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## Dissenting Shareholder: Appraisal and Other Rights under the Texas Business Corporation Act, The

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either temporary or final cessation of operations to invoke the sixty-day period of grace, the court, by inference, may have settled a related problem. The usual sixty-day provision in the commence and the continuous clauses now appears automatically to extend the lease for a like period of time. Previously there had been some adherence to the theory that "the lease terminates upon cessation of production or drilling activity only to be revived by later conduct required by lessee within this period."<sup>31</sup>

A major problem remains: What will be the attitude of Texas courts towards leases dissimilar to those in both *Reid* and *Harris*?<sup>32</sup> Since the constructions given the clauses in both cases are valid, the possibility of *Harris* overruling *Reid* is eliminated. It is apparent however, that the *Reid* case will continue to create difficulty for the lessee within the scope of its fact situation. On the other hand, *Skelly Oil Co. v. Harris* seems to have opened the door to more liberal judicial interpretation in permitting a contractual clause to span the gap between completion and actual or constructive production of a well. This result suggests that when possible, Texas courts probably will be inclined to construe the clauses to include such an extension period; but absent a direct precedent, the attorney cannot be certain on which side of the fence the clause will fall.

*Richard M. Hull*

## The Dissenting Shareholder: Appraisal and Other Rights Under the Texas Business Corporation Act

Plaintiff owned less than twenty per cent of the outstanding stock in several affiliated corporations. In accordance with the provisions of the Texas Business Corporation Act,<sup>1</sup> Defendants, as officers, directors, and stockholders holding more than eighty per cent of the outstanding voting shares of those corporations, voted to sell all the

<sup>31</sup> See Comment, *Extending the Texas Oil and Gas Lease by the Habendum, Dry Hole, and Shut-In Royalty Clauses*, 14 Sw. L.J. 365, 387 (1960), where the author states:

These cases [*Gulf Oil Corp. v. Reid*, 161 Tex. 88, 337 S.W.2d 267 (1960); *Freeman v. Magnolia Petroleum Co.*, 141 Tex. 278, 171 S.W.2d 339 (1943); *Shell Oil Co. v. Goodroe*, 197 S.W.2d 395 (Tex. Civ. App. 1946) *error ref. n.r.e.*] evolve the interesting question of whether the usual sixty-day period of the *continuous* and *commence* clauses operate to extend the lease automatically for this limited period of time regardless of whether there is a resumption of the required activity before the end of this period, or whether the lease terminates upon the cessation of production or drilling activity only to be revived by later conduct required by the lease within this period.

The answer to this question remains speculative.

<sup>32</sup> See Discussion Notes, 15 Oil & Gas Rep. 659 (1961).

<sup>1</sup> See Tex. Bus. Corp. Act Ann. art. 5.10 (1956).

corporate assets to newly formed corporations owned entirely by them. Plaintiff was not afforded an opportunity to secure stock in the purchasing entities; however, Plaintiff's proportionate share<sup>2</sup> of the proceeds from the sale of the assets of the old corporations<sup>3</sup> was deposited in escrow for his benefit. Plaintiff sued for damages for conspiracy to defraud, and in the alternative, for payment of the appraised value of his shares.<sup>4</sup> No appraiser was appointed. At the trial, the jury found the value of Plaintiff's stock to be 312,000 dollars and also assessed 54,000 dollars in damages on the fraud allegation. The court of civil appeals affirmed judgment for the damages for fraud but held that the valuation procedures were improper and reduced the judgment accordingly.<sup>5</sup> The supreme court indicated that damages could be awarded in addition to statutory appraisal rights if necessary to effect a full recovery by a dissenting minority shareholder but *held*: (1) A sale of corporate assets pursuant to statutory authorization, although effecting a "freeze out" of a minority shareholder, is not a fraudulent action that will support an award of special damages in addition to statutory appraisal rights. (2) In an action for appraisal rights, the appointment of an appraiser is not jurisdictional and may be waived by a defendant's failure to insist upon such appointment by a plea in abatement. *Farnsworth v. Massey*. — Tex. —, 365 S.W.2d 1 (1963).

