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CORPORATE LAW — FREEZE OUT MERGERS UNDER SECTION 251 OF THE DELAWARE GENERAL CORPORATION LAW — THE EFFECT OF *Singer* AND *Tanzer*.

I. INTRODUCTION

Section 251 of the Delaware General Corporation Law<sup>1</sup> permits two domestic corporations to merge where the holders of the majority of the outstanding voting stock of each corporation approve the merger agreement.<sup>2</sup> A corporation that owns a majority of the outstanding voting stock of another corporation, however, can consummate a merger between the two by creating a wholly owned subsidiary and merging the subsidiary with the corporation in which it has a majority stock interest.<sup>3</sup> This triangular process, known as an “interested” merger,<sup>4</sup> facilitates a merger since the parent corporation has majority control of both subsidiaries and can thus be assured of the merger’s approval without having to obtain the approval of its own shareholders.<sup>5</sup>

Despite the right of majority stockholders to complete a merger, various legal challenges have been made available to minority stockholders in an effort to protect their interests during the transaction. In Delaware, a majority stockholder stands in a fiduciary relationship with a minority stockholder when dealing with the property of the corporation.<sup>6</sup> Thus, a minority stockholder can have an “interested” merger enjoined unless the

1. DEL. CODE tit. 8, § 251 (1974).

2. *Id.* Section 251 provides in pertinent part:

(a) Any two or more corporations existing under the laws of this State may merge into a single corporation, which may be any one of the constituent corporations or may consolidate into a new corporation formed by the consolidation, pursuant to an agreement of merger or consolidation, as the case may be, complying and approved in accordance with this section.

(b) The board of directors of each corporation which desires to merge or consolidate shall adopt a resolution approving an agreement of a merger or consolidation. . . .

(c) The agreement required by subsection (b) of this section shall be submitted to the stockholders of each constituent corporation at an annual or special meeting for the purpose of acting on the agreement. . . . At the meeting, the agreement shall be considered and a vote taken for its adoption or rejection. If a majority of the outstanding stock of the corporation entitled to vote thereon shall be voted for the adoption of the agreement, that fact shall be certified on the agreement by the secretary or assistant secretary of the corporation. If the agreement shall be so adopted and certified by each constituent corporation, it shall then, in addition to the execution required by subsection (b) of this section, be executed, acknowledged and filed and shall become effective, in accordance with § 103 of this title. . . .

*Id.* Cf. DEL. CODE tit. 8, § 253 (1974) (permitting a merger by a vote of the board of directors of a corporation which owns more than 90% of the stock of another corporation). For a discussion of § 253, see text accompanying notes 83-87 *infra*.

3. See text accompanying notes 22-28 & 42-45 *infra*.

4. See E. FOLK, THE DELAWARE GENERAL CORPORATION LAW 333 (1972).

5. See text accompanying notes 22-28 & 42-45 *infra*.

6. See *Sterling v. Mayflower Hotel Corp.*, 33 Del. Ch. 293, 298, 93 A.2d 107, 109-10 (Del. 1952).

majority stockholder proves that the merger is fair to the minority shareholders.<sup>7</sup> The fairness of a merger has usually been challenged in the context of conversion ratios between the stock of the constituent and surviving corporations, or the liquidation value of stock of the merged corporation.<sup>8</sup>

The merger agreement must state the consideration to be given for the shares of each of the constituent corporations.<sup>9</sup> There is no requirement, however, that the consideration be in the form of stock or securities in the surviving corporation,<sup>10</sup> and, consequently, stockholders of one of the constituent corporations may be "frozen out" of any interest in the surviving corporation.<sup>11</sup> A stockholder who is dissatisfied with the cash value offered for his shares in a constituent corporation may petition the Delaware Court of Chancery to appraise the value of his stock and compel the surviving corporation to pay him the appraised value.<sup>12</sup> The court is to determine the fair value of the shares without consideration of the merger and may, in its discretion, permit pretrial discovery by either of the parties.<sup>13</sup>

The challenges available to a minority stockholder have proved to be largely ineffective, however, due to the reluctance of the Delaware courts to

7. *Id.* In *Sterling v. Mayflower Hotel Corp.*, 33 Del. Ch. 293, 93 A.2d 107 (Del. 1952), the Supreme Court of Delaware noted that the liquidation value of the merged corporation's stock was not the sole criterion to be applied in determining the merger's fairness. *Id.* at 305, 93 A.2d at 113. Rather, in arriving "at a judgment of the fairness of the merger, all of its terms must be considered." *Id.* at 305, 93 A.2d at 114, quoting *Porges v. Vadsco Sales Corp.*, 27 Del. Ch. 127, 134, 32 A.2d 148, 151 (1943).

8. See *Sterling v. Mayflower Hotel Corp.*, 33 Del. Ch. 293, 298, 93 A.2d 107, 109-10 (Del. 1952). See also note 14 *infra*.

