THE SHORT MERGER STATUTE

The demand for corporate "flexibility" has generated merger forms less stringent than the old common-law requirement of unanimous shareholder consent. The most recent is the "short merger" statute. Such a statute typically provides that a corporation may merge a ninety or ninety-five per cent owned subsidiary into itself without the consent of the shareholders of either corporation. The formal requirements for merger are simply a resolution passed by the board of directors of the parent corporation, the filing of necessary papers with a state official and notification of the shareholders. The interests of the minority shareholders of the subsidiary may be terminated by an offer of "shares or other securities or obligations of the surviving corporation or . . . cash or other consideration," in lieu of which the minority may force appraisal. Discomfited shareholders of the parent corporation are given no opportunity to dissent because the short merger "should not materially affect their rights." This comment concludes that short

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2 At least ten jurisdictions have adopted such statutes: COLO. REV. STAT. § 31-7-6 (1963); DEL. CODE ANN. tit. 8, § 253 (Supp. 1964); IOWA CODE ANN. § 496A.72 (1962); MISS. CODE ANN. § 5309-129 (Supp. 1962); N.Y. STOCK CORP. LAW § 85 (Supp. 1954); N.D. CODE ANN. § 10-20-06 (1960); S.C. CODE ANN. § 12-20.5 (Supp. 1964); TENN. CODE ANN. § 48-518 (1964); UTAH CODE ANN. § 16-10-70 (1961); VA. CODE ANN. § 15.1-76 (1964). A short merger statute is optional in the Model Business Corporation Act. ABA-ALI MODEL BUS. CORP. ACT § 68A (1960). The development of such statutes has by no means met with unanimous accolades; the limited academic reaction has been negative. See Sneed, Stockholder Votes Motivated by Adverse Interest: The Attack and the Defense, 58 Mich. L. Rev. 961, 992-98 (1960); Note, 54 NW. U.L. REV. 629 (1959); Note, 52 Calif. L. Rev. 1016 (1964); cf. Note, 74 Harv. L. Rev. 1630 (1961). Twelve jurisdictions provide for a short form merger between a parent corporation and its wholly owned subsidiary; however, these statutes do not raise the problem of unfairness to the minority of the subsidiary. CAL. CORP. CODE § 4124 (1962); CONN. STAT. ANN. § 33-370 (1960); D.C. CODE ANN. § 29-927h (1961); Md. CODE ANN. ART. 25, § 67 (1957); Mass. Ann. LAWS ch. 156, § 46A(2) (1964); Neb. REV. STAT. § 21-1, 107 (1952); NEV. REV. STAT. § 78.540 (1963); N.J. STAT. ANN. § 14:12-10 (Supp. 1964); N.C. GEN. STAT. § 55-108.1 (1965); PA. STAT. ANN. tit. 15, § 2852-908B (Supp. 1964); W. VA. CODE ANN. § 5075 (1a) (1961); Wis. Stat. ANN. § 180.685 (1958).

3 ABA-ALI MODEL BUS. CORP. ACT § 68A (1960).

4 ABA-ALI MODEL BUS. CORP. ACT § 68A, comment at 348 (1960). The combination of a parent with its ninety-five per cent owned subsidiary certainly would not significantly alter the business in which the parent shareholder had invested. The merger
merger statutes in their present form are undesirable, and that any advantages which they do offer may be obtained by a simple amendment of the traditional merger statute.

At common law, an equity interest could not be altered, and thus no merger effected, without the unanimous consent of all affected shareholders. However, the growth of corporations, both in magnitude and numbers, dictated that something less than unanimity suffice. In all jurisdictions statutes have been adopted that permit merger with the approval of at least a majority and usually two-thirds of each class of shareholders of both corporations. To allow expression of dissent, the merger plan is required to be presented to meetings of shareholders of both corporations.

