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THE APPRAISAL REMEDY IN CORPORATE FREEZE-OUTS: QUESTIONS OF VALUATION AND EXCLUSIVITY

by Joseph M. Coleman

MERGER transactions annually involve billions of dollars,¹ a significant portion of which is paid to minority shareholders² in consideration for their interest in newly merged subsidiaries. Merger statutes allow controlling shareholders to force minority shareholders to relinquish their corporate ownership in exchange for cash.³ This power to "cash-out" or "freeze-out"⁴ minority shareholders derives from statutory language authorizing cash to be used as consideration in merger transactions, and not as an explicitly granted power allowing a corporation to rid itself of troublesome shareholders.⁵

A parent corporation's position as the majority or controlling shareholder of a subsidiary⁶ leaves the subsidiary's minority or independent

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¹. In 1981 merger transactions involved more than $73 billion. The 1982 dollar volume was $66 billion. 1983 MERGERS & ACQUISITIONS ALMANAC & INDEX 4. Although experts predicted that dollar volume could drop again in 1983, they also predicted high merger activity. Id. Figures for 1983 have not yet been released.

². A minority shareholder is a stockholder who owns less than 50% of the issued and outstanding stock of a corporation. The term is usually used to categorize parties in situations in which a majority shareholder, owning more than 50% of the outstanding stock, exists. A minority shareholder who objects to a statutory merger and who has asserted rights to be paid the fair value of his shares is termed a "dissenting shareholder." See DEL. CODE ANN. tit. 8, § 262 (1983); N.Y. BUS. CORP. LAW § 910 (McKinney 1982-1983); MODEL BUSINESS CORP. ACT §§ 80, 81 (1981).


⁴. The term "freeze-out" refers to the elimination of minority shareholders' interests by those in control of the corporation. The majority can use a variety of oppressive devices to disadvantage the minority shareholders. Donahue v. Rodd Electrotype Co., 367 Mass. 578, 328 N.E.2d 505, 513 (1975). The majority can accomplish a freeze-out through merger, consolidation, or a sale of assets. See F. O'NEAL, OPPRESSION OF MINORITY SHAREHOLDERS (1974); Brudney & Chirelstein, A Restatement of Corporate Freezeouts, 87 YALE L.J. 1354, 1357 (1978); Carney, Fundamental Corporate Changes, Minority Shareholders, and Business Purposes, 1980 AM. B. FOUNDATION RESEARCH J. 69, 97-98.


⁶. This comment examines appraisal statutes primarily in the context of a parent-subsidiary merger. In this type of merger the parent corporation, which is the controlling shareholder of the subsidiary, negotiates with the subsidiary's board of directors to determine a
shareholders in a particularly vulnerable position. By exercising its control the parent corporation can decide the timing of the merger and the compensation paid to the minority shareholders.\textsuperscript{7} Appraisal statutes, however, prevent majority shareholders from abusing their favorable position.\textsuperscript{8} The statutes provide protection to minority shareholders who dissent from a freeze-out merger by creating a forum in which their interest in the newly merged subsidiary can be valued and compared with the compensation granted by the parent.\textsuperscript{9} Since unfair price is the preponderant consideration in the evaluation of merger transactions,\textsuperscript{10} appraisal statutes play a very significant role in the protection of cashed-out minority shareholders.

This Comment examines the effectiveness of the appraisal remedy in light of its basic objective of insuring that cashed-out minority shareholders receive the monetary equivalent of what they have lost, namely their proportionate share in a corporate enterprise.\textsuperscript{11} Analysis of Delaware's treatment of its appraisal remedy, as a representative state,\textsuperscript{12} reveals two

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\textsuperscript{7} See Levin v. Midland-Ross Corp., 41 Del. Ch. 276, 194 A.2d 50, 52-53 (1963). In Levin a textile company had liquidated about half of its assets in an attempt to eliminate operations that had become unprofitable because of a reduction in the tire industry's demand for rayon. The company's high degree of liquidity at the time of its merger caused the shareholders to contest the method used to value their stock. \textit{Id.} at 1359-65.

\textsuperscript{8} Two other types of mergers exist. A two-step, or tender-offer-plus, merger involves a transaction in which an aggressor, owning little or none of the potentially merged corporation, first makes a tender offer to buy a large segment of outstanding stock of the target corporation. The aggressor then negotiates with its new subsidiary's board of directors to establish a price for the remaining shares. The merger, therefore, is consummated in two steps. \textit{Id.} at 1359-65. A going-private merger involves controlling shareholders who are responsible for the company's management. When the controlling shareholders have determined that their shares are undervalued on the market, they form a separate holding company that buys all the outstanding stock and thus returns the company to private status. \textit{Id.} at 1365-70.

\textsuperscript{9} The courts of other states generally look to Delaware law for aid in fashioning rules of corporate law. Mullen v. Academy Life Ins. Co., 705 F.2d 971, 973 n.3 (8th Cir. 1983); see also Perl v. IU Int'l Corp., 61 Hawaii 622, 638-40, 607 P.2d 1036, 1045-46 (1980) (Hawaii
obstacles to achieving the objective: the valuation of a minority interest and the exclusivity of the appraisal remedy. This Comment explores these two obstacles and notes the judicial interpretations and commentators' suggestions of legal alternatives to ensure that minority shareholders receive just compensation for their relinquished interest in the newly merged subsidiary.

I. VALUATION OF A MINORITY SHAREHOLDER'S INTEREST IN A GOING CONCERN

Appraisal statutes provide the remedy by which dissenting minority shareholders receive the equivalent of their interest in the newly merged subsidiary. Upon satisfaction of the statute's procedural requirements, the cashed-out stockholders are entitled to have the fair value of their investment determined. Under special circumstances, such as when fraud is shown, the dissenting shareholders have the alternative of litigating their complaint in equity. Regardless of the forum, the courts continually face the problem of valuating an interest in a recently merged subsidiary so that a dissenting shareholder receives fair compensation for his proportionate share in a going concern.

At first glance, the determination of the dissenting shareholder's proportionate interest appears rather simple. The court first determines the subsidiary's net assets, and then divides that number by the total number of shares outstanding. This method, however, ignores the subsidiary's mar-

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Supreme Court relies on Delaware's interpretation of its appraisal statute for guidance in interpreting Hawaii's appraisal remedy; Schaefer, *The Fallacy of Weighting Asset Value and Earnings Value in the Appraisal of Corporate Stock*, 55 S. Cal. L. Rev. 1031, 1031 n.2 (1982) (Delaware corporation law is of particular nationwide importance because of the large number of enterprises that are incorporated in Delaware); Weiss, *supra* note 5, at 625 n.4 (decisions affecting Delaware corporate law have impact that extends well beyond Delaware's borders). In addition to Delaware's treatment, *see infra* notes 64-70 and accompanying text for analysis of the Seventh Circuit's interpretation.

13. Procedural requirements to perfect an appraisal right vary from state to state. Delaware requires each shareholder electing an appraisal to submit a written demand to the merging corporation. This demand must inform the corporation of the identity of the stockholder and that the stockholder intends to demand the appraisal of his shares. DEL. CODE ANN. tit. 8, § 262(d)(1) (1983). For a summary of procedural problems with the appraisal remedy, see Green v. Santa Fe Indus., Inc., 533 F.2d 1283, 1297-98 n.4 (2d Cir. 1976), rev'd and remanded, 430 U.S. 462 (1977).


15. Weinberger v. UOP, Inc., 457 A.2d, 701, 714 (1983); *see infra* notes 126, 151-58 and accompanying text.

16. Going concern value is an intangible amount distinct from goodwill and is the additional element of value that attaches to property by reason of its existence as an integral part of a concern presently doing business. North Clackamas Community Hosp. v. Harris, 664 F.2d 701, 707 (9th Cir. 1980).

17. Net assets are computed by deducting total liabilities from the total assets of a company. Net assets, therefore, equal a company's equity. Tri-Continental Corp. v. Battye, 31 Del. Ch. 523, 74 A.2d 71, 74 (Sup. Ct. 1950).

18. 74 A.2d at 75.
Numerous factors significantly affect a particular corporation's value. For example, a corporation's financial stability and prospects for growth may influence the value of its stock. Thus, despite a clear objective, courts face considerable difficulty in developing a method that awards dissenting shareholders the fair value of their investment.