9. DEL. CODE tit. 8, § 251(b)(4) (1974). Section 251(b)(4) provides:

(b) The board of directors of each corporation which desires to merge or consolidate shall adopt a resolution approving an agreement of merger or consolidation. The agreement shall state: (4) the manner of converting the shares of each of the constituent corporations into shares or other securities of the corporation surviving or resulting from the merger or consolidation and, if any shares of any of the constituent corporation are not to be converted solely into shares or other securities of the surviving or resulting corporation, the cash, property, rights or securities of any other corporation which the holders of such shares are to receive in exchange for, or upon conversion of such shares and the surrender of the certificates evidencing them, which cash, property, rights or securities of any other corporation may be in addition to or in lieu of shares or other securities of the surviving or resulting corporation . . . .

*Id.*

10. *Id.*

11. A "freeze out," in the broad sense, has been described as "any action by those in control of the corporation which results in the termination of a stockholder's interest in the enterprise." Vorenburg, *Exclusiveness of the Dissenting Stockholder's Appraisal Right*, 77 HARV. L. REV. 1189, 1192 (1964). Specifically, "[t]he term has come to imply a purpose to force a liquidation or sale of the stockholder's shares, not incident to some other wholesome business goal." *Id.* at 1192-93.

A freeze-out merger may be employed to expel a dissident stockholder who refuses to sell his stock in the corporation. *Id.* at 1197. Many corporations sold stock to the public at high prices in the late 1960's, and are now utilizing freeze-out mergers to reacquire this same stock at the lower prices currently prevailing on the stock market. See Kessler, *Elimination of Minority Interests by Cash Merger: Two Recent Cases*, 30 BUS. LAW. 699 (1975); Note, 84 YALE L.J. 903 (1975).

12. DEL. CODE tit. 8, § 262 (1974).

13. *Id.* § 262(f).

find mergers unfair,<sup>14</sup> and the frequent failure of appraisal proceedings to result in the stockholder's receipt of the actual value of his shares.<sup>15</sup> In addition, the United States Supreme Court, in a recent case involving the merger of two Delaware corporations, refused to sustain a private action brought by a minority stockholder under rule 10b-5<sup>16</sup> even though there may have existed a breach of the majority stockholder's fiduciary duty to the minority interest under state law.<sup>17</sup> Against this background of the failure of dissatisfied minority stockholders to contest a merger successfully, the Supreme Court of Delaware decided two cases in 1977, *Singer v. Magnavox Co.*<sup>18</sup> and *Tanzer v. International General Industries, Inc.*,<sup>19</sup> which emphasized the fiduciary duty of the majority stockholder in a merger with respect to the purposes of the merger,<sup>20</sup> and supplemented the claims and defenses available in this area of the law.<sup>21</sup> This article will examine the Delaware Supreme Court's decisions in *Singer* and *Tanzer* to determine their collective impact on Delaware corporate law.

## II. THE DELAWARE SUPREME COURT'S DECISIONS IN *Singer* AND *Tanzer*

In 1974, North American Philips Corporation (North American) incorporated a wholly owned subsidiary, North American Philips Development Corporation (Development), for the purpose of making a tender offer

14. See, e.g., *Sterling v. Mayflower Hotel Corp.*, 33 Del. Ch. 293, 93 A.2d 107 (Del. 1952) (merger between parent corporation and its subsidiary sustained on ground that the proposed plan of exchanging shares of the corporations on a share-for-share basis was not fraudulent or unfair); *Greene v. Schenley Indus., Inc.*, 281 A.2d 30 (Del. Ch. 1971) (where value of cash and debentures to be issued, on merger of subsidiary and parent, to minority stockholders of subsidiary approximated market price of subsidiary's shares, the merger was not so grossly unfair to minority stockholders of subsidiary as to require a preliminary injunction of the merger); *Bruce v. E. L. Bruce Co.*, 40 Del. Ch. 80, 174 A.2d 29 (1961) (complaint by minority stockholders of merged corporation to enjoin merger on the ground of gross undervaluation of stock in the exchange ratio was insufficient to state a cause of action). See also *Stauffer v. Standard Brands Inc.*, 41 Del. Ch. 7, 187 A.2d 78 (Del. 1962). For a discussion of *Stauffer*, see text accompanying notes 83-87 *infra*.

15. For a discussion of the inadequacies of the appraisal remedy, see *Green v. Santa Fe Indus., Inc.*, 533 F.2d 1283, 1297 n.4 (2d Cir. 1976), *rev'd*, 430 U.S. 462 (1977); *Vorenburg*, *supra* note 11, at 1200-05.

16. 17 C.F.R. § 240.10b-5 (1977).