Even after majority ratification, however, the dissenting shareholder cannot be forced to go along with the merged enterprise. He has the chance to accept whatever plan of merger the majority approves, but if he chooses not to participate, he can force the corporation to purchase his shares at a value fixed by appraisal. The rationale underlying this option is that in case of a change in his interests, the dissenting shareholder should not have the ability to block action which two-thirds think desirable, but he should have an equally fair chance either to continue participation or sell his shares. The majority is not permitted

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5 Voeller v. Neilston Warehouse Co., 311 U.S. 531, 535 n.6 (1941); authorities cited supra note 1; see SEC, REPORT ON THE STUDY AND INVESTIGATION OF THE WORK, ACTIVITIES, PERSONNEL, AND FUNCTIONS OF PROTECTIVE AND REORGANIZATION COMMITTEES pt. VII, at 557, 590 (1938); cf. 2 COOK, CORPORATIONS § 670 (4th ed. 1898).

6 Voeller v. Neilston Warehouse Co., supra note 5, at 535 n.6; SEC, op. cit. supra note 5, at 557, 590. See generally Gibson, supra note 1, at 283.

7 A tabulation of such legislation is presented in ABA-ALI MODEL BUS. CORP. ACT § 68, at 341-42 (1960, Supp. 1964); see PARKER, CORPORATION MANUAL § 46 (59th ed. 1958).

8 "The right to payment is regarded as an alternative one with the right of going along on the new venture or preventing it if improper . . . . If payment were held to be the exclusive right of a disserter, it seems clear that, except in the cases where the right of eminent domain exists, the provision would be unconstitutional as confiscatory." Levy, Rights of Dissenting Shareholders to Appraisal and Payment, 15 CORNELL L.Q. 420, 427 (1930). See generally BALLANTINE, CORPORATIONS §§ 290, 298 (rev. ed. 1946); Note, 54 Nw. U.L. REV. 629 (1959); Note, 107 U. PA. L. REV. 420, 423 nn. 24, 26 (1959) and authority cited therein. A useful table of appraisal statutes is presented in Skoler, Some Observations on the Scope of Appraisal Statutes, 13 BUS. LAW. 240, 249-53 (1958). Since that article, Utah has passed such a statute, UTAH CODE ANN. § 16-10-76 (1962), leaving West Virginia the only state without appraisal provisions.
to force the minority to resort to appraisal by posing an unfair offer. Not only is such an unfair plan of merger unlikely because two-thirds of the shareholders have found it appealing, but the minority shareholder may sometimes have the court of equity enjoin the transaction if it is grossly unfair.\(^9\)

Protection of the minority interests begins to break down, however, even under traditional statutes, whenever one of the corporations to be merged holds an interest in the other sufficiently great to approve the merger. No longer is there an independent majority to help guarantee the fairness of the plan. A meeting of the subsidiary's shareholders offers no protection because the individual shareholders have too few votes to affect the terms of the merger. If the parent's interest in the subsidiary is very large, for example ninety or ninety-five per cent, there is even little need for a meeting of the shareholders of the parent corporation because a merger will hardly alter their interests.\(^10\)

However, the traditional merger statutes do preserve the "right" of the minority of the subsidiary to receive a fair offer to continue in the enterprise. And although there is no independent majority to help guarantee fairness, the expense of appraisal helps render unprofitable any attempt by the company to abuse its dominant position.\(^11\) Furthermore, the minority shareholder still has equitable remedies available to enjoin a merger until he is given a reasonable chance to continue in the enterprise.

The short merger statute not only retains the objectionable features of any merger involving a controlled corporation, but adds new ones.

\(^9\) Of course, even if there is an "independent majority," the protection offered by their votes may be illusory; the inertia of the proxy machinery and the proverbial shareholder apathy suggest that a majority may be raised in favor of nearly any plan endorsed by management. See generally SEC, REPORT ON THE STUDY AND INVESTIGATION OF THE WORK, ACTIVITIES, PERSONNEL, AND FUNCTIONS OF PROTECTIVE AND REORGANIZATION COMMITTEES pt. I, at 887 (1937); Hornstein, New Aspects of Stockholders' Derivative Suits, 47 COLUM. L. REV. 1, 23 n.128 (1947); Hornstein, The Future of Corporate Control, 63 HARV. L. REV. 476 (1950). Majority approval might also be motivated by the promise of gains upon holdings of other classes of securities in which the minority might not share. See Note, 69 HARV. L. REV. 538, 544-45 (1956).


