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MERGERS, CONSOLIDATIONS, AND ASSET SALES

CHAPTERS 1.10 AND 1.11

THOMAS K. JOHNSTONE, JR. AND JEAN A. GALLOWAY*

INTRODUCTION

The main purpose of this article is the consideration of those provisions of the South Carolina Business Corporation Act of 1962 relating to consolidations, mergers¹ and certain other combinations not constituting either a consolidation or a merger, but having certain features in common therewith.² Unless otherwise identified, cited sections are sections of the act.

A consolidation and a merger are not in legal effect the same,³ and both should be distinguished from other combinations and transactions entered into by corporations which do not constitute either a consolidation or a merger; e. g., a sale of assets transaction. A consolidation is a combination by agreement between two or more corporations of the same or different states, under authority of law, by which their rights, privileges, immunities, franchises and property are fused, and become the rights, privileges, immunities, franchises and property of a newly formed corporation, composed of the original corporations.⁴ On the other hand, a merger is the absorption of one or more corporations by another corporation, which retains its name and corporate identity with the added capital, franchises and powers of the merged corporation or corporations.⁵

In a merger or consolidation, the absorbed corporations are dissolved by operation of law,⁶ while in the case of a sale of assets transaction, a dissolution of the selling corporation is

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1. Chapter 1.10, S. C. CODE §§12-20.1,12-20.9 (Supp. 1962).

2. Chapter 1.11, S. C. CODE §§12-21.1,12-21.5 (Supp. 1962).

3. The present law uses the term "consolidation" to refer to all types of statutory corporate fusions. S. C. CODE §12-451 (1962).

4. S. C. CODE §§12-20.2,12-20.7 (Supp. 1962); 15 FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS §7041 (1961).

5. S. C. CODE §12-20.1,12-20.6,12-20.7 (Supp. 1962); FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS §7041 (1961).

6. S. C. CODE §12-20.6(b) (2) (Supp. 1962); *Citizens & Southern Nat'l Bank of S. C. v. Conner*, 195 S. C. 203, 11 S. E. 2d 271 (1940).

not effected automatically.⁷ In this latter instance, further procedures must be taken under the dissolution section⁸ of the act for cessation of the corporate existence of the selling corporation.

I. POWER TO CONSOLIDATE OR MERGE

It must be borne in mind that no merger or consolidation of corporations can be effected without statutory authority of the state or sovereignty which created such corporations.⁹ It has been held that any attempt to consolidate or merge without such authority is ultra vires and void.¹⁰ Under present law, prohibitions against certain consolidations and mergers do exist,¹¹ but these prohibitions are not contained in the act and authority for both consolidation and merger with domestic and foreign corporations is conferred on all domestic corporations provided the law of the foreign jurisdiction permits.¹²

II. STEPS AND PROCEEDINGS TO EFFECT CONSOLIDATION OR MERGER

A. *Mergers and Consolidations of Domestic Corporations*

A statute enabling corporations to consolidate or merge does not, of itself, effect a consolidation or merger without some action or agreement to that end by the corporations involved, but merely authorizes them to take the proper steps to bring about the merger or consolidation. The first step to be taken under the act by the corporations is the adoption by the board of directors of each corporation involved in the transaction of a plan of merger or consolidation. The requirements respecting the contents of the plan are set forth in section 12-20.1 and section 12-20.2 of the act. It has been held that if the plan substantially complies with the requirements of the statute, mere informalities or omissions will not invalidate it.¹³

7. 15 FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS §7043 (1961).

8. S. C. CODE §§12-22.1, 12-22.23 (Supp. 1962).

9. *Clearwater v. Meredith*, 1 Wall 25, 17 L. Ed. 604 (1863).

10. *First State Bank of Mangum v. Lock*, 113 Okla. 30, 237 Pac. 606 (1925); 15 FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS §7048 (1961).

11. S. C. CODE §§12-451, 12-456.1, 12-466 (1962).

12. S. C. CODE §12-20.7(a) (Supp. 1962).

13. *Phinizy v. Augusta & K. R. R.*, 62 Fed. 678 (Cir. Ct., D. S. C. 1894); *Wells v. Rodgers*, 80 Mich. 525, 27 N. W. 671 (1886).

The act contains no requirements concerning or restricting the terms and conditions of the plan. It merely requires that such terms and conditions as are agreed upon by the respective boards of directors of the affected corporations must be set forth in the plan of the proposed merger or proposed consolidation.¹⁴ It has been held that the board of directors may agree to any terms and conditions, so long as such provisions are not in conflict with the general law and are not inconsistent with the articles of incorporation of the respective corporations.¹⁵

Once the plan of merger or consolidation has been agreed upon by the respective boards of directors, it must be submitted to a vote of the shareholders of each corporation at either an annual or a special meeting. The act^{15a} requires at least twenty days' written notice to each shareholder of record entitled to vote at the meeting. The notice must state the purpose of the meeting, must contain a clear and concise statement concerning the rights of dissenting shareholders,¹⁶ and must be accompanied by a copy of the plan,¹⁷ by reasonably detailed balance sheets of each participating corporation for the three fiscal years preceding the date of the plan, and by profit and loss statements of each corporation for a similar period. Although the act does not so state, it is presumed that if a corporation has been in existence for less than three years, balance sheets and profit and loss statements covering the company's operations from the date of its inception will satisfy the requirements of the act.