17. *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462 (1977). In *Santa Fe*, two corporations had merged under DEL. CODE tit. 8, § 253 (1974). 430 U.S. at 465. For a discussion of a § 253 merger, see text accompanying notes 83-87 *infra*. Plaintiff, a minority stockholder, was discontent with the amount of cash offered for his shares by the resulting corporation and brought suit in federal court to enjoin the merger as a violation of rule 10b-5, instead of pursuing his appraisal remedy. See 430 U.S. at 466-67. In reversing the Second Circuit's determination that a claim for relief had been stated, the Court held that no rule 10b-5 violation exists unless a breach of the fiduciary duty by majority stockholders is accompanied by "deception, misrepresentation, or nondisclosure." *Id.* at 471, 476.

18. 380 A.2d 969 (Del. 1977).

19. 379 A.2d 1121 (Del. 1977).

20. See text accompanying notes 32 & 50-51 *infra*.

21. See text accompanying notes 67 & 69 *infra*.

for the common shares of the Magnavox Company (Magnavox).<sup>22</sup> After the directors of Magnavox rejected Development's initial tender offer,<sup>23</sup> a modified offer was made which was not opposed.<sup>24</sup> As a result, Development acquired 84.1 percent of Magnavox's outstanding common stock.<sup>25</sup>

Development acquired all the equity interest in Magnavox by creating a wholly owned subsidiary, T.M.C. Development Corporation (T.M.C.), which it merged with Magnavox pursuant to section 251.<sup>26</sup> Under the terms of the merger, holders of Magnavox common stock other than Development were to receive cash — \$9.00 per share of Magnavox common stock held by them.<sup>27</sup> They were informed that if they objected to this amount they could seek appraisal.<sup>28</sup>

Owners of Magnavox common stock at the time of the merger<sup>29</sup> filed suit in the Delaware Court of Chancery against the four companies involved, alleging, *inter alia*, that: 1) the merger served no business purpose other than to force the removal of public shareholders from an equity position in Magnavox at an inadequate price and to permit North American, through Development, to obtain sole ownership of Magnavox; and 2) the defendants breached their fiduciary duties to the minority shareholders by approving the merger at a cash price for Magnavox's stock that was grossly inadequate.<sup>30</sup> The Court of Chancery granted defendants' motion to dismiss.<sup>31</sup>

22. 380 A.2d at 971.

23. *Id.* The directors opposed this initial offer due to the inadequate price offered for the Magnavox common shares. *Id.*

24. *Id.* In the modified offer, the price for the common stock was increased and 16 officers of Magnavox were assured of two-year employment contracts. *Id.*

25. *Id.*

26. *Id.* at 971-72. For the relevant text of § 251, see note 2 *supra*.

27. 380 A.2d at 972. The book value of Magnavox common stock at the time of the merger was \$10.16 per share. *Id.*

28. *Id.*

29. *Id.* at 971. Plaintiffs brought a class action on behalf of all holders of common stock in Magnavox on the day before the merger. *Id.*

30. *Singer v. Magnavox Co.*, 367 A.2d 1349, 1353 (Del. Ch. 1976), *rev'd in part and aff'd in part*, 380 A.2d 969 (Del. 1977). Plaintiffs also claimed that the merger violated the anti-fraud provisions of the Delaware Securities Act, DEL. CODE tit. 6, § 7303 (Supp. 1977). 367 A.2d at 1353. The Court of Chancery dismissed this count of the complaint, holding that the sale and purchase of plaintiff's stock pursuant to the terms of the merger were not caused by any false representation or material omission in the proxy statement. *Id.* at 1360-61.

On appeal, the Supreme Court of Delaware affirmed the Court of Chancery's dismissal of this claim on the ground of lack of subject matter jurisdiction. 380 A.2d at 982. The plaintiffs were Pennsylvania residents who had not been solicited by proxies in Delaware, and the actual sale of securities had not occurred in Delaware. *Id.* at 981. The fact that the merger vote had taken place in Delaware was "too fragile a basis on which to establish subject matter jurisdiction." *Id.*

31. *Singer v. Magnavox Co.*, 367 A.2d 1349, 1362 (Del. Ch. 1976), *rev'd in part and aff'd in part*, 380 A.2d 969 (Del. 1977). In regard to the first count, the Court of Chancery stated that no precedent in Delaware law required a "proper and independent business purpose for the merger of a corporation in order to justify the elimination of its minority shareholders." 367 A.2d at 1357. The court specifically

On appeal, the Supreme Court of Delaware reversed the dismissal, holding that an allegation that a section 251 merger was entered into for the sole purpose of freezing out minority stockholders "states a cause of action for violation of a fiduciary duty for which the Court may grant such relief as it deems appropriate under the circumstances."<sup>32</sup> Further, the court held that even if a merger is not made for the sole purpose of freezing out minority stockholders, the majority's fiduciary obligation to the minority remains.<sup>33</sup> The court must scrutinize the transaction to determine its overall fairness, and may enjoin the merger if it is determined to be unfair to the minority stockholders.<sup>34</sup>