In 1950 the Supreme Court of Delaware addressed the valuation problem in *Tri-Continental Corp. v. Batlye.* Tri-Continental Corporation merged with its subsidiary, General Shareholders Corporation, and thereby froze out the subsidiary's minority shareholders. Seven minority shareholders objected to the consideration paid for their shares by Tri-Continental and exercised their appraisal rights. After the minority shareholders appealed the appraiser's valuation, the court held that a merged corporation must be valued as a going concern and not merely at its liquidation value. The court instructed the appraisers to determine the true or intrinsic value of the minority shareholder's stock by taking into account all relevant factors. The rule of *Tri-Continental,* therefore, demands that a court recognize all factors that might reasonably influence the merged corporation's actual worth. This broader valuation approach enables courts to consider factors such as asset value, earnings value, market value, growth potential, dividend prospects, nature of the enterprise and its relative position within its particular industry, and any other relevant factor.

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19. Market value is the price of stock quoted on a recognized stock exchange. For stocks not sold on exchanges the market value is the amount a willing buyer would pay a willing seller at arm's length. See *Comment, Valuation of Dissenters' Stock Under Appraisal Statutes,* 79 Harv. L. Rev. 1453, 1460 (1966).

20. Earnings per share (EPS) is the relationship expressed by dividing the corporation's income available to the common stockholders by the number of outstanding shares of common stock. EPS is not computed for preferred stock. Black's Law Dictionary 457 (5th ed. 1979); *G. Welsch, C. Zlatkovich & W. Harrison, Intermediate Accounting* 100 (1979).

21. 31 Del. Ch. 523, 74 A.2d 71 (Sup. Ct. 1950).

22. 74 A.2d at 72; see *Lynch v. Vickers Energy Corp.,* 429 A.2d 497, 500 (Del. 1981); *In re Delaware Racing Ass'n,* 42 Del. Ch. 406, 213 A.2d 203, 209 (Sup. Ct. 1965); *Sterling v. Mayflower Hotel Corp.,* 33 Del. Ch. 293, 93 A.2d 107, 111-14 (Sup. Ct. 1952). In most cases the liquidation value of the assets is not an appropriate consideration, since liquidation comprehends the termination of the business and disposal of the assets. Valuation on such a basis is unrealistic, except possibly when the firm is insolvent or when particular assets are idle and of no further use to the company. *Comment, supra* note 19, at 1457; see also Haynsworth, *Valuation of Business Interest,* 33 Mercer L. Rev. 457, 508-09 (1982) (rationale for valuing subsidiary as going concern as opposed to liquidation results from the dissenting shareholder's giving up right to share in future business).

23. 74 A.2d at 72; see *Poole v. N.V. Deli Maatschappij,* 43 Del. Ch. 283, 224 A.2d 260, 263 (Sup. Ct. 1966) (advocating the consideration of earnings, dividends, market price, assets, and other relevant factors when valuing stock).

24. 74 A.2d at 72.

25. Inclusion of all relevant factors in the valuation process continues to be the prevailing mandate in leading corporate states such as Delaware and New York. Delaware's merger statute states that "[i]n determining . . . fair value, the Court shall take into account all relevant factors." *Del. Code Ann.* tit. 8, § 262(h) (1983). New York's appraisal statute provides that "[i]n fixing the fair value of the shares, the court shall consider the nature of the transaction . . . and all other relevant factors." *N.Y. Bus. Corp. Law* § 623(h)(4) (McKinney Supp. 1983-1984). While the above statutes codify an intent to include all relevant factors, such an approach is rarely used in practice. *See infra* notes 28-32 and accompanying text.
A. The Delaware Block

Despite the all-inclusive valuation method announced in Tri-Continental, 26 Delaware courts traditionally relied primarily on three elements to value a corporation: asset value, earnings value, and market value. 27 Apparently because of the administrative ease offered by emphasizing these three values, 28 the courts' reliance quickly evolved into a structured, mechanistic valuation technique referred to as the Delaware block. 29 Under this method, which was predominant throughout the 1960s and most of the 1970s, 30 the courts estimated the subsidiary's asset, earnings, and market values and assigned each component a percentage in accordance with its relative importance. 31 For example, the percentage assigned to the market value of a corporation not listed on a stock exchange or infrequently traded would be relatively low. 32

The asset value is determined by estimating the fair market value of the subsidiary's property. 33 An estimated value for each asset, such as machines, buildings, inventorries, and trademarks, is determined. Quite often, however, no market exists for a particular asset. In such cases the court, or court-appointed appraiser, 34 must determine the present cost of replacing

26. Two years after Tri-Continental, the Delaware Supreme Court in Sterling v. Mayflower Hotel Corp., 33 Del. Ch. 293, 93 A.2d 107, 114 (Sup. Ct. 1952), repeated its mandate that all relevant factors should be considered in valuing a merged subsidiary.


28. Cf. Weiss, supra note 5, at 671-72 (suggesting that subsequent decisions interpreting Sterling v. Mayflower Hotel Corp., 33 Del. Ch. 293, 93 A.2d 107 (Sup. Ct. 1952), have held that fairness of a merger's terms was adequately determined by the Delaware block). Weiss asserts that such interpretation robs Sterling of much of its impact since only the Delaware block elements, and not all relevant factors, are examined. Weiss, supra note 5, at 671-72.

29. See, e.g., Weinberger, 457 A.2d at 713 (Delaware block fails to incorporate factors necessary to accurate valuation); Lynch v. Vickers Energy Corp., 429 A.2d 497, 499 (Del. 1981) (court stated that it considered several factors relevant to determining proper value, but examined only three elements of Delaware block).

30. Weinberger, 457 A.2d at 712; see also In re General Realty & Utils. Corp., 29 Del. Ch. 480, 52 A.2d 6, 8-16 (1947) (illustrating early application of Delaware block method).

31. For general discussions of the Delaware block method, see Nathan & Shapiro, Legal Standard of Fairness of Merger Terms Under Delaware Law, 2 DEL. J. CORP. L. 44 (1977); Schaefer, supra note 12; Comment, supra note 19.


33. See Nathan & Shapiro, supra note 31, at 56, in which the authors stated: "By fair market value, the Delaware courts mean the price that a willing seller and a willing buyer would agree upon under usual and ordinary circumstances, after consideration of all available uses and purposes of the assets in question . . . ." Id. (citing Poole v. N.V. Deli Maatschappij, 43 Del. Ch. 283, 243 A.2d 67, 70 (Sup. Ct. 1969)).

34. While Delaware specifically mandates that the court appraise the shares in question, Del. Code Ann. tit 8, § 262(b) (1983), many other states allow the court to appoint an appraiser. E.g., MD. CORPS. & ASS'NS CODE ANN. § 3-210(a) (1975); N.J. STAT. ANN. § 14A:11-8 West (1969); N.Y. BUS. CORP. LAW § 623 (McKinney 1982-1983); Tex. BUS. CORP. ACT ANN. art. 5.12C (Vernon 1980).
the same asset by taking into account depreciation, to measure its remaining usefulness, and discounting the asset to incorporate obsolescence.\textsuperscript{35}

The earnings value measures the income capacity of the corporation and involves an attempt to predict its future income by averaging past earnings.\textsuperscript{36} Determination of this component requires a two-step analysis consisting of historical averaging and capitalization.\textsuperscript{37} The court first averages the subsidiary's earnings over a period of time, usually five years.\textsuperscript{38} This historical average is then capitalized by an appropriate price/earnings multiplier,\textsuperscript{39} which is determined by estimating the subsidiary's market price and the recent earnings from comparable companies.\textsuperscript{40} Courts and commentators generally agree that the multiplier used in the capitalization step creates the greatest disparity between opposing parties, because of the relatively wide range of price/earnings ratios that can be justified and the lack of objective criteria with which to evaluate the multiplier.\textsuperscript{41} This conflict is magnified by the large impact that a small variation in the multiplier will have on the final appraisal.\textsuperscript{42} Consistent with the Delaware