\(^11\) Such a meeting would offer no protection to the minority shareholders of the subsidiary corporation in any case because the interests of the parent's shareholders by hypothesis would be opposite those of the subsidiary's shareholders.

\(^12\) Cf. Kaplan, Problems in the Acquisition of Shares of Dissenting Minorities, 34 B.U.L. REV. 291 (1954); Note, 74 HARV. L. REV. 1192 (1959); Note, 60 YALE L.J. 397 (1951).
Not only does it dispense with the requirement of votes by shareholders of either corporation, but it also provides for termination of the interest of the minority shareholders without the requirement that the parent first present an offer of continuing participation.\textsuperscript{13}

Such a provision is not different in kind from that in traditional merger statutes allowing an offer of "shares or other securities or obligations . . ."\textsuperscript{14} Under that language the corporation could offer terminable debentures, callable bonds or redeemable preferred shares,\textsuperscript{15} and while the minority in this way would receive an offer of "continued participation," the effect would be little different from a cash offer to be paid with interest at a future time.

Similarly, it does not at first appear economically significant that the minority must take cash for their shares rather than receive equity securities of the same value in the continuing enterprise. The minority obviously could use the cash to purchase the shares of the continuing enterprise on the market, or if unavailable, they could buy shares of

\textsuperscript{13} It has been suggested that to allow the termination of the shareholder's interest for cash is unconstitutional. See note 8 \textit{supra} and authorities cited therein. Illinois courts have forbidden the conversion of equity into debt securities upon constitutional grounds, despite clear authorization under relevant statutes. Bowman v. Armour & Co., 17 Ill. 2d 45, 160 N.E.2d 753 (1959). Such a position would a fortiori bar the conversion of equity into cash; however, the language of the court seems to reflect a vestigial remnant of the old vested interest theory of shareholder's rights and will certainly fall in the face of the overwhelming rejection of that theory in favor of the contract or "social duty" theories of shareholder's rights. See generally Gibson, \textit{supra} note 1, at 283; Dodd, \textit{For Whom Are Corporate Managers Trustees?}, 45 Harv. L. Rev. 1145, 1156-61 (1932); Gower, \textit{Corporate Control: The Battle for the Berkeley}, 68 Harv. L. Rev. 1176, 1192 (1955). Although the social duty theory has not yet been applied in the context of the short merger, the contract theory has been applied to uphold the constitutionality of the short merger upon at least two occasions. Coyne v. Park & Tilford Distillers Corp., 38 Del. Ch. 514, 154 A.2d 893 (1959); Beloff v. Consolidated Edison Co., 300 N.Y. 11, 87 N.E.2d 651 (1949); see Alpren v. Consolidated Edison Co., 168 Misc. 381, 5 N.Y.S.2d 254 (Sup. Ct. 1938); cf. Voege v. American Sumatra Tobacco Corp., 192 F. Supp. 689 (D. Del. 1961).

\textsuperscript{14} ABA-ALI \textit{Model Bus. Corp. Act} § 65(c) (1960).

\textsuperscript{15} See Clarke v. Gold Dust Corp., 106 F.2d 598 (3d Cir. 1939), \textit{cert. denied}, 309 U.S. 671 (1940) (redeemable preferred given in exchange for non-redeemable preferred); Matteson v. Ziebarth, 40 Wash.2d 286, 242 P.2d 1025 (1952) (redeemable preferred shares given in exchange for common); Outwater v. Public Serv. Corp., 103 N.J. Eq. 461, 143 Atl. 729 (Ch. 1928) (issuance of terminable securities not illegal per se, but "unfair" to offer preferred shares redeemable within three years); cf. Wessel v. Guantanamo Sugar Co., 134 N.J. Eq. 271, 25 A.2d 215 (Ch.), \textit{aff'd per curiam sub nom. Murphy v. Guantanamo Sugar Co.}, 135 N.J. Eq. 506, 39 A.2d 431 (Ch. Err. & App. 1944) The legislative history of applicable statutes clearly allows such a conversion. In Delaware, for example, the statute authorizing exchange of shares only for "shares" of the continuing enterprise was amended to permit the exchange of "shares or other securities." 43 Del. Laws 1941, ch. 132, § 12. Typically, however, states have gone even further and amended statutes permitting exchange of "shares" to read "shares or other securities or obligations." \textit{E.g.}, Ill. Laws July 13, 1933, § 61, at 208. \textit{But cf.} Bowman v. Armour & Co., \textit{supra} note 13.
similar corporations. It might well be asked whether the ownership of shares in a distinct corporation is significantly different from the ownership of an altered interest in the merged entity.