In its analysis, the court recognized that the defendants had satisfied the statutory requirements of a section 251 merger,<sup>35</sup> but concluded that literal compliance with the statute did not render the transaction "legally unassailable."<sup>36</sup> The examination of the business purpose for a merger, noted the court, was not helpful as a "threshold consideration . . . in sorting out the rights of the parties."<sup>37</sup> In addition, the court determined that the defendants, as majority stockholders, could not fulfill their fiduciary duties to the plaintiffs "simply by relegating them to a statutory appraisal

declined to adopt the "business purpose" test promulgated in other jurisdictions. *Id.* at 1356. See notes 59-62 and accompanying text *infra*.

With respect to the second count, the court noted that the plaintiffs' basis for this count was the alleged inadequacy of the price paid for plaintiffs' shares under the terms of the merger agreement, and concluded that in such a case, the plaintiffs' remedy was to seek an appraisal of their shares under DEL. CODE tit. 8, § 262 (1974). 367 A.2d at 1362. See notes 12 & 15 and accompanying text *supra*.

32. 380 A.2d at 980.

33. *Id.*

34. *Id.*

35. *Id.* at 975. For the pertinent text of § 251, see note 2 *supra*.

36. 380 A.2d at 975. The *Singer* court adopted the analysis employed in *Schnell v. Chris-Craft Indus., Inc.*, 285 A.2d 437 (Del. 1971), and *Guth v. Loft, Inc.*, 23 Del. Ch. 255, 5 A.2d 503 (Del. 1939), to "reject the contention that statutory compliance insulates the merger from judicial review." 380 A.2d at 975.

In *Schnell*, the management of a company changed its bylaws to advance the date of the annual stockholders' meeting and thereby prevented the plaintiffs from waging a proxy fight against the management. 285 A.2d at 438-39. The court found that management utilized the corporate machinery and the law for the purpose of perpetuating itself in office and concluded that "inequitable action does not become permissible simply because it is legally possible." *Id.* at 439.

In *Guth*, it was alleged that an officer of a corporation usurped a corporate opportunity for his personal benefit. 23 Del. Ch. at 266-67, 5 A.2d at 508-09. The court stated that "[t]he question is not one to be decided on narrow or technical grounds, but upon broad considerations of corporate duty and loyalty." *Id.* at 273, 5 A.2d at 511.

37. 380 A.2d at 976. The court stated, however, that

[t]he point . . . is not that an exploration of the business purpose is without merit. It may well be necessary to examine that purpose in many mergers under judicial review. . . . It seems to us, rather, that the approach to the purpose issue should be made by first examining the competing claims between the majority and minority stockholders of Magnavox.

*Id.* For a discussion of the "business purpose" test, see notes 59-62 and accompanying text *infra*.

proceeding.”<sup>38</sup> Finally, the court rejected the contention by the defendants that a stockholder’s rights in stock are “exclusively in the *value* of his investment, not its *form*”<sup>39</sup> as inconsistent with the fiduciary duty owed by the defendants to the plaintiffs.<sup>40</sup>

Within one month of the *Singer* decision, the Delaware Supreme Court decided *Tanzer*, which involved a factual situation quite similar to *Singer*.<sup>41</sup> International General Industries, Inc. (IGI) owned 81 percent of the stock of Kliklok Corporation (Kliklok).<sup>42</sup> In 1975, IGI formed KLK Corporation (KLK) in order to acquire all of Kliklok’s common stock through a merger between KLK and Kliklok.<sup>43</sup> The board of directors of each company approved the merger, and the stockholders of KLK and Kliklok confirmed the merger in accordance with section 251.<sup>44</sup> By the terms of the merger agreement, IGI was to acquire all of the stock of the surviving corporation, and the minority shareholders of Kliklok were to receive \$11.00 per share of Kliklok stock.<sup>45</sup>

Plaintiffs, stockholders in Kliklok, filed suit in the Delaware Court of Chancery, alleging “that the merger should be enjoined because the sole purpose thereof was to serve the interest of the parent.”<sup>46</sup> The Chancellor

38. 380 A.2d at 977 (footnote omitted). In describing the fiduciary duty owed by the majority stockholders, the court adopted the standard used for corporate directors, stating:

While technically not trustees, . . . [corporate directors] stand in fiduciary relation to the corporation and its stockholders. A public policy, existing through the years, and derived from a profound knowledge of human characteristics and motives, has established a rule that demands of a corporate officer or director, peremptory and inexorably, the most scrupulous observance of his duty, not only affirmatively to protect the interests of the corporation committed to his charge, but also to refrain from doing anything that would work injury to the corporation, or to deprive it of profit or advantage which his skill and ability might properly bring to it, or to enable it to make in the reasonable and lawful exercise of its powers. The rule that requires an undivided and unselfish loyalty to the corporation demands that there shall be no conflict between duty and self-interest. The occasions for the determination of honesty, good faith and loyal conduct are many and varied, and no hard and fast rule can be formulated. The standard of loyalty is measured by no fixed scale.