\begin{footnotesize}
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\item\textsuperscript{35} See Gibbons v. Schenley Indus., Inc., 339 A.2d 460, 472-73 (Del. Ch. 1975); In re Delaware Racing Ass'n, 42 Del. Ch. 406, 213 A.2d 203, 209-10 (Del. 1965).
\item\textsuperscript{37} Nathan & Shapiro, supra note 31, at 52; Comment supra note 19, at 1464.
\item\textsuperscript{38} Universal City Studios, Inc. v. Francis I. duPont & Co., 334 A.2d 216, 218 (Del. 1975) (five years is a reasonable period over which to average earnings). In In re Olivetti Underwood Corp., 246 A.2d 800 (Del. Ch. 1968), shareholders of Underwood Corporation unsuccessfully urged averaging earnings for a 13-year period. Although Underwood showed a loss for each of the 5 years before the merger and average earnings of $2 per share for the preceding 8 years, the court held that a previously profitable operation was not a sufficient reason to average over 13 years. Id. at 804. Five years is the usual averaging period, but courts will vary the time period to reflect the unique circumstances of a particular corporation. Stryker & Brown v. Bon Ami, Civ. No. 1945 (Del. Ch. Mar. 16, 1964), reprinted in PLI Third Annual Inst. on Sec. Reg. 573 (1972) (shareholders of controlled corporation sought to enjoin a merger; court examined consolidated balance sheet and income statement for just one year, finding past separate histories of the companies not comparable).
\item\textsuperscript{39} See, e.g., Universal City Studios, Inc. v. Francis I. duPont & Co., 334 A.2d 216, 218-22 (Del. 1975); Gibbons v. Schenley Indus., Inc., 339 A.2d 460, 474 (Del. Ch. 1975); Swanton v. State Guar. Corp., 215 A.2d 242, 244-46 (Del. Ch. 1965). The capitalization rate reflects the confidence of a potential shareholder in the corporation's ability to continue to earn at least its average income. Thus the capitalization rate takes into account the risk involved in a particular corporate enterprise. Note, supra note 36, at 638. See also Annot., 48 A.L.R.3d 430 (1973) (survey of valuation techniques, including multiplier considerations).
\item\textsuperscript{40} See Nathan Shapiro, supra note 31, at 55-56, for an analysis of the court's choice of comparable sporting goods companies in David J. Greene & Co. v. Dunhill Int'l, Inc., 249 A.2d 427, 434-35 (Del. Ch. 1968).
\item\textsuperscript{41} See, e.g., Gibbons v. Schenley Indus., Inc., 339 A.2d 460, 471 (Del. Ch. 1975) (the multiplier is "always difficult and imprecise"); A. Dewing, THE FINANCIAL POLICY OF CORPORATIONS 390-91 (5th ed. 1953) (describing seven common types of businesses and suggesting capitalization ratios ranging from one to ten times earnings); Comment, supra note 19, at 1467 ("The multiplier is likely to represent the point of greatest disparity between the contending parties because of the absence of objective criteria by which to measure it . . . .").
\item\textsuperscript{42} For an example of the impact of the multiplier on valuation, see Gibbons v. Schenley Indus., Inc., 339 A.2d 460, 468-70 (Del. Ch. 1975). In Gibbons the appraiser dropped the multiplier from 20.2 to 14 in order to compensate for capital gains that had resulted in
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block valuation approach, both the historical average and capitalization steps relied primarily on historical data as an acceptable means of anticipating future occurrences likely to result from the merger.43

Market value, the third component of the Delaware block valuation method, is the price at which the subsidiary's stock is traded.44 As with the earnings value, the appraiser must designate a time period over which to examine the trading history. The appraiser must then ascertain what extraneous factors affect the market price and adjust the estimate accordingly.45 For less active stocks, however, an estimate of the price at which a particular company's stock would trade in a representative market is necessary.46 Compensation for the absence of a reliable market is further accomplished by assigning the market value less weight than that assigned to the asset value and earnings value.47

Under the Delaware block method, after the court has computed an estimate of the asset, earnings, and market values, each factor is assigned a percentage, which produces a weighted-average price of the subsidiary's stock.48 The percentage or weight assigned to each value is intended to reflect the unique characteristics of the company being valued.49 The reliability of each estimate also affects the percentage assigned to the three values.50 In one instance, for example, the court assigned less weight to the asset value merely because it differed substantially from the other two

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44. Comment, supra note 19, at 1460.

45. See, e.g., David J. Greene & Co. v. Schenley Indus., Inc., 281 A.2d 30, 31, 34 (Del. Ch. 1971) (court, refusing to enjoin a merger claimed to be unfair on the basis of market price analysis, instead took into account fact that competing take-over offers had inflated market prices); David J. Greene & Co. v. Dunhill Int'l, Inc., 249 A.2d 427, 430-31 (Del. Ch. 1968) (court acknowledged unreliability of market price because of large holdings by parent corporation).

46. Nathan & Shapiro, supra note 31, at 50 n.16.

47. See Piemonte v. New Boston Garden Corp., 377 Mass. 719, 387 N.E.2d 1145, 1153 (1979), in which the court assigned the following percentages: asset value 50%, earnings value 40%, and market value 10%. The lower weight of the market value was due to the limited trading of Boston Garden Arena Corporation's stock. 387 N.E.2d at 1148.


49. See, e.g., Universal City Studios, Inc. v. Francis I. duPont & Co., 334 A.2d 216, 219-22 (Del. 1975), modifying 312 A.2d 344 (Del. Ch. 1973) (court stressed earnings value because at the time of the merger the valued corporation had a better than average earnings picture); Gibbons v. Schenley Indus., Inc., 339 A.2d 460, 472-73 (Del. Ch. 1975) (court ignored asset value because the assets consisted of idle and obsolete manufacturing plants); Note, supra note 36, at 641-42 (further examples of weightings).

50. Comment, supra note 19, at 1468.
Upon final analysis, if the consideration the parent corporation offered the dissenting minority shareholder was less than the amount calculated by the Delaware block, the court awarded the shareholder the appraised value.  

B. The Decline of the Delaware Block

Despite the Delaware block's popularity, its accuracy eventually became suspect. Since its analysis was limited to assets, earnings, and market value, which were based solely on historical data, the Delaware block failed to implement fully Tri-Continental's mandate to incorporate all relevant factors, including those elements indicating the merged subsidiary's future prospects. The inadequacies of the Delaware block become apparent upon analysis of the appraisal proceeding in the following three contexts: ability to incorporate postmerger gains, enlargement of equity's role in valuation, and the rescissory damages experiment.

I. Postmerger Gains

A natural consequence of the Delaware block's historical valuation process was the failure to consider the anticipated gains that may result from a merger. The postmerger gain consists of the incremental increase in value of the newly merged corporation over the combined premerger values of the two separate entities. This synergistic gain motivates the parent to cash-out the minority shareholders and assume full ownership of the subsidiary. Specifically, the postmerger gain accrues because the new corporation can take advantage of the economies of scale and eliminate duplicate departments and functions. The merger may also generate tax

51. Heller v. Munsingwear, Inc., 33 Del. Ch. 593, 98 A.2d 774, 777 (1953). The asset figure was more than three times as large as the earnings and market values.
55. E.g., Mills v. Electric Auto-Lite Co., 552 F.2d 1239 (7th Cir.), cert. denied, 434 U.S. 922 (1977). In Mills the Seventh Circuit stated: [Flaimess requires that minority shareholders be compensated not only for the market value of their shares in the old corporation, but also for the share of the synergism generated by the merger that is proportionate to the interest that those shares represented in the combined premerger value of the two old corporations.

Mills had an elaborate history. Seven years and three reported decisions elapsed before the courts determined that the plaintiffs had a cause of action. 281 F. Supp. 826 (N.D. Ill. 1967), rev'd, 403 F.2d 429 (7th Cir. 1968), vacated and remanded, 396 U.S. 375, 383 (1970). A determination that the plaintiffs had not suffered any harm and were not entitled to any other damages occurred after another seven years and two more reported decisions. 552 F.2d 1239, 1249 (7th Cir.), cert. denied, 434 U.S. 922 (1977). The district court's decision on the computation of the damages is not reported; the court decided it would be impractical to rescind the merger. See Mills v. Electric Auto-Lite Co., [1971-1972 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,354 (N.D. Ill. Jan. 10, 1972); Lorne, A Reappraisal of Fair Shares in Controlled Mergers, 126 U. Pa. L. Rev. 955, 955 n.4 (1978).
56. See Brudney & Chirelstein, Fair Shares in Corporate Mergers and Takeovers, 88 Harv. L. Rev. 297, 308 (1974); see also Grimes v. Donaldson, Lufkin & Jenrette, Inc.,
benefits, and the former parent can take advantage of the subsidiary's depressed market price. Because of the controlling interest it holds in the subsidiary, the parent corporation may time the merger such that the post-merger gain to the parent will be the greatest.