But the major economic impact will be that the minority receiving cash must immediately incur a capital gains tax.\textsuperscript{16} The minority shareholder who desires to participate in the enterprise could thus always be forced to settle for securities worth less than the fair value of his interest. He could be threatened that any truly fair offer would be paid only in cash—an offer unimpeachable under the statute but potentially worth even less to him because of the burden of immediate taxation.\textsuperscript{17}

Further, where the short merger statute has been adopted, courts have limited minority protection even beyond what the statute permits. On the theory that the short merger statute legislatively sanctions quick elimination of the minority from an enterprise, courts have been hesitant to allow equity to restrain a fraudulent short merger even where it is admitted that the dissenters under a traditional merger statute may avail themselves of full equitable remedies.\textsuperscript{18} Although a given dissenter might not resort to equitable relief where the cost of going to court would be disproportionate to the small interest for which he seeks protection,\textsuperscript{19} this diminution of equitable remedies portends a toleration of inequitable treatment which would not otherwise be permitted.

For example, the courts have already extended the short merger's

\textsuperscript{16} Int. Rev. Code of 1954, §§ 356, 1002. The shareholder receiving "stock or securities" need only pay capital gains tax if the "principal amount" of the shares or securities received exceeds the "principal amount" of the shares tendered. Int. Rev. Code of 1954, § 354(a)(2)(A).

\textsuperscript{17} Of course the amount received in appraisal would be subject to such a tax under either the short merger or the traditional merger. This is not unjust in the latter case because the shareholder who resorts to appraisal in lieu of equitable remedies presumably does so because he wishes to sell his shares, and sale would entail a tax in any case. It is because equitable remedies under the short merger can require no more than payment of cash that such pressure is possible.

\textsuperscript{18} In Stauffer v. Standard Brands, Inc., 187 A.2d 78 (Del.), affirming 178 A.2d 311 (Del. Ch. 1962), the court affirmed the dismissal of a complaint seeking to enjoin a short merger stating that the availability of equitable remedies "refers generally to all mergers, and is nothing but a reaffirmation of the ever-present power of equity to deal with illegality or fraud. But it has no bearing here. . . . [T]he very purpose of the statute is to provide the parent corporation with a means of eliminating the minority shareholder's interest in the enterprise. Thereafter the former stockholder has only a monetary claim." However, the court found it "unnecessary to hold that under no conceivable circumstances could a minority stockholder obtain relief for fraud." 187 A.2d at 80; see Beloff v. Consolidated Edison Co., 300 N.Y. 11, 87 N.E.2d 561 (1949); Rank Organization Ltd. v. Pathe Labs., Inc., 33 Misc. 2d 748, 227 N.Y.S.2d 562 (Sup. Ct. 1962); Blumenthal v. Roosevelt Hotel, Inc., 202 Misc. 988, 115 N.Y.S.2d 92 (Sup. Ct. 1952).

relaxation of protection into other areas of recapitalization. In the Mid-
states Oil cases,20 plaintiff owned shares of Midstates Oil, ninety-six per
cent of whose shares were owned by Middle States. Tennessee Gas, for
the avowed purpose of dissolving both Middle and Midstates and trans-
fering their properties to itself, purchased all of Middle's shares, evalu-
ing its portfolio of Midstates shares for the purpose of this transaction
at about $1,700.00 per share. Pursuant to Tennessee's plan, Middle
offered to purchase Midstates' assets for an amount equivalent to
$1,100.00 per share, which offer was accepted. When plaintiff was in turn
offered $1,100.00 for his shares, he brought suit to enjoin the transaction
on the ground that, because Middle and Midstates had an interlocking
directorate, the offer to purchase Midstates' assets should not be taken
to determine the value of plaintiff's shares. In affirming a judgment for
the defendant, the court stated:

An argument is made that Midstates should have solicited other
offers, which might have been higher . . . . This argument . . .
overlooks that . . . Tennessee had the power to merge Midstates
into Middle by the use of the "short-merger" statute (§ Del.
C. § 253), in which case the plaintiffs' sole remedy would have
been an appraisal.21

Although it was accurate to state that Tennessee could have effected
such a short merger, it was clear that Tennessee had, for whatever reason,
chosen other ways to reach its goal of ownership of the assets of Midstates.
The fairness of the valuation was certainly impugned by the significantly
greater valuation of plaintiff's shares by Tennessee in the prior trans-
action.22 If the reasoning of the court were applied literally, virtually
any treatment of a five per cent minority could be justified, even though
its effect would be to render more difficult the evaluation of the share-
holders' interest through appraisal. Such reasoning is even more anom-
alous in a case like Midstates Oil, where it abrogates a universally recog-
nized "fiduciary" duty upon interlocking boards of directors.23

20 Abelow v. Symonds, 40 Del. Ch. 462, 184 A.2d 173 (Ch. 1962), aff'd sub nom.
Abelow v. Midstates Oil Corp., 189 A.2d 675 (Del. 1963); Abelow v. Symonds, 173 A.2d
167 (Del. Ch. 1961); Abelow v. Symonds, 156 A.2d 416 (Del. Ch. 1959).
21 189 A.2d at 678-79.
22 The court's decision for the defendant may well have been equitable because the
valuation of $1,000 was reinforced by the findings of a reputable appraising firm. 189
A.2d at 677. The offer was, moreover, some $275 greater than "average market value"
at the time of Tennessee's offer to Middle. Ibid. The court, however, relied upon none
of this in dismissing plaintiff's contention.
23 See, e.g., Everett v. Phillips, 288 N.Y. 227, 43 N.E.2d 18 (1942); Note, 74 Hary.
L. REV. 1630, 1645-47 (1961), arguing that the injustice portended by the merger situa-
tion demands an extension rather than an impugning of the "fiduciary" concepts.
In assessing the desirability of the short merger statutes, their advantages must, of course, be considered. The original impetus for the adoption of short merger statutes apparently was the collapse of over-leveraged utility empires during the depression. To facilitate a simplification of holding and operating company relationships, the legislature of New York enacted the short merger to circumvent blocking or delaying tactics employed by small but belligerent minority interests.\textsuperscript{24} As similar procedures were made available to all corporations, the check upon arbitrary application furnished by the necessity of obtaining the permission of a state regulatory body, such as a public utilities commission, was eliminated, and the decision whether or not to merge was left in the discretion of the majority.\textsuperscript{25}

The original need for such statutes appears to have diminished substantially. The utility empires are now subject to stringent regulation by federal administrative bodies to prevent questionable pyramiding; the activities of holding companies are closely restricted.\textsuperscript{26} The delaying tactics of the minority interests, such as spurious derivative litigation, are now less available due to the increased costs of litigation\textsuperscript{27} and the more onerous burdens placed by the courts upon those seeking to thwart statutorily authorized corporate action.\textsuperscript{28}

The short merger has endured, and shows signs of flourishing, because it offers the opportunity of merger without the needless expense of holding meetings whose outcomes would be pre-determined. Such savings will be significant, however, only where the corporation is of substantial size and where the question would have to be presented at a special meeting. It has been suggested that the short merger may also facilitate an advantageous business deal,\textsuperscript{29} or, in the case of a subsidiary with which the parent does a significant amount of business, may promote


\textsuperscript{25} N.Y. Sess. Laws 1949, ch. 762.


\textsuperscript{27} See Hornstein, supra note 19, at 123.


\textsuperscript{29} Matteson v. Ziebarth, 40 Wash. 2d 286, 242 P.2d 1025 (1952); see Vorenberg, Exclusiveness of the Dissenting Stockholder's Appraisal Right, 77 HARV. L. REV. 1189, 1195-1200 (1964).
Like possible savings from the elimination of a meeting, however, the benefit gained by shortcutting traditional procedures must be quite limited.