The approval by the shareholders of the plan is obtained by a vote taken at the meeting called for such purpose. Each outstanding share is entitled to vote on the proposed plan, whether or not such share has the right to vote under the provisions of the articles of incorporation of such corporation. The affirmative vote required for approval of the plan may be either that vote properly prescribed by the articles of incorporation, or in the absence of such a provision in the articles, that vote prescribed by the act.

14. S. C. CODE §§12-20.1(b) (2), 20.2(b) (2) (Supp. 1962).

15. *Adams v. Yazoo & M. Val. R. R.*, 77 Miss. 194, 24 So. 200, 28 So. 956, *aff'd*, 180 U. S. 1 (1898).

15a. S. C. CODE §12-20.3 (Supp. 1962).

16. As provided in §6.27 of the act (S. C. CODE §12-16.27 (Supp. 1962)) and discussed hereinafter in Part III.

17. If the plan is unduly long or complex, the statement may contain an outline of its material features. S. C. CODE §12-20.3(b) (2) (Supp. 1962).

Certain provisions were included in the act for the benefit of close corporations in order that the shareholders of such corporations, if they so desired, could have the benefit of some of the advantages of a partnership. One of these is the right to insert superstatutory voting requirements into the articles of incorporation, and this right was carried over into the voting requirement provisions of the merger and consolidation sections of the act. Therefore, provisions can be inserted in the articles of incorporation prescribing stricter requirements on the affirmative vote of shareholders for the approval of a plan of merger or consolidation.¹⁸ If any such provisions are included in the articles of incorporation, they, of course, must be complied with to effect a valid approval of the plan.

If no provisions concerning the required vote for approval of a plan of merger or consolidation are contained in the articles of incorporation, then the requirements as promulgated by the act must be satisfied.¹⁹ The act specifies a two-thirds affirmative vote of all the outstanding shares of the corporation. In addition, if any class of shares is entitled to vote thereon as a class, there must be a two-thirds affirmative vote by the holders of the shares of such class. The instances in which a class vote must be taken are prescribed by section 12-19.5 of the act. This section is effective only when there exists in the corporate structure more than one class of stock. The provision requiring a class vote will operate to prevent common shareholders, by effecting a merger or consolidation, from destroying preference rights of other classes of shareholders which may have become distasteful to the common shareholders.

Upon approval of the plan of merger or consolidation by the shareholders of each of the participating corporations, articles of merger or of consolidation must be prepared,²⁰ executed, and verified pursuant to the general provisions of the act.²¹ The articles are then delivered to the Secretary of State for filing, and the transaction is deemed effected as of

18. See S. C. CODE §12-20.3(d) (Supp. 1962). Note particularly that these limitations do not carry forward and are not applicable to the new or surviving corporation unless the plan of merger or of consolidation so provides.

19. S. C. CODE §12-20.3(c) (Supp. 1962).

20. S. C. CODE §12-20.4 (Supp. 1962) sets forth the information which must be included in the articles of merger or consolidations.

21. See S. C. CODE §§12-11.4, 12-11.5 (Supp. 1962).

the filing date. If the articles so specify, the effective date of the merger or consolidation can be postponed to a date not to exceed sixty (60) days from the filing date of the articles.²²

B. *Parent-Subsidiary Mergers*

Section 12-20.5 offers a simple, speedy and inexpensive procedure for merging one or more subsidiaries into a parent corporation. This procedure is known as the "short form" merger and is the only part of these sections dealing with mergers and consolidations which is radically new. This section, which in essence is taken from the Model Business Corporation Act,^{22a} provides that a parent corporation owning at least 95% of the outstanding shares of each class of stock of another corporation or corporations may merge such subsidiary or subsidiaries into the parent by doing the following:

- (1) The board of directors of the parent adopts the plan of merger.²³
- (2) Mailing a copy of the plan to the shareholders of the subsidiaries.²⁴
- (3) On the 30th day after mailing such plan to the shareholders, filing the papers necessary to effect the merger with the Secretary of State.²⁵

It should be noted that no shareholder approval is required in the short form merger. This is based upon the fact that a 5% interest of outside shareholders of the subsidiary is insufficient to block the merger, and upon the reasoning that any unfair treatment of these outside shareholders can be adequately protected under the appraisal rights available to any shareholders who dissent. Shareholders of the parent are given neither voting rights nor dissenters' rights, because normally a parent-subsubsidiary merger of this type would not materially affect their interests as the merger merely effects

22. S. C. CODE §§12-11.6, 12-20.6 (Supp. 1962). It should be noted that there is no comparable provision in the act to S. C. CODE §12-454 (1962) which required recording of the articles of merger or consolidation in the county where the new or surviving corporation was to be located and in the counties where the participating corporations' original charters were filed. Under the act the only required filing is with the Secretary of State; there is no recording.

22a. Hereinafter referred to as the "MODEL ACT."