*Id.*, quoting *Guth v. Loft, Inc.*, 23 Del. Ch. 255, 270, 5 A.2d 503, 510 (Del. 1939). The court concluded that while this definition pertained to directors, “the spirit of the definition is equally applicable to a majority stockholder in any context in which the law imposes a fiduciary duty on that stockholder for the benefit of minority stockholders.” 380 A.2d at 977.

39. 380 A.2d at 977 (emphasis in original).

40. *Id.* at 977-78. In a separate opinion, Justice McNeilly concurred in the result and emphasized that an alleged violation of the *Singer* rule shifts “the burden to the majority to establish the entire fairness of the transaction.” *Id.* at 982 (McNeilly, J., concurring). He further stated that “[t]o determine whether that burden has been met . . . I think the Court must scrutinize the business purpose, or economic necessity, desirability and feasibility involved, evidence of self-serving, manipulation, or overreaching, and all other relevant factors of intrinsic fairness or unfairness.” *Id.*

41. *Singer* was decided on September 23, 1977, and *Tanzer* was decided on October 18, 1977.

42. 379 A.2d at 1122.

43. *Id.*

44. *Id.*

45. *Id.* at 1122-23. The minority stockholders also had appraisal rights under § 262. *Id.* at 1123. See notes 12 & 15 and accompanying text *supra*.

46. 379 A.2d at 1122.

found that the sole reason for the merger was to facilitate long term debt financing by IGI,<sup>47</sup> and refused to grant the requested relief.<sup>48</sup>

On appeal,<sup>49</sup> the Supreme Court of Delaware affirmed, holding that “a merger made primarily to advance the business purpose of the majority stockholder”<sup>50</sup> is not a violation of the fiduciary duty owed by the majority stockholder to a minority stockholder.<sup>51</sup> In reaching this conclusion, the court did not consider the merger itself in terms of its “business purpose,” since it did not view this standard as helpful.<sup>52</sup> Rather, the court focused upon the powers and rights of IGI as a stockholder of Kliklok,<sup>53</sup> and stated that “a stockholder in a Delaware corporation has a right to vote his shares in his own interest, including the expectation of personal profit, limited, of course, by any duty he owes to other stockholders.”<sup>54</sup> The court did note, however, that the majority stockholder’s motives in ratifying a merger must be *bona fide* and not a subterfuge for eliminating minority stockholders.<sup>55</sup> Moreover, the court stated that notwithstanding the existence of a *bona fide* purpose, the majority stockholder still has to bear the burden of proving the fairness of the merger in order to satisfy the fiduciary duty it owes to the minority stockholders.<sup>56</sup>

47. *Id.* at 1124.

48. *Id.* at 1125. The Court of Chancery, in an unreported opinion denying the requested preliminary injunction, stated:

The question presented is whether the merger should be enjoined because the purpose is to serve the interest of the parent. It should be noted in this regard that IGI has a legitimate and present and compelling business reason to be the sole owner of Kliklok. IGI is not freezing out the minority just for the purpose of freezing out the minority.

*Singer v. Magnavox Co.*, 380 A.2d 969, 975 n.5 (Del. 1977), quoting *Tanzer v. International Gen. Indus., Inc.*, Del. Ch. C. A. 4945 (Dec. 23, 1975), *aff'd and remanded*, 379 A.2d 1121 (Del. 1977).

49. In response to defendant’s contention that the case was not appealable on the merits, the Delaware Supreme Court noted that although the Court of Chancery had not made a summary judgment ruling, that court, in denying a preliminary injunction, had “determined a substantial issue and established a legal right between the parties.” 379 A.2d at 1122. Thus, “the interlocutory order [met] the test of appealability.” *Id.*

50. *Id.* It should be noted that the Delaware Supreme Court expressly indicated that it was answering a question left unresolved by *Singer* — whether a merger made primarily to advance the business purpose of a majority stockholder is a violation of its fiduciary duty. *Id.*

51. *Id.* at 1124-25.

52. *Id.* at 1123. See notes 59-62 and accompanying text *infra*.

53. 379 A.2d at 1123-24.