The common rationale for excluding evidence of a resulting postmerger gain is its speculativeness and difficulty of calculation. Professors Brudney and Chirelstein, however, devised a formula for determining the synergistic gain and its apportionment to the parent and subsidiary in accordance with their respective premerger value.

For example, P corporation is worth $3,000,000 and owns 50.1% of S corporation, which is worth $1,000,000. The combined value should be $4,000,000, but because of the elimination of duplicate functions and tax benefits the newly merged entity is worth $4,400,000, which includes a $400,000 synergistic gain.

The merger between Hilton Hotels and Statler Hotels is an example of a merger resulting in a synergistic gain caused by the presence of economies of scale. A Hilton executive estimated that the savings accruing from the combined management of the Statler Hotel in New York and Hilton's New York hotel amounted to $700,000 a year because of the more efficient economies of scale in laundry, food, advertising, and administrative costs. J. Weston & E. Brigham, Essentials of Managerial Finance 643 (5th ed. 1979).

As a general rule, a subsidiary's stock is "worth" more than the market price listed on the stock exchange. This depression of a subsidiary's stock price occurs because of the majority's control. Investors are less willing to buy stock in a company in which the majority shareholders may cash them out. In addition, stock in a subsidiary allows the investor himself no potential for majority ownership. See generally David J. Greene & Co. v. Dunhill Int'l Inc., 249 A.2d 427, 432 (Del. Ch. 1968) (acknowledging unreliability of stock's market price because of large holdings by parent corporation).

The management of the controlling company is the most likely to know the availability of those benefits and when the disparity between market value and real value is the greatest. That advantage should create an additional reason to be dissatisfied with a procedure for valuation that allows dissenting minority shareholders to receive the premerger value.

The authors' explanation analo-


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57. Brudney & Chirelstein, supra note 56, at 308; Haynsworth, supra note 22, at 511 n.186. In a dissenters' rights case, a cash award given a minority shareholder may not compensate the shareholder for transaction costs. For example, mergers and consolidations involving exchanges of securities are often tax-free transactions. Receipt of the proceeds from a take-out merger, however, is a taxable event to the minority shareholders. Brudney & Chirelstein, supra note 56, at 308.

58. As a general rule, a subsidiary's stock is "worth" more than the market price listed on the stock exchange. This depression of a subsidiary's stock price occurs because of the majority's control. Investors are less willing to buy stock in a company in which the majority shareholders may cash them out. In addition, stock in a subsidiary allows the investor himself no potential for majority ownership. See generally David J. Greene & Co. v. Dunhill Int'l Inc., 249 A.2d 427, 432 (Del. Ch. 1968) (acknowledging unreliability of stock's market price because of large holdings by parent corporation).

59. Lorne, supra note 55, at 958. The management of the controlling company is the most likely to know the availability of those benefits and when the disparity between market value and real value is the greatest. That advantage should create an additional reason to be dissatisfied with a procedure for valuation that allows dissenting minority shareholders to receive the premerger value.


61. Brudney & Chirelstein, supra note 56, at 307-25. The authors' explanation analogizes the determination of the synergistic gain to a trustee who manages two savings accounts for two different beneficiaries. The trustee combines the two accounts, which represents the merger, and thereby saves administrative and transaction costs, which is analogous to the merged corporation's synergistic gain. For example, beneficiary A has assets of $100, and beneficiary B has assets of $50. The trustee determines that a cost savings of $10 can be realized if both accounts are joined in a single administrative unit. The question then becomes one of how the $10 savings should be apportioned. If the synergistic gain is divided by the number of entities, in this case two, the result of allocating $5 each to A and B would be unfair. Beneficiary A would have received a return on investment of 5% (5/100), while B received a return of 10% (5/50). The authors suggest that the only fair distribution would be to promise each beneficiary the identical return on investment. This result would allocate $6.67 to A and $3.33 to B, which is approximately a 6% return on investment to each beneficiary. Id. at 319-20.
Under the Brudney and Chirelstein formula, one-fourth\(^6\) of the resulting $400,000 synergistic gain will be allocated to S and its minority shareholders, making its total value $1,100,000.\(^6\) The Delaware block’s use of historical data, however, would have valued the subsidiary at $1,000,000 and ignored any future gain caused by the subsidiary.

The Seventh Circuit Court of Appeals adopted the Brudney and Chirelstein synergistic gain formula in *Mills v. Electric Auto-Lite Co.*\(^{64}\) In *Mills* the minority shareholders sought to set aside the merger on the ground that the proxy statement was deceptive. The Seventh Circuit Court of Appeals refused to set aside the merger and remanded the case to the district court for a determination of the plaintiff’s fair valuation.\(^65\) After the district court awarded $1,233,918.35 to the dissenting minority shareholders, both parties appealed. The minority shareholders claimed that the award failed to include postmerger gains and the defendant corporation contended that the minority shareholders were limited to the appraised value. The Seventh Circuit found that the merged corporation was worth $4,281,915 more than the combined premerger value of the two separate entities and attributed this increase to the synergistic effects of the merger.\(^66\) This postmerger gain was then allocated in proportion to each corporation’s percentage of the combined premerger value.\(^67\)

Although subsequent cases disapproved of the synergistic gain formula,\(^68\) and several commentators criticized the approach as too simplistic,\(^69\) this attempt to proportion postmerger gains has had significant

\(^{62}\) The one-fourth is determined by dividing A’s premerger value of $1,000,000 by the combined premerger value of $4,000,000.

\(^{63}\) P Corporation, therefore, would receive $300,000, making its total value $3,300,000. P’s premerger value of $3,000,000 is divided by the total premerger value of $4,000,000 and multiplied by the $400,000 post-merger gain to calculate its share of the synergistic gain. See *Brudney & Chirelstein*, supra note 56, at 313-23. For further explanation and examples, see Lorne, supra note 55, at 957-64. Professor Lorne puts Brudney and Chirelstein’s synergistic gain formula into an equation. The fair amount to compensate minority shareholders is equal to

\[
\text{MKT}_s + \left( \frac{\text{MKT}_s}{\text{MKT}_s + \text{MKT}_p} \right) MB
\]

when \(\text{MKT}_s\) = total market value of the minority ownership of S; \(\text{MKT}_p\) = total market value of P; \(MB\) = additional benefit from the merger or the synergistic gain. *Id.* at 961.

\(^{64}\) 552 F.2d 1239, 1248 (7th Cir.), cert. denied, 434 U.S. 922 (1977).

\(^{65}\) 552 F.2d at 1241.

\(^{66}\) *Id.* at 1248-49. The court found the subsidiary’s premerger value to be $27,825,737 and the parent’s to be $67,133,197, for a combined premerger value of $94,958,934. The value of the merged corporation one month later was $99,240,849, which represented a postmerger or synergistic gain of $4,281,915. The subsidiary’s dissenting minority shareholders, therefore, received 29.3% ($27,825,737/$94,958,934) of the $4,281,915 gain, or $1,254,601. The parent corporation received 70.7% of the synergistic gain, or $3,027,314. *Id.*


\(^{69}\) Lorne, supra note 55, at 957-77. Professor Lorne disagreed with Brudney and Chirelstein’s analogy of a parent-subsidiary merger to a trustee for two combined accounts,
impact. In addition to recognizing the need to consider postmerger gains, the synergistic gain formula demonstrated the failings of the Delaware block's historical analysis of the asset value, earnings value, and market value. The Seventh Circuit's brief acceptance of the formula also revitalized the demand in *Tri-Continental* to consider all relevant factors, including future gains of the merged corporation.\textsuperscript{70}

2. *Equity’s Increased Role in the Valuation Process*

The judiciary's dissatisfaction with the appraisal process was further acknowledged by the Delaware Supreme Court in *Singer v. Magnavox Co.*\textsuperscript{71} In *Singer* the frozen-out shareholders declined to seek their appraisal remedy and brought an action in equity seeking the nullification of the merger. The court permitted the plaintiffs' suit in equity, as opposed to an appraisal action, and imposed a burden on the defending corporation to establish the entire fairness of the transaction.\textsuperscript{72} *Singer* increased this initial burden on the defending parent corporation by also requiring the parent to have a valid “business purpose” for commencing the merger.\textsuperscript{73} Finally, the court found that any unfairness, including price, should be alleviated by granting whatever relief equity required.\textsuperscript{74} After *Singer*, therefore, dissenting minority shareholders could escape the appraisal proceeding's inflexible reliance on the Delaware block by filing a class action or derivative suit alleging unfair price. Once in equity, the court would scrutinize the entire transaction by considering relevant factors in addition to the asset, earnings, and market values.\textsuperscript{75}

Subsequent cases affirmed *Singer’s* equity approach to valuation.\textsuperscript{76} In *Roland International Corp. v. Najjar*\textsuperscript{77} the dissenting minority shareholders sued in equity, claiming that the parent corporation’s inadequate payment constituted a breach of the parent’s fiduciary duty to the cashed-out minor-

\textsuperscript{70} *Tri-Continental Corp. v. Battye*, 31 Del. Ch. 523, 74 A.2d 71, 72 (Sup. Ct. 1950), was revitalized in the sense that *Mills* took prospective factors into account. *Mills*, 552 F.2d at 1243-49.