23. S. C. CODE §12-20.5 (a) (1) (Supp. 1962).

24. S. C. CODE §12-20.5 (a) (2) (Supp. 1962).

25. S. C. CODE §12-20.5 (a) (3) (Supp. 1962).

a formal change in the corporate structure. However, under the act, it is possible that these shareholders may have the nature of their investment changed against their wills by reason of a short form merger. Massachusetts, New York, and Nevada provide for a short form merger only when the subsidiary's business is similar or incidental to the business of the parent.²⁶ Our act contains no such provision; however, it seems that a provision of this type would afford protection to the shareholders of the parent against a radical change in the nature of their investment. In any event, these shareholders should have or should be given the right to seek an injunction to set aside a bad-faith or fraudulent transaction.²⁷

The constitutionality of a similar provision in Delaware was sustained in the case of *Coyne v. Park & Tilford Corp.*²⁸ on the authority of the state's reserved power to amend corporate charters by subsequent general legislation.

The interpretation of this statute by the Delaware courts in the *Coyne* case, *supra*, and in *Stauffer v. Standard Brands, Inc.*²⁹ is quite interesting. In the *Coyne* case, the court held that this section granted substantive as well as procedural rights by giving the parent corporation the power and the election of paying the minority shareholders of the subsidiary cash rather than offering them securities or other obligations of the parent and thus eliminating their interest in the corporate entities.³⁰ In the *Stauffer* case, the plaintiffs, minority shareholders of the subsidiary, were seeking to set aside a short form merger on the grounds that the price to be paid the minority shareholders so grossly undervalued their stock that it constituted a constructive fraud on them. The court stated that in a merger, other than short form mergers, such a gross undervaluation, shocking to the court's conscience, may be constructive fraud warranting setting aside a merger. How-

26. MASS. GEN. LAWS Ch. 156, §46A(2); NEV. REV. STAT. §78.540; N. Y. STOCK CORP. LAW §85.

27. See discussion, *Rights of Dissenting Shareholders*, page 422, *infra*.

28. 154 A. 2d 893 (Del. Sup. Ct. 1959), *affirming* 146 A. 2d 785 (Del. Ch. 1958).

29. 178 A. 2d 311 (Del. Ch. 1962). This case has been appealed to the Supreme Court of Delaware and was argued on November 17, 1962. Therefore, the rationale of this case may be entirely erroneous by the time of the publication of this article.

30. In the regular merger transaction, minority stockholders may not be summarily eliminated from the continuing enterprise, but are given the option of accepting securities in the surviving corporation, or, alternatively, of demanding payment in cash for their holdings by an appraisal proceeding pursuant to S. C. CODE §20-16.27 (Supp. 1962).

ever, under the short form merger provisions, such undervaluation does not afford grounds for setting aside the merger and the appraisal remedy of the minority shareholders of the subsidiary under these circumstances provides them with an adequate and complete remedy which is *exclusive*.³¹

Finally, subsection (b) of section 12-20.5 states that "Any plan of merger which requires or contemplates any changes other than those specifically authorized by this section shall be accomplished under the provisions of section 12-20.1." This subsection is for the protection of the shareholders of the parent corporation; otherwise the board of directors of the parent, through the short form merger provisions, could effectively amend the articles of incorporation of the parent and circumvent the required vote of the shareholders in favor of such amendment.³²

C. *Mergers and Consolidations of Domestic and Foreign Corporations*

It is well known that a merger or consolidation of a domestic corporation and a foreign corporation is not authorized in the absence of specific statutory authority even where such authority exists for mergers and consolidation of domestic corporations.³³ Subsection (a) of section 12-20.7 of the act is the grant of such general merger and consolidation authority respecting foreign and domestic corporations and subsection (b) of this section grants authority for the short form merger, provided, in both instances, the laws of the jurisdiction of the foreign corporation permit such combinations.

This section provides that each corporation shall comply with the provisions of the law of its respective jurisdiction, and in the event the surviving or new corporation is a foreign corporation, such corporation shall comply with the laws of this state in respect to foreign corporations in order to do business in this state.³⁴ In any event, the new or surviving foreign corporation shall file with the Secretary of State a

31. *Query*: Would illegality in the proceedings be sufficient grounds for setting the merger aside?

32. Section 10.6(b) (6) of the act (S. C. CODE §12-20.6(b) (6) (Supp. 1962) states that the articles of incorporation shall be deemed to be amended to the extent that changes in the articles are stated in the plan of merger.

33. *William B. Ricker & Son Co. v. United Drug Co.*, 79 N. J. Eq. 580, 82 Atl. 930 (1912).

34. S. C. CODE §12-20.7(d) (1) (Supp. 1962).

document, containing certain information and undertakings, the primary purpose of which is to ensure service of process on the surviving or new corporation and the payment of shareholders who dissent to the transaction.³⁵

There is nothing radically new in these provisions. They adhere closely to section 70 of the Model Act and are in substantial harmony with the present law governing mergers and consolidations between foreign and domestic corporations.³⁶

D. *Authority to Abandon Merger or Consolidation*

There is no comparable provision to section 12-20.8 in the existing corporation laws of this state. This section permits the board of directors of any participating corporations to abandon the merger or consolidation at any time prior to the filing of the articles of merger or consolidation, *provided* the plan of merger or consolidation contains such authority.