### I. DEVELOPMENT OF APPRAISAL RIGHTS

At common law, as a general rule, affirmative action by one shareholder can prevent the sale of all or substantially all of the assets of a corporation.<sup>6</sup> This rule is based upon the theory that an implied contract exists among the shareholders to pursue the purpose for which the corporation was originally chartered.<sup>7</sup> Also, there is a strong public policy against "corporate suicide."<sup>8</sup> An exception to

<sup>2</sup> Plaintiff's proportional share amounted to \$151,529.27.

<sup>3</sup> The court referred to the respective corporations as "old" and "new," the latter indicating the newly formed corporations. These marks of identification are employed hereafter.

<sup>4</sup> See Tex. Bus. Corp. Act Ann. art. 5.12 (1956) which provides that a minority shareholder who dissents from a merger, consolidation, or sale of substantially all the assets, may receive from the corporation the fair value of his shares. Since an impartial appraiser usually determines "fair value," the provision is said to create "appraisal rights."

<sup>5</sup> 353 S.W.2d 262 (Tex. Civ. App. 1961). The judgment for Plaintiff was reduced to \$205,529.27. This amount equalled the \$151,529.27 set aside by Defendants as Plaintiff's share of the proceeds from the sale of the assets, plus the \$54,000 fraud damages found by the jury. The court found that the valuation of the shares by the jury was improper because the appointment of an appraiser was jurisdictional and could not be waived.

<sup>6</sup> *Tillis v. Brown*, 154 Ala. 403, 45 So. 589 (1908); *Myerhoff v. Bankers Sec., Inc.*, 105 N.J. Eq. 76, 147 Atl. 105 (Ch. 1929); *Kean v. Johnson*, 9 N.J. Eq. 401 (Ch. 1853).

<sup>7</sup> *Small v. Minneapolis Electro-Matrix Co.*, 45 Minn. 264, 47 N.W. 797 (1891); *Kean v. Johnson*, *supra* note 6; 58 Colum. L. Rev. 251, 252 (1958).

<sup>8</sup> *People v. Ballard*, 134 N.Y. 269, 32 N.E. 54 (1892); 78 U. Pa. L. Rev. 881 (1930).

the general rule applies if the corporation is insolvent and is not affected with a public interest.<sup>9</sup> In addition to his ability to enjoin a sale of all corporate assets for lack of unanimous consent, the minority shareholder has other common law rights and remedies. For example, an ultra vires transaction can be enjoined;<sup>10</sup> and when a consolidation is not approved by all stockholders, the dissenting shareholder can recover from the consolidated company the value of his equitable interest in the corporate property.<sup>11</sup> A conversion theory has been used in special instances to give the dissenting stockholder an action against the purchaser of the corporation's assets for the value of his shares.<sup>12</sup> Moreover, the minority shareholder can enjoin or set aside a fraudulent or illegal transaction,<sup>13</sup> or an unfair contract entered into by the corporation with an officer or director.<sup>14</sup>

The right of a dissenting shareholder to a valuation of and payment for his shares is a legislative innovation. One of its purposes is to nullify the troublesome common law rule that gives one dissenting shareholder the ability to enjoin or set aside a corporate reorganization desired by the majority.<sup>15</sup> The older approach often was intolerable since it led to "strike suits" in which a minority stockholder sought to be paid a handsome sum merely for his agreement to settle. The newer appraisal right, in this respect, affords protection to the minority by permitting an independent valuation of and payment for their shares, and at the same time, it promotes corporate flexibility by permitting the majority to carry out their plans.<sup>16</sup> Today, all but two of the American jurisdictions provide for these rights.<sup>17</sup> Although seven states<sup>18</sup> purport not to allow that

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<sup>9</sup> See *Geddes v. Anaconda Copper Mining Co.*, 254 U.S. 590 (1921).

<sup>10</sup> *Country Club v. McLaughlin*, 300 S.W.2d 124 (Tex. Civ. App. 1957).

