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CORPORATIONS

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I. MERGER

A corporation law topic of national interest and importance, sparked by recent decisions in Delaware and elsewhere,¹ is the doctrine of *de facto* merger. Merger (or consolidation) is the traditional device for combining corporations, or, at least, it is the device originally recognized by corporation statutes and singled out for rather full regulation.² Thus, the new South Carolina statutes authorizes mergers and consolidations,³ prescribes in detail their consequences,⁴ and gives appraisal rights to shareholders of all participating corporations.⁵ Merger is not, however, the sole, or even most commonly used, technique of corporate fusion. More commonly a corporation will sell its assets, usually for the purchaser's shares, and may thereafter dissolve and distribute these shares in liquidation. Or Corporation A will purchase all or a substantial number of Corporation B's shares from the B shareholders, usually for a consideration consisting of A shares; thereafter A may dissolve B, thereby acquiring the B assets, or it may continue to operate B as a subsidiary. These examples reveal how a merger-like result can be brought about by coupling statutory dissolution proceedings with a sale of assets or an exchange of shares. The *de facto* merger doctrine broadly stated, recognizes the power of courts to inquire whether a sale of assets or exchange of shares is "really" a merger with the statutory incidents of a merger. The issue is especially important in connection with appraisal rights. Although statutes almost invariably grant such rights to everyone in a merger, only one-half of the states recognize them in a sale of assets even for

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1. See cases cited note 21 *infra*.

2. Sales of assets are much more briefly provided for in statutes, *e.g.*, S.C. CODE §§ 12-21.1 to -21.5 (Supp. 1962). Statutes rarely do more than merely authorize corporations to purchase shares of other corporations, *e.g.*, S.C. CODE § 12-12.2(a)(14)(A) (Supp. 1962). The reason, probably, is that conceptually a merger is a very drastic change, involving as it does the disappearance of the corporate entity of at least one of the participating corporations, while sale of assets and exchange of shares do not of themselves bring about such traumatic changes.

3. S.C. CODE §§ 12-20.1 (merger), 12-20.2 (consolidation) (Supp. 1962).

4. S.C. CODE § 12-20.6 (Supp. 1962).

5. S.C. CODE § 12-20.9 (Supp. 1962).

the shareholders of the selling corporation.⁶ They are rarely if ever available to the shareholders of the purchasing corporation,⁷ and have never been granted by statute to any shareholders in connection with a corporate fusion by way of an exchange of shares.⁸ As a result, corporate managers try to put corporations together so as to avoid appraisal rights, while disgruntled shareholders seek to enjoin the transaction or contend that it is a merger although in form an assets sale or exchange of shares.

South Carolina has had only peripheral encounters with the *de facto* merger doctrine, since the court has never been squarely faced with the question in the context of shareholders' demand for appraisal rights, as have the courts in Delaware, Pennsylvania, or New Jersey.⁹ In *Beckroge v. South Carolina Power Co.*,¹⁰ involving a creditor's claim against corporate assets which had been sold to another corporation, the court recognized the existence of the *de facto* merger doctrine when it asserted that

The transfer of the assets of one corporation to another may amount to a merger in fact, although the corporate existence of the transferrer [sic] continues. Where such is the case, equity looks past the form and at the real effect of the transaction, and by an application of the trust fund doctrine holds the transferee liable to the extent of the assets received, as in such case it is not a bona fide purchaser for value.¹¹

This dictum is simply a statement, in *de facto* merger terms, of the disposition of courts to attach the selling corporation's liabilities to the assets acquired by the purchaser, to avoid injury to the seller's creditors.¹²

In *Stephenson Fin. Co. v. South Carolina Tax Comm'n*,¹³ the court had another brush with the *de facto* merger concept, but in

6. See the tabulation in Manning, *The Shareholder Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L.J. 233, 262-65 (1962).

7. The only instance appears to be PA. STAT. ANN. tit. 15, § 2852-311(F) (Supp. 1961) granting appraisal rights to shareholders of a purchasing corporation when the assets acquisition is "accomplished by the issuance of more than a majority of the voting shares of such corporation to be outstanding immediately after the acquisition." This statute was partly designed to recognize, partly to draw the sting from, *Farris v. Glen Alden Corp.*, 393 Pa. 427, 143 A.2d 25 (1959).

8. This is the negative implication of *Manning, supra* note 6 at 262-65, and was so stated in note, 72 HARV. L. REV. 1132, 1142 (1959).

9. See cases cited note 21 *infra*.

10. 197 S.C. 184, 15 S.E.2d 124 (1941).

11. *Id.* at 194-95, 15 S.E.2d at 128.