Since the authority for abandonment must be contained in the plan, it would appear that, from a practical standpoint, all plans should contain such a provision, as the transactions may evoke such a number of demands for "appraisal" and resulting payment that the surviving or new corporation may not be able to withstand the financial burden. Also, changes in economic conditions may indicate that the proposed combination is no longer feasible. Without this statutory authority, a provision for abandonment in the plan may be held to constitute an improper delegation of authority by the shareholders.³⁷

III. RIGHTS OF DISSENTING SHAREHOLDERS

A. *Mergers and Consolidations*

At common law no merger or consolidation could take place without the unanimous consent of all shareholders. As stated in *Johnson v. Baldwin*:³⁸

Unanimous consent required at common law empowered a dissenting stockholder to compel the majority to buy him out on his own terms in order to effect a merger or

35. S. C. CODE §12-20.7(d) (2) (Supp. 1962).

36. S. C. CODE §§12-456.1, 12-456.8 (1962).

37. See Fuld, *Some Practical Aspects of a Merger*, 60 HARV. L. REV. 1092, 1096 (1947).

38. 221 S. C. 141, 69 S. E. 2d 585, 591 (1952).

consolidation. In seeking to remedy the foregoing condition, however, it was found necessary to protect the minority, if they regarded the sale as opposed to their interests, and allow them to retire from the enterprise upon the payment to them of the value of their shares. The remedy of appraisal and payment was intended to afford fair and just compensation to the dissenters and at the same time provide a method by which their objections could be fairly composed so as to enable the consolidation to proceed.

Section 12-20.9 contains the general grant of authority to shareholders to dissent from mergers and consolidations. In order to perfect this right a shareholder must comply with the provisions of section 12-16.27.³⁹ There are two exceptions to this general right: (1) The shareholders of the parent corporation in a short form merger have no right of dissent, unless the parent is a corporation of a foreign jurisdiction which grants such a right, and (2) the shareholders of a surviving parent corporation in a merger which owns all the outstanding shares of its merging subsidiaries on the date of the filing of the articles of merger have no such right. These two exceptions are perfectly logical since the essential position of the shareholders of the parent normally remains unchanged.

B. Sale of Assets

A shareholder, by compliance with section 12-16.27⁴⁰ has the right of a dissenting shareholder to the payment of the fair value of his shares, in a sale of assets transaction, except in two situations: (1) when the sale is in the usual and regular course of business and (2) when the sale is for cash and the proceeds are to be distributed within one year to the shareholders.⁴¹ The reason for the first exception is self-explanatory. The basis for the second exception is that there is no reason in such a case to permit any shareholder to attempt to realize more than he is to receive in the normal course of distribution, nor more than his fellow shareholders who do not dissent.

39. See discussion, *Rights of Dissenting Shareholders*, page 422, *infra*.

40. See discussion, *Rights of Dissenting Shareholders*, page 422, *infra*.

41. S. C. CODE §12-21.5 (Supp. 1962).

C. Procedure

The procedure which must be followed by dissenting shareholders to perfect and preserve their rights of appraisal in fundamental corporate changes is carefully set forth in section 12-16.27. For the sake of clarity, this procedure will be outlined briefly, followed by a discussion of the section as a whole. It must be borne in mind that a shareholder must follow the required procedure precisely in order to protect his rights of appraisal.⁴²

The procedure under this section is as follows:

1. *Prior to or at the shareholders meeting* a shareholder must file a written objection to the proposed corporate action.⁴³

2. *At the meeting* the shareholder must not vote in person or by proxy in favor of the action. Silence on the part of the shareholder at the meeting will apparently satisfy this requirement,⁴⁴ as he is not required by the language of the statute to vote against the action.

3. *Within 20 days after the meeting* a written demand for the payment of his shares must be filed with the corporation, or in the case of a merger or consolidation, with the surviving or new corporation. In the case of a short form merger the demand must be filed with the parent corporation within twenty days after the plan of merger shall have been mailed to the shareholders of the subsidiary corporation.⁴⁵

4. *At the time of filing the demand or within 20 days thereafter* the shareholder must submit his share certificates to be stamped with a notation thereon to the effect that a demand for appraisal of such shares has been made and that the holder thereof is no longer entitled to any of the normal shareholder rights. A failure on the part of the shareholder to comply with this requirement does not automatically work a forfeiture of his right to appraisal; however, the corporation does have the option of terminating his rights of appraisal unless a court of competent jurisdiction directs otherwise.⁴⁶

42. *In re* Universal Pictures Co., 28 Del. Ch. 72, 37 A. 2d 615 (1944); *In re* O'Brien, 182 Misc. 577, 45 N. Y. S. 2d 208 (Sup. Ct. 1943).