\textsuperscript{71} 380 A.2d 969 (Del. 1977).

\textsuperscript{72} Id. at 976.

\textsuperscript{73} Id. at 979-80. The *Singer* court stated, “We hold the law to be that a Delaware Court will not be indifferent to the purpose of a merger when a freeze-out of minority stockholders on a cash-out basis is alleged to be its sole purpose.” Id. at 979. For an in-depth discussion of the business purpose test, see Weiss, supra note 5, at 657-80.

\textsuperscript{74} 380 A.2d at 980.

\textsuperscript{75} Id.


\textsuperscript{77} 407 A.2d 1032 (Del. 1979).
ity shareholders. The parent corporation claimed that the dissenting shareholders could either accept the price offered for their interest or seek an appraisal. The Delaware Supreme Court rejected the parent's contention, stating that the defendant corporation's burden of entire fairness was not met merely by remitting the minority shareholders to an appraisal remedy, especially since the timing of the merger was entirely within the parent's control.

As a result of Singer and its progeny, the Delaware Supreme Court created a "damage forum" in addition to the statutory right to an appraisal remedy. A dissenting minority shareholder had to show only an invalid business purpose, such as cashing out minority shareholders at an unfair price, to circumvent the appraisal remedy and litigate in equity. Justice Quillen, dissenting in Najjar, disapproved of Singer's expansive use of equity as an alternative to an appraisal of the minority shareholder's interest. Justice Quillen suggested that instead of creating an alternative forum, the court should revise the structure of the existing appraisal remedy, the Delaware block.

3. Rescissory Damages

In addition to its recognition of post merger gains and its willingness to expand equitable relief, the Delaware Supreme Court expressed further dissatisfaction with the Delaware block valuation technique in Lynch v. Vickers Energy Corp. In Lynch the court found that the parent corporation had failed to disclose all material facts regarding the merger to the minority shareholders and remanded the case to the chancery court for valuation of the minority's interest. The minority shareholders appealed the chancery court's valuation. In overruling the chancery court's weighted-average approach, the Lynch court combined the need to rec-

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ognize postmerger gains demonstrated in Mills with Singer’s willingness to fashion a remedy in equity. The court ordered rescissory damages and denied the injunctive relief sought by the minority shareholders. Rescissory damages are calculated by determining the minority shareholder’s interest in the merged subsidiary as if the shareholder had kept his stock after the merger. The court in Lynch reasoned that because the parent corporation had a fiduciary duty to the minority shareholders, the parent should not be permitted to profit at the minority’s expense. The important aspect of Lynch’s rescissory damage formula is that the award is determined at the time of trial. The subsidiary, therefore, is valued after the merger, and the postmerger gain is thereby incorporated. The court explained that the damages should equal the increase in value that the merged corporation enjoyed as a result of acquiring full ownership of the subsidiary.

Even after Singer and Lynch, the Delaware Supreme Court continued to search for a valuation technique that would accomplish the objective defined thirty years earlier in Tri-Continental: payment to the minority stockholder “for that which has been taken from him, viz., his proportionate interest in a going concern.” The Seventh Circuit, in Mills and later Delaware cases, clearly indicated the necessity of including postmerger gains, in the valuation process, but the opinions failed to develop an acceptable valuation technique. Singer created an alternative forum, which enabled minority shareholders to circumvent the inadequate appraisal remedy, and also required the majority shareholders to prove a valid business purpose for the merger. Subsequent cases, however, substantially limited Singer’s effectiveness. Finally, Lynch also suggested an alternative

402 A.2d at 12. The Delaware Supreme Court, however, adopted a rescissory damages formula, 429 A.2d at 500-05, and remanded the case back to the chancery court. Id. at 507. 86. 429 A.2d at 500-05. 87. Id. at 501; 4 A. Bromberg & L. Lowenfels, Securities Fraud & Commodities Fraud § 9.1 (1981); 12A W. Fletcher, Cyclopedia of the Law of Private Corporations § 5598 (perm. rev. ed. 1980). 88. 429 A.2d at 502-04. 89. Id. at 501-03. 90. Id. at 501. 91. 74 A.2d at 72. 92. See, e.g., Weinberger, 457 A.2d 701, 713 (Del. 1983) (citing with approval Tri-Continental, 74 A.2d at 72). The Weinberger court reiterated the Tri-Continental rule that a court should consider all factors that “throw any light on future prospects of the merged corporation . . . .” 457 A.2d at 713 (emphasis by Weinberger court); see also Lynch v. Vickers Energy Corp., 429 A.2d 497, 501 (Del. 1981) (the Delaware block has a built-in limitation in that it fails to incorporate postmerger gains). 93. Tanzer v. International Gen. Indus., Inc., 379 A.2d 1121 (Del. 1977), held that the majority shareholder’s purpose must be bona fide, and not a subterfuge to escape the mandate of Singer that mergers designed solely to eliminate minority stockholders are barred. Id. at 1124. More significantly, the Tanzer court held that the business purpose need not be that of the subsidiary and that the business purpose of the parent would suffice. The parent need not sacrifice its own interest in dealing with the subsidiary. Id. at 1123-24. Therefore, because the parent most likely will have some reason to merge, such as to increase profits, the only teeth left in the business purpose test is in a situation in which the parent has no reason to eliminate the minority shareholders, but does so anyway. Thus the business purpose test offers little protection. For further discussion of the demise of the business purpose
to the appraisal remedy, but the court indicated that it was not ready to overrule the well-established Delaware block.94

C. The Weinberger Solution

In February 1983 the Delaware Supreme Court, in \textit{Weinberger v. UOP, Inc.}95 addressed the inadequacies of the appraisal remedy and restructured the valuation method. In \textit{Weinberger} the parent corporation acquired the remaining outstanding shares of its subsidiary by a merger transaction, paying cash to the subsidiary's dissenting shareholders in exchange for their minority interest.96 The dissenting minority shareholders instituted a class action suit in equity seeking to nullify the merger or, alternatively, to receive rescissory damages. The chancery court entered a judgment for the parent corporation.97 The Delaware Supreme Court reversed and held that the parent corporation failed to meet the burden of entire fairness, both as to the circumstances of the merger and the value paid as consideration.98 \textit{Weinberger}'s holding significantly affected the valuation of minority interests by overruling the use of the Delaware block to the extent that it excludes other valuation techniques generally accepted by the financial community.99 The holding also revitalized the appraisal proceeding as the remedy for unfair price disputes.100

The \textit{Weinberger} court described the Delaware block's structured, mechanistic approach as clearly outdated and criticized the method's inability to value adequately a minority shareholder's interest.101 A more liberal approach including valuation techniques acceptable in the financial community would, the court concluded, more adequately ensure that dissenting shareholders receive a fair price for their interest in the merged subsidiary.102 For example, the court specifically acknowledged the plaintiff's use

\begin{footnotes}
94. \textit{Lynch}, 429 A.2d at 505. Although the court ruled that damages were to be set at the value of the subsidiary's stock at the time of trial, the court failed to state how to determine the subsidiary's value except to express doubt about the weight assigned to the asset and market value. Thus the court seemed to suggest that the continued use of the Delaware block might be appropriate. For criticism of the \textit{Lynch} decision, see Weiss, \textit{supra} note 5, at 673-75.


96. Signal Companies, Inc., cashed-out the UOP minority shareholders at $21 per share. 457 A.2d at 701.


98. 457 A.2d at 715.

99. \textit{Id.} at 703-04.


101. 457 A.2d at 712.