<sup>11</sup> *Lauman v. Lebanon Valley R.R.*, 30 Pa. 42 (1858); *International & G.N. Ry. v. Bremond*, 53 Tex. 96 (1880). See also 46 Calif. L. Rev. 283 (1958).

<sup>12</sup> *Ely v. Credit Mens Adjustment & Interchange Bureau, Inc.*, 106 N.J. Eq. 472, 151 Atl. 208 (Ch. 1930); *Wunsch v. Consolidated Laundry Co.*, 116 Wash. 44, 198 Pac. 383 (1921). See also 72 Harv. L. Rev. 1132 (1959).

<sup>13</sup> *Robb v. Eastgate Hotel, Inc.*, 106 N.E.2d 848 (Ill. App. 1952); *Opelka v. Quincy Memorial Bridge Co.*, 82 N.E.2d 184, 188 (Ill. App. 1948).

<sup>14</sup> *Zorn v. Brooks*, 125 Tex. 614, 83 S.W.2d 949, 951 (1935).

<sup>15</sup> See *Tillis v. Brown*, 154 Ala. 403, 45 So. 589 (1908); *Myerhoff v. Bankers Sec., Inc.*, 105 N.J. Eq. 76, 147 Atl. 105 (Ch. 1929); *Kean v. Johnson*, 9 N.J. Eq. 401 (Ch. 1853). See also 58 Colum. L. Rev. 251-53 (1958).

<sup>16</sup> See *Anderson v. International Minerals & Chem. Corp.*, 295 N.Y. 343, 67 N.E.2d 573 (1946); *Johnson v. Baldwin*, 221 S.C. 141, 69 S.E.2d 585 (1952). See also Lattin, *Remedies of Dissenting Stockholders Under Appraisal Statutes*, 45 Harv. L. Rev. 233, 236 (1931).

<sup>17</sup> Utah and West Virginia do not have statutes permitting the valuation action. For a complete collection of the state statutes, see Skoler, *Some Observations on the Scope of Appraisal Statutes*, 13 Bus. Law. 240, 249-53 (1958).

<sup>18</sup> California, Delaware, District of Columbia, Hawaii, Minnesota, Nebraska, Puerto Rico. See 72 Harv. L. Rev. 1132 (1959).

remedy when a reorganization is consummated by the sale of corporate assets, appraisal rights may still be upheld on the theory that the sale of assets constitutes a "de facto" merger.<sup>19</sup>

## II. EFFECT OF APPRAISAL ON OTHER RIGHTS

Whether the statutory appraisal rights preclude the use of common law remedies by a minority shareholder is a question answered by statute in some jurisdictions and by court decision in others. A few states expressly preserve the non-statutory equitable remedies;<sup>20</sup> others provide only that the statutory appraisal rights are not exclusive<sup>21</sup> or else sanction the injunction actions as alternatives to the statutory rights;<sup>22</sup> still others deny the equitable relief on the ground that the appraisal right is an adequate legal remedy.<sup>23</sup> When the matter of the exclusiveness of the appraisal right has been left to the courts, some have held that the equitable relief is barred.<sup>24</sup> Apparently, the rationale is that a shareholder's financial interest in the corporation is all that merits protection, *i.e.*, he has no vested right to continue in the particular business.<sup>25</sup> However, some of the more recent opinions recognize that although the exclusiveness rule provides corporate flexibility, it nevertheless paves the way for "freeze outs," and the purchase of corporate assets and appropriation of the business by the majority become relatively simple.<sup>26</sup> In fact, the modern trend does not favor exclusiveness of appraisal rights when equity should otherwise take jurisdiction, for example, when the transaction is *ultra vires*,<sup>27</sup> illegal,<sup>28</sup> or fraudulent.<sup>29</sup> One theory offered in support

<sup>19</sup> See *Troupiansky v. Henry Disston & Sons, Inc.*, 151 F. Supp. 609 (E.D. Pa. 1957), discussed in Note, 46 Calif. L. Rev. 283 (1958). *But see Hariton v. Arco Electronics, Inc.*, — Del. —, 188 A.2d 123 (1963).