43. S. C. CODE §12-16.27 (b) (Supp. 1962).

44. S. C. CODE §12-16.27 (c) (Supp. 1962).

45. S. C. CODE §12-16.27 (c) (Supp. 1962).

46. S. C. CODE §12-16.27 (f) (Supp. 1962).

5. *Within ten days after the corporate action is effected⁴⁷ or ten days after the expiration of the demand period (whichever is later), the corporation must make a written offer to the demanding shareholders to purchase their shares at a fixed price. The price offered must be the same for all shareholders of each class and must be accompanied by a balance sheet of the corporation in which the dissenting shareholder holds shares, and a profit and loss statement of the same corporation covering twelve months' operations and ending with the date of the balance sheet. The balance sheet must be as of the latest available date and not more than twelve months prior to the date of such offer.*⁴⁸

6. *Within thirty days of the effected corporate action or thirty days of the expiration of the demand period, whichever is later, and upon a failure of the shareholder and the corporation to agree, the corporation has an additional thirty days in which to institute an *in rem* proceeding to determine the fair value of the shares. Upon failure of the corporation to act within the subscribed period, a dissenting shareholder has thirty days in which to institute action for this purpose. Upon institution of suit by either party, the court determines whether the shareholders are entitled to be paid, and the "fair value" of their shares. Appraisers may be appointed. Judgment may be entered, including, at the court's discretion, interest and costs. Thereafter, the corporation pays the "fair value" of the shares of such dissenters and satisfies any judgment that may have been entered.*⁴⁹

If the above procedure is carefully adhered to, a demanding shareholder will be entitled to payment of the fair value of his shares. However, certain questions are likely to arise under this section. It is impossible in an article of this type to fully cover each of these problems or questions, as any one of them could well be the topic of a separate article, but some of them will be dealt with in summary form.

The decisions of the courts of this state in dealing with the rights of dissenting shareholders are practically nonexistent. Therefore, it has been necessary to use decisions of jurisdic-

47. Corporate action is deemed to have been effected (a) in a merger or consolidation when the articles are filed or on the effective date when such is postponed under the articles to a time subsequent to the filing date, and (b) in a sale of assets transaction when the sale is consummated. S. C. CODE §12-16.27(g) (Supp. 1962).

48. S. C. CODE §12-16.27(g) (Supp. 1962).

49. S. C. CODE §12-16.27(h), 12-16.27(i) (Supp. 1962).

tions other than South Carolina which have statutes similar to the act in arriving at a conclusion as to the manner in which this section will probably be interpreted by the courts of this state. It should be borne in mind, however, that it has been held in this state that statutes of this type are to be liberally construed in favor of the shareholder, on the theory that they have deprived the shareholder of his right to prevent a major corporate change and have abrogated the rule requiring unanimous approval of such change.⁵⁰

Must a shareholder be a registered shareholder in order to have the right to dissent and, if so, must he be registered on the record date in order to avail himself of the appraisal right granted by the statute? Throughout section 12-16.27, the word "shareholder" is used. In subsection (a) of section 12-11.2 "shareholder" is defined as one who is a holder of record in the corporation. It is submitted that the words of the statute should be construed to mean that only registered holders of shares will be entitled to dissent to the proposed corporate action.⁵¹ Since the shareholder must make his first move in order to perfect his appraisal rights at the meeting at which the proposed action is to be voted upon, it would appear that he must be a registered holder on the meeting date; but the question remains that perhaps the right is limited to shareholders as of the record date for the meeting. In *Lewis v. Corroon and Reynolds Corp.*⁵² the court, in interpreting a statute similar to this section, stated:

A reading of the appraisal statute reveals two things pertinent here. One, the record date is not mentioned. Two, a stockholder in order to qualify for an appraisal need not vote against the proposed merger. The only requirement voting-wise is that such a stockholder must not vote in favor of the merger if he intends to qualify for an appraisal of his shares.

... I can find no necessary connection here between the requirements for an appraisal and the record date for voting on a proposed merger since a shareholder seeking an appraisal need not vote at all.⁵³

50. *Manning v. Brandon Corp.*, 163 S. C. 178, 161 S. E. 405 (1931).

51. *Coyne v. Schenley Indus., Inc.*, 155 A. 2d 238 (Del. Sup. Ct. 1959); *Salt Dome Corp. v. Schenck*, 28 Del. Ch. 433, 41 A. 2d 583, 158 A. L. R. 975 (Sup. Ct. 1945).

52. 30 Del. Ch. 200, 57 A. 2d 632 (Ch. 1948).

53. *Accord*, Application of Bozar, 183 Misc. 736, 50 N. Y. S. 2d 521 (Sup. Ct. 1944).

Based on this reasoning, it appears that the registration requirements are satisfied if the shareholder is a registered shareholder on the meeting date.