102. \textit{Id.} at 713. \textit{But see Blasingame v. American Materials, Inc.}, 654 S.W.2d 659 (Tenn. 1983). The Tennessee Supreme Court refused to modify its use of the Delaware block with
of the discounted cash flow method. This valuation method is analogous to the earnings value estimate used in the Delaware block method. Both methods use streams of income to approximate the subsidiary's earning capacity. The discounted cash flow analysis anticipates future earnings, but the earnings value relies solely on past income. The discounted cash flow method, therefore, incorporates the merger into its valuation and necessarily includes postmerger gains.

In addition to liberalizing the valuation techniques used in the appraisal proceeding, Weinberger also broadened the court's discretion, which enables the chancellor to fashion such relief as he deems appropriate under the facts of the case. This allows the court to fulfill Tri-Continental's mandate to consider all relevant factors in valuing an enterprise. Moreover, Weinberger's expanded appraisal remedy also allows the court to award rescissory damages in certain circumstances, as was suggested by the Lynch court. By correcting the appraisal proceeding, the Weinberger approach espoused by Weinberger, stating, "We do not find anything in Weinberger that causes us to alter the adoption of the weighted average method." Id. at 668 n.1.

103. 457 A.2d at 712. The court also acknowledged the applicability of a premium-over-market analysis. Id. This method of valuation is a comparative analysis of several other mergers of similar companies within the same industry. The court averages the premium, the difference between the merger price and market price, that is paid to minority shareholders in several similar mergers. See generally J. Weston & E. Brigham, supra note 56, at 351-55 (discussion of premium-over-market analysis including calculations). The plaintiff in Weinberger determined the average premium-over-market value to be 80% to 100%. Brief of Signal Companies, Inc. & UOP, Inc. at 100-01, Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983).

104. While the earnings value method and discounted cash flow method both use streams of income to project future earning capacity, each method computes its streams of income differently. The earnings value method uses the net income from the business, but the discounted cash flow method uses cash flow computed by adding the corporation's net income and depreciation, then subtracting the cash used to operate the company. See E. Nemes, Dictionary of Economics & Business 142 (1978).

105. The court in Dermody v. Sicco, 191 N.J. Super. 192, 465 A.2d 948 (Super. Ct. Ch. Div. 1983), cited Weinberger with approval after noting the advantages the discounted cash flow method has over the historically based earnings value analysis:

In an earnings analysis, the value of a stock is conceptualized as the product of the corporation's representative earnings multiplied by . . . the price/earnings ratio of comparable stocks. The approach is only reliable, however, if it also reflects any diminution in a stock's worth because of priority obligations that may preclude shareholders from participating in anticipated profits in the immediate future.

The discounted cash flow method necessarily takes such realities into consideration. This method . . . [is an] evaluation of a stock in terms of the present value of the income stream it may be expected to produce, factored for the element of risk inherent in the enterprise. Id. at 951.

106. 457 A.2d at 714.

107. 74 A.2d at 72; see supra notes 21-25 and accompanying text. For approval of Weinberger's revitalization of Tri-Continental's mandate to consider all relevant factors, see Walter v. Elizabeth, 462 A.2d 414, 415-16 (Del. 1983), in which the court applied Weinberger's more liberal approach to valuation of corporate stock during a divorce.

108. Weinberger, 457 A.2d at 714. The court will award rescissory damages if they can be proven and if they are an appropriate remedy considering all issues of fairness. Id.; see supra notes 83-90 and accompanying text.
berger court alleviated the need, recognized in Singer, to offer an alternative forum to dissenting shareholders. The court, therefore, relegated dissenting shareholders to the use of appraisal as their sole remedy.

II. THE EXCLUSIVITY OF THE APPRAISAL REMEDY

Under Weinberger a defendant corporation must show the "entire fairness" of the merger to prevent the dissenting shareholder from collecting damages in the appraisal proceeding. The concept of entire fairness comprises two basic elements: fair dealing and fair price. Fair dealing encompasses the timing, negotiation, initiation, disclosure, structure, and means of obtaining approval of the merger transaction. Thus the fair dealing aspect of entire fairness examines the majority or controlling shareholder's fiduciary obligation to the minority shareholders. Fair price, in contrast, embraces the financial consideration paid to the minority shareholders and does not automatically concern questions of fiduciary duty. Since an appraisal is the dissenting minority shareholder's remedy, Weinberger apparently mandates that the appraisal proceeding determine both aspects of entire fairness. If an appraisal is the dissenting shareholder's sole remedy, then the parent corporation may breach its fiduciary duty without fear of the merger's being invalidated, and the minority shareholders must settle for additional compensation at the appraisal hearing. The parent, therefore, in effect buys a right to deceive the minority shareholder.

A. Appraisal: The Dissenting Shareholder's Nonexclusive Remedy

Weinberger does not clarify whether the appraisal remedy is the cashed-out shareholder's sole recourse or whether the minority shareholders may, under certain circumstances, litigate the validity of the merger. Neither

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109. Singer, 380 A.2d at 975-80; see supra notes 71-80 and accompanying text.
110. 457 A.2d at 715. The court said: "Thus, we return to the well established principles of Stauffer v. Standard Brands, Inc. . . . and David J. Greene & Co. v. Schenley Industries, Inc. . . . mandating a stockholder's recourse to the basic remedy of an appraisal." Id. (citations omitted).
111. Id. at 710-11.
112. Id. at 711.
113. Id.
114. Id.
115. Id. at 703. The Weinberger court ruled that considering the nature of the relief available to minority shareholders under Delaware law, the remedy to the minority in a cash-out merger should be an appraisal. Id.
117. The argument emphasizes the majority's ability to freeze-out the minority shareholder fraudulently without any fear of having the merger invalidated. Because an appraisal is limited to monetary relief, the parent will only have to pay the dissenting shareholder additional compensation. See supra note 3 and accompanying text.
118. See Weiss, supra note 116, at 256, in which the author asserted that Weinberger created significant uncertainty as to when a shareholder has standing to challenge the fairness of a freeze-out merger.
courts in other jurisdictions nor commentators have agreed on the exclusivity or nonexclusivity of the appraisal remedy. Despite this history of disparate treatment, careful examination of the Weinberger decision reveals clear indications that the court did not intend the appraisal hearing to be the minority shareholder's sole remedy. An historical analysis of the precedent revitalized by Weinberger demonstrates that an appraisal is not the exclusive remedy for unfair dealing. A discussion of the decisions and rationale of other states struggling with the exclusivity problem provides additional support for the conclusion that an appraisal is not the dissenting minority shareholder's sole remedy.

I. Weinberger v. UOP, Inc.

Specific language in the Weinberger decision appears to declare that the appraisal hearing is the exclusive remedy available to the shareholder. The court stated that Delaware's appraisal remedy governs the financial relief available to cashed-out minority shareholders and announced a return to the well-established principles of Stauffer v. Standard Brands, Inc., and David J. Greene & Co. v. Schenley Industries, Inc. Both cases recognized the appraisal proceeding as the sole remedy available to dissenting shareholders. The language in Weinberger appears particularly forceful in light of the fact that Stauffer stands for the proposition that the very purpose of the appraisal statute is to provide the parent corporation with a means of eliminating the minority shareholder's interest in


121. 457 A.2d at 715.

122. 41 Del. Ch. 7, 187 A.2d 78 (Sup. Ct. 1962). In Stauffer a minority stockholder of the subsidiary corporation sued to set aside the merger because of unfair price. The Delaware Supreme Court held for the defendant parent corporation. Id. at 79-80.

123. 281 A.2d 30 (Del. Ch. 1971). In Schenley a minority shareholder sought injunctive relief from a freeze-out merger, claiming that the merger price was unfair. Delaware's chancery court held that the price paid by the parent was not so grossly inadequate as to constitute fraud. Id. at 33-34. The court denied injunctive relief. Id. at 35-36.

the merged subsidiary.125 The Weinberger court did expressly recognize, however, that the appraisal remedy may not be adequate in cases in which fraud, misrepresentation, or self-dealing is found.126 The court, therefore, specifically acknowledged that at least some forms of unfair dealing, although admittedly only the most severe forms, may be litigated outside the statutory appraisal. Moreover, interpreting the opinion as making an appraisal the exclusive remedy would render irrelevant the court's extensive and prospective discussion of fair dealing because appraisal proceedings do not allow the shareholder to attack the validity of the merger.127 Some ambiguity exists, therefore, as to the exclusivity of the appraisal remedy.