<sup>20</sup> North Carolina: N.C. Gen. Stat. § 55-113(c) (1960); Virginia: Va. Code Ann. § 13-85 (1954).

<sup>21</sup> Kentucky: Ky. Rev. Stat. § 271.415(4)(b) (1960); Maine: Me. Rev. Stat. Ann. ch. 53, § 85 (1954).

<sup>22</sup> *Robb v. Eastgate Hotel, Inc.*, 106 N.E.2d 848 (Ill. App. 1952); *Opelka v. Quincy Memorial Bridge Co.*, 82 N.E.2d 184 (Ill. App. 1948). See also *Petty v. Harwood Elec. Co.*, 280 Pa. 142, 124 Atl. 302 (1924). *But see Johnson v. Baldwin*, 221 S.C. 141, 69 S.E.2d 585 (1952).

<sup>23</sup> *Katz v. R. Hoe & Co.*, 99 N.Y.S.2d 899 (Sup. Ct. 1950), *modified*, 227 App. Div. 966, 99 N.Y.S.2d 853 (1950).

<sup>24</sup> *Blumenthal v. Roosevelt Hotel, Inc.*, 202 Misc. 988, 115 N.Y.S.2d 52 (Sup. Ct. 1952); *Blumner v. Federated Dept. Stores*, 99 N.Y.S.2d 691, 694 (Sup. Ct. 1950); *Beloff v. Consolidated Edison Co.*, 300 N.Y. 11, 87 N.E.2d 561 (1949).

<sup>25</sup> *Beachwood Sec. Corp. v. Associated Oil Co.*, 104 F.2d 537, 540 (9th Cir. 1939).

<sup>26</sup> Even if the injunction is denied, liability for breach of a fiduciary relation or fraud might be imposed. See *Southern Pac. Co. v. Bogert*, 250 U.S. 483 (1919); *Fletcher, Corporations* § 7296, at 569 (1961). The court in the instant case, in denying Plaintiff's claim for special damages based upon the alleged "freeze out," states that the transaction is "one which the law permits." 365 S.W.2d at 5.

<sup>27</sup> *Johnson v. Spartanburg County Fair Ass'n*, 210 S.C. 56, 41 S.E.2d 599 (1947).

<sup>28</sup> *Opelka v. Quincy Memorial Bridge Co.*, 82 N.E.2d 184 (Ill. App. 1948).

<sup>29</sup> *Weckler v. Valley City Mill Co.*, 93 F. Supp. 444 (W.D. Mich. 1950); *Robb v. Eastgate Hotel, Inc.*, 106 N.E.2d 848 (Ill. App. 1952).

of the trend is that the purported corporate sale is void when fraud or illegality is involved, and hence, the appraisal statutes have no application.<sup>30</sup> Of course, there is a better justification for denying the exclusiveness of the appraisal technique when the corporation is insolvent: The legal remedy of appraisal then becomes inadequate, and equity jurisdiction attaches.<sup>31</sup> Thus, absent express statutory provisions regarding exclusiveness, most courts hold that appraisal rights are the exclusive remedy only when the transaction is consummated in good faith and meets all of the specified requirements.<sup>32</sup>

The Texas act, in an express provision regarding exclusiveness of appraisal rights, somewhat ambiguously states:

Nothing contained in part Five of this Act [which authorizes majority action with appraisal rights for dissenters] shall ever be construed as . . . abridging any right or rights of a dissenting stockholder under existing laws.<sup>33</sup>

Quite obviously, under the statute, appraisal rights are not exclusive. However, many problems arise in determining what other rights a dissenting minority shareholder may have. The plaintiff in the instant case sought special damages for an alleged conspiracy to defraud him of his shares as an *alternative* to appraisal rights. The court, in dictum, stated that special damages, if necessary to effect a full recovery, could be awarded in *addition* to the appraised "fair value" of the shares.<sup>34</sup> The court pointed out that such additional recovery would be justified, for example, if the fraud or unfair dealing of the majority depressed the value of the shares prior to a sale of the assets and thus made the appraised value inadequate.