In the normal situation, an equitable owner may fully protect his rights by procuring a proxy and a power of attorney from the registered owner. The necessity for a power of attorney stems from the requirement that a written objection must be filed as the first step towards perfecting appraisal rights. The only instance in which inequities might arise is in those cases where brokers, trustees, or agents hold stock in their names for several beneficial owners, some of whom wish to dissent. As it now stands, the shareholder must dissent on an "all or nothing" basis. There is a provision in the Model Act that a shareholder may dissent to less than all the shares registered in his name.⁵⁴ A provision of this type would eliminate inequities which might arise in such a situation. The reasoning behind this provision of the Model Act is quite sound, and it would appear that a similar provision should be incorporated in the act. However, it is suggested that the right granted be limited to shareholders who are fiduciaries for several beneficial owners, and that all the shares of a particular beneficial owner be required to be voted alike. This would prevent a normal shareholder from hedging on the transaction by voting half his shares in favor of the proposed action and dissenting as to the other half.

What is the meaning of the term "fair value"? The statute does not attempt to define this phrase and there are no decisions interpreting the word "value" as used in the existing statutes of this state.⁵⁵ Twenty-two states and the District of Columbia use fair value as the basis for appraisal awards and "the cases from these jurisdictions indicate that there is no definite rule for determining 'fair value' but that the proper result in each case will depend on the particular cir-

54. MODEL ACT §73. This provision appeared as subsection (j) of the Draft Version of §6.27 of the act, but was deleted prior to the introduction of the bill into the Legislature. It read as follows: "A shareholder may dissent as to less than all of the shares registered in his name. In such event, his rights shall be determined as if the shares to which he has dissented and his other shares were registered in the names of different shareholders."

55. S. C. CODE §§12-459, 12-461 (1962).

cumstances of the corporation involved.”⁵⁶ However, the act does set forth the date as of which “fair value” is to be determined⁵⁷ and that it is not to reflect any appreciation or depreciation in the value of the shares resulting from the action taken by the corporation.

Under the act, a dissenting shareholder is thereafter entitled only to payment of the fair value of his shares and loses all other rights as a shareholder.⁵⁸ However, under subsection (e) a shareholder's status will be restored in certain situations. Upon the restoration of a shareholder's status, is he entitled to corporate distributions made during the interim? It would seem so, but to eliminate all doubt it might be wise that a provision similar to that contained in the old New York Stock Corporation Law be added to clarify the situation.⁵⁹

Finally, is the shareholder's appraisal remedy an exclusive remedy? There apparently is no definite answer to this question. The following is taken from an annotation⁶⁰ on this question and quite succinctly gives the status of the law:

. . . [T]he cases are conflicting on the question whether statutes of the type under consideration furnish the exclusive remedy to the minority stockholder who objects to the plan of consolidation, merger, or reorganization of the corporation, or whether disregarding that remedy he may pursue other equitable remedies on the theory that his remedy under the statute is inadequate, to recover from the resulting corporation an amount greater than that permitted under the statute as the fair value of his stock.

In some of the more recent cases also the view is taken that the statutory remedy of the dissenting stockholder is exclusive of all other remedies . . .

56. MOD. BUS. CORP. ACT ANNOT. §74(¶4), at 411 (1960). However, for a discussion of the factors which must be taken into account in determining “fair market value” see *American Gen. Corp. v. Camp*, 171 Md. 269, 190 Atl. 225 (1937); *Phelps v. Watson-Stillman Co.*, 365 Mo. 1124, 293 S. W. 2d 429 (1956).

57. The date for determination of fair value is the day prior to the date on which the vote was taken approving the corporate action. S. C. CODE §12-16.27(a) (Supp. 1962).

58. S. C. CODE §12-16.27(d) (Supp. 1962).

59. . . . provided, that such shareholders shall thereupon be entitled to receive any dividends, distributions or other rights to which he would have been or would have become entitled had he not demanded payment for his stock. N. Y. STOCK CORP. LAW §21.

60. See annotation, 162 A. L. R. 1237, 1250, 1251 (1946).

First, is a shareholder required to elect between dissenting and thereby securing in the prescribed manner the fair cash value of his stock, or, failing to dissent, being bound by the terms of a combination? Secondly, is he required to make an election even though the transaction is illegal or is tainted with unfairness or fraud? There are no cases in this state directly in point. However, Mr. Justice Oxner, in *Johnson v. Baldwin*⁶¹ in which the court held that a dissenting shareholder cannot continue to prosecute a derivative action, stated:

It is generally held that a dissenting stockholder is put to an election by a statute of this kind. [Cases cited.] There are sound reasons for this view. The proper financing of the corporation may demand quick action. The management is entitled to know how many of the stockholders dissent from the proposed merger and thus become potential demandants of cash. The requirement as to election is reasonable. . . . Of course, as pointed out in *Cole v. National Cash Credit Ass'n, supra*, there may be circumstances under which the duty to make an election does not arise. For instance, if the merger is not authorized by law or if brought about through fraudulent conduct, the dissenting stockholder has the right to go into a court of equity and seek an injunction against consummation of the merger.

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. . . Under these circumstances we think she was bound by her election and may not now withdraw her demand and restore her status as a stockholder. The statute admits of no other reasonable construction and to hold otherwise would lead to great uncertainty and much confusion.