54. *Id.* at 1124. As support for this conclusion, the court noted previous Delaware cases where the stockholders had voted their shares in their own interest. *Id.* at 1123. See *Ringling Bros. — Barnum & Bailey Combined Shows v. Ringling*, 29 Del. Ch. 610, 53 A.2d 441 (Del. 1947) (stockholders may lawfully contract with one another to vote as they or a majority of their group determine); *Heil v. Standard Gas & Elec. Co.*, 17 Del. Ch. 214, 151 A. 303 (1930) (stockholder may use his own judgment in voting and may include personal profit in the motives which determine his choice, if the advantage thereby obtained is not at the expense of other stockholders). See generally W. FLETCHER, *CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS* § 2031 (rev. perm. ed. 1976).

55. 379 A.2d at 1124. The court stated that if the real purpose of the merger was to eliminate unwanted minority stockholders, this would constitute a violation of the *Singer* rule. *Id.*

56. *Id.* at 1125. See notes 7 & 33-34 and accompanying text *supra*.

Recognizing that the Court of Chancery found that the primary reason for the merger was to benefit long term debt financing by IGI, and not to freeze out the minority stockholders of Kliklok, the Delaware Supreme Court concluded that no violation of the *Singer* rule existed.<sup>57</sup> Consequently, the court affirmed the lower court's decision, but remanded the case for a determination of the fairness of the merger.<sup>58</sup>

### III. *Singer, Tanzer, AND THE BUSINESS PURPOSE TEST*

In *Bryan v. Brock & Blevins Co.*,<sup>59</sup> the Fifth Circuit adopted a "business purpose" test to determine the validity of freeze-out mergers.<sup>60</sup> In *Bryan*, an ex-employee who refused to relinquish his 15 percent stockholdings in Brock & Blevins Company was frozen out of that corporation as a result of a merger between the corporation and Power Erectors Inc., a subsidiary that was created by Brock & Blevins Company for the sole purpose of accomplishing the merger.<sup>61</sup> The Fifth Circuit concluded that "[i]n the absence of [a] business purpose Power Erectors was purely a sham party created to circumvent the rule of law that prohibits a majority of stockholders of a corporation . . . to force the minority interests to surrender their stock holdings."<sup>62</sup>

57. 379 A.2d at 1124-25. See text accompanying notes 32-34 & 47 *supra*.

58. 379 A.2d at 1125.

59. 490 F.2d 563 (5th Cir.), *cert. denied*, 419 U.S. 844 (1974).

60. 490 F.2d at 570; see note 62 and accompanying text *infra*.

61. 490 F.2d at 565-68.

62. *Id.* at 570. The court further stated:

Implicit in [the district court's] holding was a construction of the Georgia statute that comports with equity in good conscience. Such construction would read out of the statute a situation where there was no pre-existing corporation to be merged, but instead where such corporation was created solely for the purpose of accomplishing an illegal result.

*Id.* See *Grimes v. Donaldson, Lufkin & Jenrette, Inc.*, 392 F. Supp. 1393 (N.D. Fla. 1974), *aff'd*, 521 F.2d 812 (5th Cir. 1975). In *Grimes*, the plaintiff, a minority stockholder, was frozen out of a corporation as a result of a merger between his corporation and the wholly owned subsidiary of the majority stockholder, another corporation. 392 F. Supp. at 1395. The court found that there were valid business reasons for the merger, since money would be saved by both companies and a conflict of interest problem would be eliminated. *Id.* at 1402. Therefore, the court denied plaintiff's request to enjoin the merger and found no need to apply the *Bryan* rule. *Id.* at 1402, 1404.

Other jurisdictions have also utilized the "business purpose" test in merger cases. The Second and Eighth Circuits have applied the "business purpose" test in determining whether federal securities laws have been violated. *Polin v. Conductron Corp.*, 552 F.2d 797 (8th Cir.), *cert. denied*, 434 U.S. 857 (1977); *Marshel v. AFW Fabric Corp.*, 533 F.2d 1277 (2d Cir.), *rehearing en banc denied*, 533 F.2d 1309 (2d Cir.), *vacated*, 429 U.S. 881 (1976). However, these decisions have been effectively overruled by *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462 (1977). See note 17 and accompanying text *supra*.

Several state courts had read the "business purpose" test into recent decisions. See *Berkowitz v. Power/Mate Corp.*, 135 N.J. Super. 36, 342 A.2d 566 (1975); *Schulwolf v. Cerro Corp.*, 86 Misc. 2d 292, 380 N.Y.S.2d 957 (1976). Moreover, the Seventh Circuit recently certified a merger case to the Indiana Supreme Court in order to ascertain whether the "business purpose" test is to be employed in the interpretation of Indiana corporate law. *Gabhart v. Gabhart*, 545 F.2d 877 (7th Cir.