There is certainly no indication that the court in its dictum in *Farnsworth* intended to render an exhaustive interpretation of the Texas appraisal rights statute. Many questions remain unanswered. For example, can the provision be construed to allow an initial "election" of whether to proceed under the act or to assert common

<sup>30</sup> Weckler v. Valley City Mill Co., *supra* note 29; Robb v. Eastgate Hotel, Inc., *supra* note 29; Opelka v. Quincy Memorial Bridge Co., 82 N.E.2d 184 (Ill. App. 1948); Wick v. Youngstown Sheet & Tube Co., 188 N.E. 514 (Ohio App. 1932).

<sup>31</sup> Brown v. Ramsdell, 227 App. Div. 224, 237 N.Y. Supp. 573 (1929).

<sup>32</sup> See Stauffer v. Standard Brands, Inc., — Del. —, 187 A.2d 78 (1962). However, Ballantine states that, in the absence of express limitation, the statutory remedy of appraisal rights is generally held to be only an alternative to other equitable or legal remedies. Ballantine, *Corporations* § 298, at 703 (1946). See also Henn, *Corporations* § 349, at 553 (1961); Lattin, *A Reappraisal of Appraisal Statutes*, 38 Mich. L. Rev. 1165, 1168-73, 1187 (1940).

<sup>33</sup> Tex. Bus. Corp. Act Ann. art. 5.14 (1956). It is noteworthy that article 5.14 was added by floor amendment and was not part of the draft submitted by the Bar Committee. See *Comment of Bar Committee*, 3A Vernon's Ann. Tex. Civ. Stat. 276 (1956).

<sup>34</sup> 365 S.W.2d at 5.

law rights?<sup>35</sup> In view of the wording of the statute, such a construction would be possible. However, that interpretation would conflict with two of the basic purposes of appraisal rights, *viz.*, the elimination of "strike suits" and the promotion of corporate flexibility.

Another problem is whether the express preservation of "rights" under existing law impliedly excludes the preservation of "remedies." The doctrine of *expressio unius est exclusio alterius*<sup>36</sup> may support such a construction. Thus, injunctive relief, which is technically a remedy, could be denied on this basis. Some courts have reached this result by finding an adequate legal remedy available in the form of appraisal rights.<sup>37</sup> It would seem then that appraisal rights would usually be "adequate" in Texas, especially since a claim for special damages is recognized when necessary to effect a full recovery. Under this approach, only when the corporation is insolvent, and statutory rights are obviously inadequate,<sup>38</sup> or when the transaction lacks statutory authorization<sup>39</sup> or the required shareholder approval,<sup>40</sup> should the injunction still be available.

A final consideration is whether the Texas statute should be construed as merely a savings clause designed to preserve accrued rights, *i.e.*, only those rights that arose prior to the date the act became effective. That was the position taken by the court of civil appeals<sup>41</sup> in the instant case as well as the interpretation given by the Texas State Bar Committee.<sup>42</sup> However, there was an implication in the principal case that the article was not to be so limited. In the example given by the court regarding preservation of the action for special damages, there was no indication that the measure of such damages should be limited to the date the act was adopted by the corporation. Thus, when the provision refers to rights under "existing" laws, it apparently means the rights existing at common law and not the time of accrual of such rights.

<sup>35</sup> The court in the instant case declared it was not concerned with this point. 365 S.W.2d at 5. In the opinion after the motion for rehearing, the court stated that it "did not hold that a dissenting stockholder is deprived . . . of his common law remedies and under proper facts could not originally proceed other than by the statutory 'fair value' remedy." 365 S.W.2d at 5, 6.

<sup>36</sup> The expression of one excludes all others, *i.e.*, if remedies were intended to be preserved they would have been listed. See *State v. Mauritz-Wells Co.*, 141 Tex. 643, 175 S.W.2d 238 (1943); *Siebert v. Richardson*, 86 Tex. 295, 24 S.W. 261 (1893).

