuing the lost expectations of an owner/employee still remains, such that the legal remedy under the statute is inadequate).

340. 638 F.2d 628 (3d Cir. 1981) (decision handed down during the period when Delaware recognized both the "entire fairness" and the "business purpose" tests).

341. N.C. GEN. STAT. § 55-7-31 (1990); see also *Blount v. Taft*, 295 N.C. 472, 246 S.E.2d 763 (1978) (the court stopped short of formulating a precise definition of a shareholders' agreement, although it upheld a bylaw that empowered the corporate directors to designate an executive committee to oversee the corporation's employment needs).

vestment.³⁴² At the very least, such a rule would encourage communication between the parties so that the minority shareholder will fully appreciate the conflict and squeeze-out risks associated with his minority interest.

The parameters regarding when one shareholder could buy out another shareholder at any time "for any reason whatsoever"³⁴³ should be negotiated at arm's length with full disclosure to all the parties of the contract's consequences. If the contract terms are unsuitable, any potential shareholder could refrain from investing in the business. The controlling shareholder typically has the power to initiate negotiating efforts prior to incorporation. If he knows he cannot otherwise eliminate a minority shareholder without a valid business purpose in a fair manner at a fair price under the dual standard suggested for adoption by North Carolina, the controlling shareholder will have more of an incentive to negotiate upfront. If North Carolina does not adopt the dual standard for mergers where close corporation minority shareholders are cashed out, controlling shareholders can easily cash out minority shareholders and are thereby encouraged to surprise the minority shareholders by their later forced elimination.

In sum, the entire fairness and business purpose tests would benefit all North Carolina close corporation shareholders by encouraging both parties to contract before they invest. Where good faith negotiations are not undertaken, true economic progress is not impeded by the dual standard because mergers are allowed where true valid business purposes support them and the minority shareholders receive a fair price. As such, this standard would encourage economic progress. Mergers would be justified where a valid business purpose supports the transaction and where the minority shareholder is paid a fair price and dealt with in a fair manner. In essence, this dual standard represents a balancing by the courts, as a last resort, of the competing interests held by majority and minority shareholders should the parties fail to balance their competing interests on their own through communication and negotiations.

JULIE GWYN HUDSON

342. See Brudney and Chirelstein, *supra* note 10, at 1357 n.9; see also Business Corporation Act Drafting Committee Minutes at 13 (October 28, 1987) (committee member noted the "the world would be better off in the long run if potential investors are *told clearly and in no uncertain terms* that, if they buy into a minority situation, they had better treat their investment as a redeemable bond or *obtain an agreement* to the contrary" (emphasis added)).

343. See *Taub*, 638 F.2d at 636.