Superfluous costs could be saved, however, by a simple amendment of the traditional merger statute to permit eliminating both parent and subsidiary shareholder meetings and appraisal for parent shareholders when the parent corporation holds a ninety or ninety-five per cent interest in the subsidiary. Such an amendment would make no other change in merger procedure, and it would bring about all the real advantages of the short merger statute without retaining its evils.

Where short merger statutes have already been enacted, their deleterious effects can be minimized by requiring that the parent corporation offer an equity interest unless demonstrably impractical. Further, in the absence of a specific legislative prohibition, equitable remedies should not be abridged and appraisal should not be deemed an exclusive remedy. Construction of the statute to require an offer of equity securities need not do violence to its language; the provisions permitting offer of "shares or other securities or obligations . . . or cash or other consideration . . ." could be read as options stated in declining order of preference.


Some jurisdictions which were once willing to hold the appraisal remedy exclusive where the short merger was applied have moved to a position where equitable remedies have been partially restored but in a much-weakened condition. New York, which once clearly held appraisal to be exclusive, Blumenthal v. Roosevelt Hotel, Inc., supra note 30, retreated from that position in Ribakove v. Rich, 173 N.Y.S.2d 506 (Sup. Ct. 1958), but stated in Rank Organization Ltd. v. Pathe Labs., Inc., 33 Misc. 2d 748, 227 N.Y.S.2d 562 (Sup. Ct. 1962), that the requirement of "good faith" extended only to providing a fair opportunity for appraisal. Delaware has most recently taken the position that the courts will inquire into a short merger but only where the substantive transaction "might be so tainted with illegality as to require invalidation of the merger." Braasch v. Goldschmidt, 199 A.2d 760, 764 (Del. Ch. 1964). A few states provide that appraisal should be an exclusive remedy. E.g., Cal. Corp. Code § 4123 (1962); Mich. Comp. Laws §§ 450.44, 450.54 (1948). Courts have, however, been properly reluctant to abide with such pronouncements. See Weckler v. Valley City Milling Co., 93 F. Supp. 444 (W. D. Mich. 1950), aff'd per curiam, 188 F.2d 367 (6th Cir. 1951), holding that the Michigan statute was inapplicable in the absence of "good faith." Indeed a few jurisdictions say that to hold appraisal an exclusive remedy would be unconstitutional as abrogating the power of equity guaranteed by the constitution. E.g., Robb v. Eastgate Hotel, Inc., 347 Ill. App. 261, 278, 107 N.E.2d 845, 856 (1952), holding that appraisal "is not a full and adequate remedy where fraud is charged . . . . Fraud is an independent ground for the exercise of equitable jurisdiction . . . . That jurisdiction of equity courts is preserved by the constitution (art. 6, sec. 12), and the legislature cannot deprive them of any part of it."

By first requiring a showing of the reason for offering debt securities or cash, the court would be furnished with information which would certainly be as useful as the
The offer of an equity interest will often be easily made out of available unissued or treasury shares. If the corporation is precluded from issuing securities by costly SEC requirements or prior indenture commitments, it will be a simple and inexpensive process to so inform the court. If the corporation is unable or unwilling to demonstrate why it cannot offer equity shares, the court should require further proof of good faith. The merger should be permitted regardless of the demonstrated feasibility of offering an equity interest only on the showing of a substantial reason, such as a previous history of minority obstruction of business operations through spurious derivative suits.

In summary, the short merger may offer a possible saving in costs, but it threatens the minority with both a diminution of equitable remedies and, by permitting the initial offer to be in cash subject to an immediate capital gains tax, the pressure to take an unfair offer. It is suggested that these disadvantages outweigh the remote possibility of savings and that the short merger statutes as presently proposed should thus not be adopted.

33 See Note, 74 HARV. L. REV. 412, 413 (1960).

34 Of course this process will be costly to the corporation. In view of the much greater expense of dissolution, the alternative method of removing a troublesome minority, this cost seems justified however.