From the above it would appear that the courts of this state would hold that the appraisal remedy is exclusive in the absence of fraud or illegality, and in the case of a transaction which is illegal or tainted with fraud, the shareholder's only remedy is to enjoin the proposed corporate action. Unfortunately, the opinion continues:

Finally, the argument is made that section 7759 does not furnish an adequate remedy for the fair determination of the value of the plaintiff's stock. Since it appears to

61. 221 S. C. 141, 69 S. E. 2d 585 (1952).

be conceded, and properly so we think, that under the procedure laid down by section 7759, any right of the Brandon Corporation sought to be enforced by plaintiff may be considered as an asset in evaluating plaintiff's stock, there would seem to be little, if any, basis for the claim that she cannot get proper compensation under this statute. But be that as it may, the question as to whether the remedy afforded to a dissenting stockholder under section 7759 is exclusive, upon which there is so much conflict of authority, . . . is a question that is not properly before us.

It is difficult to determine what effect this last statement of the court has on its prior statement in this same case. What the courts of this state will finally decide on this question is a matter of conjecture. It would appear, however, that the better rule is that a dissenting shareholder is limited to his remedy under the appraisal statutes in the absence of illegality or fraud, and where illegality or fraud is present in a transaction, the shareholder is limited to injunctive proceedings to prevent the proposed merger. Otherwise, corporations can be subjected to a multiplicity of suits in different courts having concurrent jurisdiction and to conflicting judgments affecting the same class of shares of stock.

This whole subject is complicated by subsection (k) of this section.⁶² This subsection did not appear in the Draft Version of the act and is peculiar to this state. *Johnson v. Baldwin*⁶³ held that a dissenting shareholder cannot continue to prosecute a derivative action. After a dissenting shareholder has made demand for payment, there is a transitory period when he is a shareholder in name only with none of the ordinary incidents or rights of a shareholder. The reasoning of this case appears sound and in keeping with the tenor of the appraisal statutes. It would seem that no purpose will be served by enacting legislation in complete derogation of this decision and other provisions of the act and allowing such a shareholder to sue in the right of the corporation. This provision may also have the effect of making less certain the exclusive-

62. This subsection is as follows: "No action by a shareholder in the right of the corporation shall abate or be barred by the fact that the shareholder has filed a demand for payment of the fair value of his shares pursuant to the provisions of this section." S. C. CODE §12-16.27 (k) (Supp. 1962).

63. 221 S. C. 141, 69 S. E. 2d 585 (1952).

ness of the appraisal remedy. Since this provision is likely to lead to conflicts and uncertainty, the Legislature should consider its repeal.

IV. *Sale or Other Disposition of Corporate Assets*

When all or substantially all of the assets of a corporation are sold, leased or exchanged in the regular course of business, approval by the board of directors is sufficient authorization to constitute a valid sale, lease or exchange.⁶⁴ However, if the articles of incorporation so provide, shareholder approval of the transaction will be necessary.⁶⁵ Whether or not a transaction is to be deemed within the regular course of business is a question of fact which is determined by the circumstances surrounding the transaction.⁶⁶ However, section 12-21.2(c) gives certain guidelines for determining this question. If the nature of the business will be changed thereby, the sale is not in the regular course of business, but if the business was incorporated for the purpose of liquidating such assets, or if the sale is a transaction or one of a series of transactions made in the furtherance of the business of the corporation and not to terminate or dispose of its business, then the sale is deemed to be one in the regular course of business.⁶⁷

If the sale is not within the regular course of business, not only is the approval of the board of directors necessary, but a two-thirds vote of all the shareholders is required, including a two-thirds class vote, if such class is entitled to vote thereon as a class.⁶⁸ Super-statutory voting requirements may be included in the articles of incorporation.⁶⁹ The act gives the board of directors authority to abandon the sale, subject to the rights of third parties to any contracts relating thereto.⁷⁰

The Model Act also requires the above procedure for mortgages and pledges.⁷¹ However, section 12-21.4 of the act entirely eliminates shareholder approval for mortgages or pledges unless the articles of incorporation otherwise pro-

64. S. C. CODE §12-21.2(a) (Supp. 1962).

65. S. C. CODE §12-21.2(b) (Supp. 1962).

66. S. C. CODE §12-21.2(c) (Supp. 1962).

67. S. C. CODE §12-21.2(c) (Supp. 1962).

68. S. C. CODE §12-21.3(a) (Supp. 1962).

69. S. C. CODE §12-21.3(b) (Supp. 1962).

70. Note: This authority for abandonment is absolute in the Board of Directors, whereas for such to exist in mergers and consolidations, it must be included in the plan of merger or consolidation.

71. MODEL ACT §§71,72.

vide. The elimination of shareholder approval in these transactions is wise, since the advantage gained by the shareholders in approving such liens is outweighed by the inconvenience which the necessity for such approval creates in legitimate mortgage situations. It seems clear that normal business transactions of this type would be facilitated by eliminating all requirements for shareholder approval of mortgages or pledges, regardless of provisions contained in the articles of incorporation. This becomes even more important when the articles are not required to be recorded in the appropriate local public records.

Three of the areas of probable litigation under the sale of assets provisions are (1) the determination of when the transaction is deemed to be in the regular course of business; (2) the rights of creditors; and (3) the determination of whether there has been a *de facto* merger so as to allow the shareholders of the purchasing corporation the right to dissent from the transaction.