The Supreme Court of Delaware, in the *Singer* and *Tanzer* decisions, refused to apply the "business purpose" test,<sup>63</sup> concluding that "it states a result and not a right or a duty."<sup>64</sup> The court noted that the "business purpose" rule is ambiguous, since it "leads to such questions as: 'Whose purpose?' or 'Whose business?'"<sup>65</sup> Instead of relying on the "business purpose" test, the court preferred to examine the competing claims of the majority and minority stockholders and then apply the test only if it would be helpful.<sup>66</sup>

As a result of *Singer*, a minority stockholder who alleges that the sole purpose of a merger is to terminate his interest in the corporation has a valid cause of action grounded upon a breach of the fiduciary duty owed by the majority stockholder.<sup>67</sup> In *Tanzer*, however, the court held that a freeze-out merger would not violate the fiduciary duty of the majority stockholder if it were made primarily to further a *bona fide* business purpose of the majority stockholder.<sup>68</sup> Thus, *Tanzer* seems to create a defense to a case brought under the *Singer* principle, since proof of a legitimate business purpose will satisfy the majority stockholder's fiduciary obligation,<sup>69</sup> subject to the requirement of the general fairness of the transaction.<sup>70</sup>

Although the Supreme Court of Delaware refused to apply the "business purpose" test,<sup>71</sup> it is submitted that both decisions focused on the purposes of the challenged mergers. *Singer* and *Tanzer* therefore appear to have implicitly adopted the "business purpose" test. When a plaintiff alleges a cause of action under *Singer*, the court must determine whether the sole purpose of the merger is to freeze out the plaintiff. To make this determination, the court must resolve whether or not there exists a valid business purpose for merging the constituent corporations.<sup>72</sup> Moreover, since a *bona fide* purpose of the majority stockholder will also serve as a defense to a freeze-out merger,<sup>73</sup> the Supreme Court of Delaware has, in effect, liberalized the "business purpose" test. However, no guidance, general or specific, was given as to what constitutes a valid purpose. Indeed, the only sure ground on which to base an opinion is that the long term debt financing of a majority stockholder will serve as an adequate purpose for a freeze-out merger.<sup>74</sup>

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1977). For other discussions of the "business purpose" test, see Kessler, *supra* note 11; Comment, *Protection of Minority Shareholders From Freezeouts through Merger*, 22 WAYNE L. REV. 1421 (1976).

63. 379 A.2d at 1123; 380 A.2d at 975-76.

64. 379 A.2d at 1123.

65. 380 A.2d at 976; see 379 A.2d at 1123.

66. 380 A.2d at 976; see 379 A.2d at 1123.

67. See text accompanying note 32 *supra*.

68. See text accompanying notes 50 & 51 *supra*.

69. 379 A.2d at 1124.

70. *Id.*

71. See text accompanying notes 63-66 *supra*.

72. The presence of a valid business purpose would necessarily lead to the conclusion that the *sole* purpose of the merger was not to freeze out minority stockholders. See *Bryan v. Brock & Blevins Co.*, 490 F.2d 563, 570 (5th Cir.), *cert. denied*, 419 U.S. 844 (1974).

73. See text accompanying note 69 *supra*.

74. See text accompanying note 57 *supra*.

The issue of the extent of judicial inquiry into the motives of the majority stockholder was not resolved by these two decisions. In *Tanzer*, the Supreme Court of Delaware sustained the merger on the ground that it would facilitate long term debt financing by IGI, the majority stockholder.<sup>75</sup> Since most mergers could be construed in some manner as helpful to a corporation's long term debt financing,<sup>76</sup> it appears that the implicit "business purpose" test adopted by the court can easily be satisfied by a corporate defendant.<sup>77</sup> Furthermore, a wide variety of commercial advantages may inure to the benefit of the surviving corporation as a result of a merger, many of which may prevent the application of the *Singer* doctrine.<sup>78</sup>

If the fiduciary duties imposed by *Singer* can be easily met as a result of *Tanzer* and the attitude of the Delaware courts, then the law has not really been altered in favor of the minority stockholder. There will have to be continued reliance on the nebulous fairness standard,<sup>79</sup> under which the minority shareholders have not been very successful in obtaining relief.<sup>80</sup>

Finally, notwithstanding the apparent ease with which the *Tanzer* court found a *bona fide* business purpose on the part of the majority stockholder,<sup>81</sup> if the degree of scrutiny to be given a merger is left to individual courts, varying and inconsistent decisions will likely result.

75. See text accompanying notes 57 & 58 *supra*.

76. For example, the merger of two corporations could leave the surviving corporation in a better cash position, thus enabling it to make sinking fund payments, redemptions, interest payments, and payments for the debt at maturity with greater ease, or at least without having to borrow. The acquisition of liquid assets by a merger would serve the same ends.

The acquisition of another company's assets may also make it easier for a corporation to effectuate the terms of an indenture. Similarly, the increase in assets could make the corporation's debentures more attractive to the public, since debenture holders will seek payment from the corporation's assets in the event of default, insolvency, or bankruptcy. See also FEDERAL TRADE COMMISSION, REPORT ON CORPORATE MERGERS AND ACQUISITIONS 103-43 (1955).