2. Historical Perspective

If Stauffer and Schenley are examined in their historical setting, Weinberger's return to their principles does not necessarily preclude the dissenting shareholder's maintainance of a class action suit that attacks the validity of the merger. In Stauffer the dissenting shareholder never alleged unfair dealing by the parent; he merely complained that the compensation paid was inadequate.128 Likewise, in Schenley the plaintiffs claimed that the valuation of their shares was grossly underpriced.129 Thus in both cases the minority shareholder complained of an unfair price and the courts responded by noting that an appraisal hearing was the sole remedy. In neither case did the court consider failure to disclose facts, unfair negotiations, or other breaches of fair dealing, because the plaintiffs made no such allegations.130 The courts' holdings therefore, should not be construed to limit the remedy when a claim of unfair dealing exists.131

That the Stauffer and Schenley courts did include claims of unfair dealing within their mandate of an exclusive appraisal remedy could be argued, however, because both cases favorably cited the New York case of Beloff v. Consolidated Edison Co.132 In Beloff the plaintiff claimed unfair dealing in addition to unfair price, but the court refused to take these factors into account and held that the merged corporation's shareholder had only one right, which was the protection of his investment value.133 That protection, the court noted, was fulfilled by his right to an appraisal.134

125. Stauffer, 187 A.2d at 80; see Weiss, supra note 5, at 651.
126. 457 A.2d at 714.
127. Weiss, supra note 116, at 258.
128. 187 A.2d at 80.
129. 281 A.2d at 31.
130. The court in Stauffer, however, hinted at the possibility of litigating unfair dealing cases by saying "it is unnecessary to hold that under no conceivable circumstances could a minority stockholder obtain relief for fraud." 187 A.2d at 80.
131. The court in Green v. Santa Fe Indus., Inc., 576 F. Supp. 269, 271 (S.D.N.Y. 1983), analyzed Weinberger's return to Stauffer and Schenley and noted that while the court's power to deal with illegality and fraud is vested in equity, appraisal is the exclusive remedy for the valuation of the stock's price.
133. Id. at 19, 87 N.E.2d at 564. The court continued: "He has no right to stay in the picture, to go along with the merger, or to share in its future benefits." Id.
134. Id.
This argument is supported by Schenley's holding that shareholders are fully protected by their right to an appraisal.\textsuperscript{135}

While logical on its surface, the argument contains a fundamental flaw in that it fails to account for an amendment to New York's merger statute,\textsuperscript{136} which occurred after Beloff, but before the Stauffer and Schenley decisions. Stauffer could not have included allegations of unfair dealing in its holding because the court cited the New York amendment.\textsuperscript{137} The New York appraisal statute provided that the appraisal remedy was exclusive, but the amendment made an exception, which allowed the dissenting shareholder to maintain an independent action claiming illegality or fraud.\textsuperscript{138} Stauffer's acknowledgment of Delaware's dependence on New York's merger statutes\textsuperscript{139} and its holding that an appraisal is the exclusive remedy can be reconciled in only one way. The appraisal statute provides the exclusive remedy in only one context, unfair price, but a dissenting shareholder may maintain a separate action for unfair dealing.

3. Other Jurisdictions

Several states other than Delaware have grappled with the exclusivity of the appraisal remedy.\textsuperscript{140} The Maryland Supreme Court, in construing its state's appraisal remedy,\textsuperscript{141} held that a statute that is silent as to exclusivity would be interpreted to allow the dissenting shareholder to maintain a separate action upon proof of wrongful conduct by the controlling shareholder.\textsuperscript{142} The court reasoned that a presumption against exclusivity would parallel the prevailing view among state courts that in the absence of express statutory language making the appraisal remedy exclusive, the appraisal is not the dissenter's exclusive remedy in cases of fraud, illegal purpose, or other wrongful conduct by the majority or controlling

\textsuperscript{135} 281 A.2d at 36.
\textsuperscript{136} N.Y. BUS. CORP. LAW § 623(k) (McKinney 1963) (as amended).
\textsuperscript{137} 187 A.2d at 80.
\textsuperscript{138} The New York statute provided that appraisal was an exclusive right "except that this section shall not exclude the right of such shareholder to bring or maintain an appropriate action to obtain relief on the ground that such corporate action will be or is illegal or fraudulent as to him." N.Y. BUS. CORP. LAW § 623(k) (McKinney 1963). The Stauffer court further cited the Revisor's Notes, which called this amendment a "well-recognized exception." 187 A.2d at 80.
\textsuperscript{139} The court declared that its merger law was modeled after New York law. Id. (citing Coyne v. Park & Tilford Distillers Corp., 38 Del. Ch. 514, 154 A.2d 893 (Sup. Ct. 1959) (parent owned 96% of the subsidiary and was allowed to cash-out minority shareholders despite the dissenting shareholders' claims that the transaction was against public policy)).
\textsuperscript{140} See, e.g., Lachman v. Bell, 353 F. Supp. 37, 41-42 (S.D.N.Y. 1972) (existence of appraisal as exclusive statutory remedy under Delaware merger law does not foreclose suit in equity); Miller v. Steinbach, 268 F. Supp. 255, 270-71 (S.D.N.Y. 1967) (exclusivity of appraisal under Pennsylvania merger law relates only to mergers not tainted by fraud); Weckler v. Valley City Milling Co., 93 F. Supp. 444, 455 (W.D. Mich. 1950) (phrase "exclusive remedy" under Michigan appraisal statute relates only to good faith sales), aff'd per curiam, 189 F.2d 567 (6th Cir. 1951).
\textsuperscript{141} MD. CORPS. & ASS'NS CODE ANN. § 3-210(a) (1975).
\textsuperscript{142} Twenty Seven Trust v. Realty Growth Investors, 533 F. Supp. 1028, 1036 (D. Md. 1982) (statutory appraisal held not to be dissenting shareholder's exclusive remedy in all cases under state law).
shareholder.  

In Mullen v. Academy Life Insurance Co., decided a month after Weinberger, a minority stockholder brought a diversity action in federal court against the majority stockholder, Academy Life, claiming that Academy Life had violated its fiduciary duty to the minority by under-valuing minority shares in the acquisition plan. The trial court entered summary judgment in favor of Academy Life, noting that under New Jersey law the plaintiff's sole recourse was an appraisal action and collateral attacks were not available. On appeal the Eighth Circuit Court of Appeals held that the New Jersey appraisal statute was not necessarily a minority shareholder's exclusive remedy. The court reasoned that New Jersey would be more likely to follow the lead of courts that had held the appraisal remedy to be nonexclusive. The Mullen court reached this conclusion despite statutory language that implied exclusivity. New Jersey's appraisal statutes only allow the dissenting shareholder to be paid for the fair value of his investment. The Eighth Circuit Court also noted that Delaware's merger law does not foreclose a suit in equity. Therefore, when state merger laws are silent as to the exclusivity of the appraisal remedy, or even when such laws only imply exclusivity, case law supports the minority shareholder's ability to seek alternative remedies in cases of misconduct or unfair dealing. In states where the merger statutes expressly mandate exclusivity, however, the dissenting shareholder is barred from litigating the validity of the merger and is relegated solely to an appraisal remedy for both unfair price and unfair dealing. The exclusive remedy in effect lowers the status of a minority shareholder to that of a holder of a note that is prepayable at the will of the lender, since the parent corporation may cash-out a minority shareholder

143. Id.
144. 705 F.2d 971 (8th Cir. 1983).
145. Id. at 972.
147. 705 F.2d at 974.
148. Id.
149. Id. at 973-74.
150. Section 14A:11-5(2) of the New Jersey statute states that the dissenting shareholder shall cease to have any rights of a shareholder, except the right to be paid the fair value of his shares.
151. 705 F.2d at 973-74.
152. E.g., DEL. CODE ANN. tit. 8, § 262(h) (Supp. 1982) (providing for appraisal remedy, but not expressly excluding other state remedies).
153. E.g., N.J. STAT. ANN. § 14A:11-5(2) (West 1969) (dissenting shareholders cease to have any rights as shareholders, except for right to be compensated fairly for their shares).
154. For example, Connecticut's appraisal statute provides that "[w]here the right to be paid the value of shares is made available to a shareholder by this section, such remedy shall be his exclusive remedy as holder of such shares against the corporate transaction, whether or not he proceeds with an appraisal action . . . ." CONN. GEN. STAT. ANN. § 33-373(f) (West 1981). For a discussion approving Connecticut's exclusivity approach to freeze-outs, see Yanow v. Teal Indus., Inc., 178 Conn. 263, 422 A.2d 311 (1979); Manning, supra note 120, at 246-47 n.38.
at any time and in any manner.\textsuperscript{156} Such exclusivity also elevates the controlling corporation to a position from which it may exercise private eminent domain, by taking the minority shareholder's property whenever the parent desires and at a price determined by the parent.\textsuperscript{157} If the shareholders are unable to attack the validity of the merger itself in the presence of unfair dealing, then the subsidiary has lost all of its bargaining power, which makes the subsidiary vulnerable to mistreatment by the majority corporation.\textsuperscript{158}

Although \textit{Weinberger} appears to relegate minority shareholders to the sole remedy of an appraisal, examination of both the court's analysis and the precedent it revitalizes reveals that exclusivity is actually a function of entire fairness: unfair price determined solely at an appraisal and unfair dealing decided at an appraisal hearing or equity litigation. This conclusion is reinforced by the general rule that unless a state's appraisal statute expressly mandates its exclusivity, courts follow the prevailing view of nonexclusivity.