The basis of the determination of the first question will be the facts of the particular situation, and questions regarding the rights of creditors are beyond the scope of an article of this type. However, it appears that the third litigable area should be discussed.

Section 12-21.5, like the Model Act,⁷² confers dissenter's rights only upon the shareholders of the selling corporation, although the shareholders of the purchasing corporation may have an interest in the matter and a real grievance.^{72a} This can happen, for instance, when a small corporation purchases assets of a large corporation so that the business of the purchasing corporation is substantially changed, or a large block of stock is issued in payment for such assets.

In such a situation the judicial doctrine of *de facto* merger can well come into play whereby the court concludes that what is in form a sale of assets is in reality a merger subject to appraisal rights of dissenters. The courts of South Carolina have perhaps recognized the *de facto* merger situation. By dictum, the court in *Beckroge v. South Carolina Power Co.* said:

... The transfer of the assets of one corporation to another may amount to a merger in fact, although the cor-

72. MODEL ACT §73.

72a. 197 S. C. 184, 194-195, 15 S. E. 2d 124 (1941).

porate existence of the transferrer corporation continues. Where such is the case, equity looks past the form, and at the real effect of the transaction, . . .

The three leading cases in this area are: *Farris v. Glen Alden Corp.*,⁷³ *Heilbrun v. Sun Chem. Corp.*,⁷⁴ *Applestein v. United Bd. & Carton Corp.*⁷⁵

In the *Farris* case, an agreement was entered into by a relatively small corporation to purchase the assets of a large corporation. After the consummation of the sale the purchasing corporation would be transformed from a coal mining company to a diversified holding company; its assets would amount to approximately \$169,000,000 with a long-term debt of \$38,000,000 as compared with its prior assets of one-half that size and with one-seventh the long-term debt; the directors of the selling corporation would have control; 76.5% of the stock would be owned by the shareholders of the selling corporation; and the book value of the stock would decrease from \$38.00 a share to \$21.00 a share. The Pennsylvania court stated that the rationale of the appraisal statutes was "that when a corporation combines with another so as to lose its essential nature and alter the original fundamental relationships of the shareholders among themselves and to the corporation, a shareholder who does not wish to continue his membership therein may treat his membership in the original corporation as terminated and have the value of his shares paid to him."^{75a}

The court, in interpreting provisions similar to those of the act, held:

So, as in the present case, when as part of a transaction between two corporations, one corporation dissolves, its liabilities are assumed by the survivor, its executives and directors take over the management and control of the survivor, and, as consideration for the transfer, its stockholders acquire a majority of the shares of stock of the survivor, then the transaction is no longer simply a purchase of assets or acquisition of property . . . but a merger . . .

73. 393 Pa. 427, 143 A. 2d 25 (1958).

74. 150 A. 2d 755 (Del. Sup. Ct. 1959).

75. 60 N. J. S. 333, 159 A. 2d 146 (Super. Ct. 1960).

75a. 393 Pa. 427, 143 A. 2d 25 (Sup. Ct. 1958).

The court went on to say that even if it were not a *de facto* merger, in reality the nominal purchaser was the real seller and under the statute granting the shareholders of the selling corporation appraisal rights, the shareholders of the nominal purchasing corporation had the right of dissent.⁷⁶

In the *Heilbrun* case, a sale of assets was involved and the plaintiffs, shareholders in the purchasing corporation, asserted a *de facto* merger which in turn entitled them to appraisal rights. Unlike this state, Delaware grants no appraisal rights by statute to either the shareholders of the purchasing or the selling corporation in sale of assets transactions. The court held that the plaintiffs had no appraisal rights although a *de facto* merger existed, as no injury had been inflicted upon them. They were not forced to accept stock in another corporation; the reorganization had not changed the essential nature of the enterprise of the purchasing corporation; nor was it a case where it could be said that the seller acquired the purchaser.

The New Jersey court in the *Applestein* case was confronted with a sale of stock situation in which the shareholders of the purchasing corporation were asserting a *de facto* merger which would give rise to appraisal rights for such shareholders. The court in applying corporate statutes similar to those of the act, held that a *de facto* merger took place and, therefore, all shareholders were entitled to appraisal rights. The court stated that the purchasing corporation was, in reality, the selling corporation. However, the opinion of the court intimated that in every *de facto* merger situation, regardless of the consequences to the shareholders (as apparently is of such vital importance in Delaware) all shareholders become entitled to appraisal rights.

No attempt is made to predict how this question will be resolved by the courts of this state, as the law elsewhere is in such a state of flux. However, when the law on this point crystallizes, it would seem that the problem should be eliminated by the passage of appropriate legislation.⁷⁷

76. The PENNSYLVANIA BUSINESS CORPORATION LAW has been amended to deal with such a situation as existed in the *Farris* case. See PENN. B. C. L. §311, as amended by 1957 P. L. 711; 1959 P. L. 1406.

77. See Note, *The Rights of Shareholders Dissenting from Corporate Combinations to Demand Cash Payment for Their Shares*, 72 HARV. L. REV. 1132 (1959) for an excellent discussion of this problem.