<sup>37</sup> See *Katz v. R. Hoe & Co.*, 99 N.Y.S.2d 899 (Sup. Ct.), *modified*, 277 App. Div. 966, 99 N.Y.S.2d 853 (1950).

<sup>38</sup> *Brown v. Ramsdell*, 227 App. Div. 224, 237 N.Y. Supp. 573 (1929).

<sup>39</sup> See *Eisenberg v. Central Zone Property Corp.*, 306 N.Y. 58, 115 N.E.2d 652 (1953).

<sup>40</sup> See *Matter of MacDonald*, 205 App. Div. 579, 199 N.Y.S. 873 (1923).

<sup>41</sup> 353 S.W.2d 262, 267 (Tex. Civ. App. 1961).

<sup>42</sup> See *Comment of Bar Committee*, 3A Vernon's Ann. Tex. Civ. Stat. 276 (1956).

## III. THE FARNSWORTH CASE

The *rationes decidendi* of *Fansworth v. Massey* are twofold: (1) that the appointment of an appraiser is not jurisdictional; and (2) that a properly authorized reorganization is not to be considered a fraud on a minority shareholder even though it effects a "freeze out" of his interest. The first appears sound. Generally any failure by the shareholder in following the prescribed dissent procedures will result in his being bound by the corporate action.<sup>43</sup> However, since the appraiser is to be appointed by the court, this should not be considered as a step to be taken by a shareholder in his dissent. Defendant-corporations desiring determination of "fair value"<sup>44</sup> by an appraiser in preference to some other method can protect themselves by filing a plea in abatement, as indicated by the court.<sup>45</sup> One disadvantage of this holding should be pointed out: In the normal appraisal action, waiver of the appointment of an appraiser may work to the disadvantage of the dissenting shareholder.<sup>46</sup> An appraiser is presumably sophisticated in financial matters and is able to evaluate objectively certain relevant factors, e.g., capitalization of earnings. In contrast, few juries understand these concepts, and, unfortunately, the dissenting stockholder's attorney may overlook such complex rudiments of the evaluation process. At that point, "fair value" will lose all objective meaning and become subjectively related to the sophistication of the attorney and his ability to convey the knowledge he has to the jury.

The holding that a properly authorized "freeze out" is not actionable fraud may be too broad for general application. To a certain extent, majority stockholders stand in a fiduciary relation toward the interest of the minority.<sup>47</sup> They must exercise fairness and good faith in effecting a reorganization so as not to acquire the business for themselves in breach of their fiduciary duties.<sup>48</sup> Plaintiff,

<sup>43</sup> *Root v. York Corp.*, 56 F. Supp. 288 (D. Del. 1944).

<sup>44</sup> For a good treatment of how the valuation is made, see Comment, *Valuation of Dissenting Stockholder's Shares Under an Appraisal Statute*, 23 Mo. L. Rev. 223 (1958). See also Comment, *Corporations—Appraisal Statutes—Elements in Valuation of Corporate Stock*, 55 Mich. L. Rev. 689 (1957).

<sup>45</sup> 365 S.W.2d at 4.

<sup>46</sup> Also, when many dissenting shareholders are involved, the appraisal action somewhat resembles a class action in that one consolidated proceeding determines the "fair value" of all dissenters' shares and the final judgment binds all shareholders having notice of the proceeding. Tex. Bus. Corp. Act Ann. art. 5.12(B) (1956). Thus, the situation could arise in which an active dissenter could effectively waive the rights of the non-litigating dissenters to the appointment of an appraiser.

<sup>47</sup> *Pepper v. Litton*, 308 U.S. 295 (1939); *Southern Pac. Co. v. Bogert*, 250 U.S. 483 (1919), *modifying* 244 Fed. 61 (2d Cir. 1917); *Zahn v. Transamerica Corp.*, 162 F.2d 36 (3d Cir. 1947); *Lebold v. Inland Steel Co.*, 125 F.2d 369, 372 (7th Cir. 1941), *cert. denied*, 316 U.S. 675 (1942).

<sup>48</sup> See *Southern Pac. Co. v. Bogert*, *supra* note 47.