\textbf{B. Implementing the Nonexclusive Appraisal Remedy by Allocating the Burden of Proof}

Although in most jurisdictions the appraisal remedy is not a minority shareholder's exclusive recourse,\textsuperscript{159} predicting when a shareholder is entitled to an alternative remedy is difficult. Much of the authority allowing a dissenting shareholder to litigate the terms of the merger at equity pertains only to severe cases of unfair dealing such as fraud, illegality, and misconduct.\textsuperscript{160} This authority provides little guidance since fraud is an actionable ground even outside the context of a corporate freeze-out.\textsuperscript{161} The question, therefore, is when may a dissenting shareholder litigate for less severe breaches of the duty of fair dealing.\textsuperscript{162} If courts allow all plaintiffs claiming unfair dealing to litigate the validity of the merger, most dissenting

\textsuperscript{156} Vorenberg, supra note 120, at 1192; see also Lattin, Remedies of Dissenting Stockholders Under Appraisal Statutes, 45 Harv. L. Rev. 233, 245 (1931) (arguing that if shareholder is comparable to small banker, he should have banker's security, assurance of interest, and fair profit).

\textsuperscript{157} Vorenberg, supra note 120, at 1191.

\textsuperscript{158} Id. at 1195.


\textsuperscript{160} See supra notes 126 & 142 and accompanying text.

\textsuperscript{161} Perl v. IU Int'l Corp., 61 Hawaii 622, 607 P.2d 1036, 1045 (1980).

\textsuperscript{162} The minority shareholder has an independent cause of action for fraud or misrepresentation in tort law. Cases noting that minority shareholders may litigate fraud claims in equity, instead of being relegated to an appraisal, are therefore not advocating an additional forum. The significance of questioning exclusivity is not in the clear fraud cases, but in transactions with unfair dealings not as severe as fraud. For example, fraud requires intent to deceive. \textit{E.g.}, Harmon v. Masoneilan Int'l., Inc., 442 A.2d 487, 499 (Del. 1982); James v. Weisheit, 279 Md. 41, 367 A.2d 482, 484 (1977); Jewish Center v. Whale, 86 N.J. 619, 432 A.2d 521, 525 (1981). Often, however, management may negligently fail to disclose proper information, thus harming the minority shareholders. Such cases not independently action-
shareholders will claim both unfair price and unfair dealing in order to recover damages in both forums. This outcome would either force the courts to adopt the appraisal remedy as exclusive out of administrative practicality or to eliminate corporate mergers since every potential disserter could force the parent corporation to defend itself. A procedure is necessary, therefore, that will balance the competing interests of the minority shareholders and parent corporation, while permitting courts to investigate the severity of the unfair dealing on a case-by-case basis.

Allocating the burden of proof can effectively distinguish frivolous claims from legitimate ones. Judicial interpretation and commentators' analysis of this allocation provides an entire spectrum of possibilities. At one extreme on the continuum, Schenley required the minority shareholder to demonstrate blatant overreaching by the majority shareholder before the court would allow unfairness to be litigated outside of an appraisal hearing. In fact, the Schenley court implied that this burden will not be met by anything less than the most extraordinary circumstances. At the other extreme on the burden of proof continuum, Sterling v. Mayflower Hotel Corp. requires the court to put the initial burden on the defendant corporation because of the parent's fiduciary duty to the subsidiary. As a result of this duty, the parent bears the initial burden of establishing the entire fairness of the transaction. This burden is even more onerous because failure by the parent to prove entire fairness could lead to an injunction of the merger.

Between the Schenley and Sterling extremes lie more workable alternatives. For example, Professor Vorenberg places the initial burden, as did the court in Sterling, with the defending corporation. Vorenberg suggests that to meet this initial burden the parent need only demonstrate that the price offered the minority shareholders falls within a reasonable range of prices that could possibly result from arm's-length negotiations. Vorenberg also recommends that, in determining the appropriate price range, the courts use the objective test of whether a reasonable businessman would accept the terms of the proposed merger.

In contrast, Professor Weiss's allocation of the burden of proof is closer to the method used in Schenley. Weiss encourages the courts to allow a dissenting shareholder who alleges unfair dealings to maintain an action in equity only if he first shows some evidence of unfair dealing. Weiss,
therefore, reduces the burden imposed by *Schenley*, but leaves the initial proof to the dissenting shareholders.\(^{173}\) Examination of the shareholder's complaint before shifting the burden to the parent would enable the court to discern the severity of the unfair dealing on a case-by-case basis. Although fraud automatically gives the plaintiff grounds for a suit in equity,\(^{174}\) questions of inadequate disclosure, tainted approval, or other elements of unfair dealing can be examined before the expense of a full-scale trial is incurred.

Weiss's solution most effectively balances the minority shareholder's interest in litigating substantive breaches of fiduciary duty with the defendant corporation's concern in preventing frivolous suits.\(^{175}\) Requiring some evidence of unfair dealing prior to shifting the ultimate burden of proof to the parent company will both discourage and prevent superfluous lawsuits. The parent will save the expense of defending itself in all but legitimate actions. When the dissenting shareholders show some evidence of unfair dealing, however, the ultimate burden should be on the parent corporation to demonstrate fair dealing and fair payment to the minority shareholders. Parent corporations would thereby be encouraged to deal fairly with their subsidiary affiliates.

### III. Conclusion

The appraisal remedy's objective is clear: to ensure that the dissenting minority shareholder receives the monetary equivalent of his interest in the newly merged subsidiary. The means of obtaining this objective were designed to take into account all relevant factors, but judicial interpretation eventually narrowed these means by examining only the asset, earnings, and market values under the Delaware block valuation.

The Supreme Court of Delaware in *Weinberger* reversed this trend by expanding the appraisal remedy to include valuation techniques generally accepted by the financial community. This liberalization of the appraisal remedy can be viewed as follows:

<table>
<thead>
<tr>
<th>MS* must initially demonstrate &quot;blatant overreaching&quot;</th>
<th>MS must demonstrate some evidence of unfair dealings</th>
<th>Defendant Corp.'s offer must be within a reasonable price range</th>
<th>Defendant Corp. must initially prove &quot;entire fairness&quot;</th>
</tr>
</thead>
<tbody>
<tr>
<td>David S. Greene &amp; Co.</td>
<td>Weiss</td>
<td>Vorenberg</td>
<td>Sterling Mayflower Hotel Corp.</td>
</tr>
</tbody>
</table>

*Minority Shareholder


174. See supra text accompanying notes 126 & 142.

175. *Weinberger*, 457 A.2d at 703, adopts this approach. Even though the ultimate burden of proof is on the parent corporation to show by a preponderance of the evidence that the transaction is entirely fair, the burden of the plaintiff arises first in attacking the merger to demonstrate some basis for invoking the fairness obligation. *Id.*
remedy enables courts to consider prospective evidence incorporating post-merger gains. *Weinberger* also attempted to reestablish the appraisal remedy’s dominant role in freeze-out disputes, but failed to delineate clearly when a complainant would be relegated solely to an appraisal hearing and when, if at all, a dissenting shareholder had an opportunity to litigate the terms of the merger. Despite the court's ambiguous language, examination of precedent revitalized by *Weinberger*, together with other states' interpretations, indicates that an appraisal is not a cashed-out minority shareholder's sole remedy. The determination of when unfair dealing may be litigated is most effectively regulated by an allocation of the burden of proof and the consideration of all relevant factors on a case-by-case basis.