77. The majority stockholder in a freeze-out merger situation is often a corporation. See, e.g., *Stauffer v. Standard Brands, Inc.*, 41 Del. Ch. 7, 187 A.2d 78 (Del. 1962); *Sterling v. Mayflower Hotel Corp.*, 33 Del. Ch. 293, 93 A.2d 107 (Del. 1952); *Greene v. Schenley Indus., Inc.*, 281 A.2d 30 (Del. Ch. 1971); *Bruce v. E. L. Bruce Co.*, 40 Del. Ch. 80, 174 A.2d 29 (1961).

78. Other purposes which could conceivably be furthered by a corporate merger include the ability of the corporation to pay dividends, an increase in the market value of the surviving corporation's stock, the relief of a cash flow problem, the acquisition of certain assets of the merged corporation, or the facilitation of extension into other commercial or industrial areas by the surviving corporation. See FEDERAL TRADE COMMISSION, REPORT ON CORPORATE MERGERS AND ACQUISITIONS 103-43 (1955).

79. See text accompanying notes 34 & 56 *supra*. See also notes 14-21 and accompanying text *supra*.

80. See note 14 and accompanying text *supra*.

81. See text accompanying notes 50-51 & 57 *supra*.

## IV. CONCLUSION

The application of the *Singer* rationale to areas of corporate law other than section 251 mergers<sup>82</sup> is difficult to predict. In a case decided prior to *Singer*, *Stauffer v. Standard Brands, Inc.*,<sup>83</sup> a minority stockholder contested the validity of a merger under section 253,<sup>84</sup> which permits a corporation that owns more than 90 percent of the stock of another corporation to merge with that corporation by a vote of its board of directors.<sup>85</sup> The Supreme Court of Delaware refused to invalidate the merger, stating that "the very purpose of the statute is to provide the parent corporation with a means of eliminating the minority shareholder's interest in the enterprise."<sup>86</sup> However, the Court of Chancery recently applied the *Singer* rationale and granted a preliminary injunction in two cases where minority stockholders sued to enjoin a section 253 merger.<sup>87</sup>

Language in the *Singer* opinion to the effect that a stockholder's interest in his investment is not restricted solely to its value,<sup>88</sup> and that the fiduciary duty of the majority stockholder cannot be satisfied by relegation of the minority stockholder to appraisal proceedings,<sup>89</sup> indicates the possible extension of the *Singer* rationale to stock repurchases by the corporation and/or the majority stockholder, redemption of stock holdings, and restrictions placed upon the transfer of stock. In each of these situations, the

82. For the relevant text of § 251, see note 2 *supra*.

83. 41 Del. Ch. 7, 187 A.2d 78 (Del. 1962).

84. DEL. CODE tit. 8, § 253 (1974).

85. *Id.*; see 41 Del. Ch. at 8, 187 A.2d at 79.

86. 41 Del. Ch. at 10-11, 187 A.2d at 80.

87. *Najjar v. Roland Int'l Corp.*, 387 A.2d 709 (Del. Ch. 1978); *Kemp v. Angel*, 381 A.2d 241 (Del. Ch. 1977). In *Kemp*, INA Corp., through a series of transactions, acquired 90.6 percent of the outstanding stock of Aid, Inc. (Aid), and merged Aid with a wholly owned subsidiary pursuant to § 253. *Id.* at 241-42. Plaintiffs, minority stockholders of Aid, were offered \$14.00 per share of Aid stock held by them. *Id.* at 243. A preliminary injunction enjoining the merger was requested on the grounds that the merger was "designed fraudulently to eliminate the interests of the minority stockholders of Aid, Inc., in their corporation." *Id.* at 241. The Chancellor did not feel bound by the decision in *Stauffer*, and granted the preliminary injunction, stating that he failed

to see how a determination as to whether or not the duty now imposed on a majority stockholder in a merger based on 8 Del. C. Section 253 has been properly carried out requires any less scrutiny by the Trial Court than that called for in a case in which the rights of minority stockholders have been allegedly diminished by a merger based on 8 Del. C. Section 251.

*Id.* at 244.

In *Najjar*, where a merger was accomplished under § 253, the defendants sought to distinguish *Kemp* on the basis that fraud had not been alleged by the plaintiffs. 387 A.2d at 711-12. The Chancellor refused to grant defendants motion to dismiss, stating:

[W]hen a complaint attacking a merger "alleges" that its sole purpose is to eliminate minority interests, such a complaint is now virtually immune from a motion to dismiss for failure to state a cause of action, especially when the basis for such a motion would be, as here, that the plaintiff is only complaining about the amount paid for the minority shares.

*Id.* at 712.

88. See text accompanying note 39 *supra*.

89. See text accompanying note 38 *supra*.