12. For a concise survey of these problems, see LATTIN, CORPORATIONS 542-47 (1959).

13. 242 S.C. 98, 130 S.E.2d 72 (1963). This case is also noted in the Administrative Law section at note 91 and in the Taxation section at note 40.

the context, not of a sale of assets, but of an exchange of shares. There an automobile finance company, seeking control of two insurance companies with which it did business, "accomplished this purpose by exchanging its own stock for that of the shareholders of the insurance companies on a book value basis," an exchange solely "between the individual shareholders [of the insurance companies] and the finance company," involving "no corporate action" on the part of the insurance companies.¹⁴ "Each of the three corporations retained its corporate existence, assets and liabilities and each continued to conduct the business authorized by its charter."¹⁵ The issue was whether this transaction was "a reorganization, consolidation or merger" exempted from taxation under the then applicable South Carolina tax law.¹⁶ Holding that the transaction was not exempt, the court rejected a *de facto* merger contention by the corporations—surely an unusual source for this argument but understandable in the factual situation. The court stressed that since no merger or consolidation "can be lawfully accomplished without compliance with the terms of the statute,"¹⁷ the exchange of shares, which was clearly a different sort of fusion technique, was not a merger, *de facto* or *de jure*. Alternatively, "neither nor consolidation was intended or effected,"¹⁸ and, indeed, this would have defeated the objective of maintaining the three companies as separate entities. Finally, two distinctive hallmarks of a merger were absent: "A transfer of assets and assumption of liabilities."¹⁹

The court's decision is unquestionably sound. If ever there was a transaction which was *not* a *de facto* merger, it was this, where separate corporate entities were strictly maintained, and where the exchange of shares was obviously not a device to get at the underlying assets of the subsidiaries. It is, of course, unfortunate that the now superseded provisions of the state tax law failed to give an exemption whatever the technique used; but this deficiency could not be remedied by the court except by rewriting the unmistakable terms of the statute. Thus, the court rightly

14. *Id.* at 101, 125 S.E.2d at 73.

15. *Id.* at 101-02, 125 S.E.2d at 73.

16. S.C. CODE § 65-275 (1952): "In a reorganization, consolidation or merger the exchange of stock or property for stock of a corporation a party to the reorganization, consolidation or merger shall not be deemed to result in gain or loss."

17. Stephenson Fin. Co. v. South Carolina Tax Comm'n, 242 S.C. 98, 105, 130 S.E.2d 72, 75 (1963).

18. *Ibid.*

19. *Id.* at 105, 130 S.E.2d at 76.

resisted the temptation, if it felt any, to produce a result in harmony with federal tax law exemptions and with the subsequent revision of the state income tax statute.²⁰

We can only speculate on the implications of the decision for future cases squarely presenting the *de facto* merger contention in a corporate law context. *Stephenson* holds only that one corporation's acquisition of control of another by an exchange of shares is not of itself a merger. There were no further transactions to produce a merger-like result such as a transfer of assets from the new subsidiary to the parent, liquidation of the subsidiary, or an assumption of the new subsidiary's liabilities. Certainly, it is bad logic to argue from *Stephenson* that the presence of one or more of these features would mean that a transaction is a merger "in substance" or *de facto*, although in form and intention a sale of assets or exchange of shares. It should never be forgotten that a decision to apply or not apply the *de facto* merger concept is purely a policy question, and more specifically one which the courts have to face themselves since the doctrine is a judicial, not a legislative, invention. Application of the doctrine is a matter of sharp dispute among the courts.²¹ Since *Stephenson* very wisely avoids implying, let alone dictating, any rule on this question, the application and scope of the *de facto* merger concept is still a completely open question in South Carolina law.

It may be noted that the occasions under the new South Carolina Corporation Law for invoking the *de facto* merger concept are limited to rather special situations. Under the statute, appraisal rights are available for shareholders of all corporations participating in a merger,²² and for the shareholders of a cor-

20. By defining "reorganization" in harmony with INT. REV. CODE OF 1954, § 368, the new South Carolina statute precludes a repetition of the *Stephenson* holding. S.C. CODE § 65-275 (1962).

21. Compare *Hariton v. Arco Electronics, Inc.*, 188 A.2d 123 (Del. S.Ct. 1963) (no *de facto* merger although sale of assets was coupled with mandatory plan to liquidate selling corporation and distribute to its shareholders the selling corporation's shares) with *Farris v. Glen Alden Corp.*, 393 Pa. 427, 143 A.2d 25 (1958) (comparable, but not identical situation). Also compare *Orzeck v. Englehart*, 192 A.2d 26 (Del. Ch. 1963) (finding no *de facto* merger on exchange of shares) with *Applestein v. United Bd. & Carton Corp.*, 33 N.J. Super. 333, 159 A.2d 146, *aff'd per curiam*, 33 N.J. 72, 161 A.2d 474 (1960) (exchange of shares; situation similar to *Farris* case). For a discussion of all of these cases, see Folk, *De Facto Mergers in Delaware: Hariton v. Arco Electronics, Inc.*, 49 VA. L. REV. (1963).

22. S.C. CODE § 12-20.9 (Supp. 1962).

poration selling its assets.²³ This contrasts with Delaware which grants appraisal rights only in a merger,²⁴ but not in a sale of assets, and thus affords a built-in incentive to cast a corporate combination in the form of an assets sale. The chief advantage of doing so under the South Carolina law is that a sale of assets will require paying cash only to dissenters of the selling, but not of the purchasing, corporation, whereas the same transaction cast in the form of a merger or consolidation will require appraisal rights for both participating corporations. Thus, a dissenting shareholder of a corporation purchasing another corporation's assets might insist on appraisal rights on the theory that this is a *de facto* merger.²⁵ A second possible occasion for arguing the *de facto* merger concept is an exchange of shares coupled with liquidation of the acquired corporation. The out-of-state decisions disagree as to whether such a transaction is a *de facto* merger.²⁶ However, it is clear that if it is not, it is possible to combine corporations without appraisal rights for anyone.²⁷

II. OTHER CASES

Corporation law points were considered only incidentally in two other cases during the Survey period. *Bulova Watch Co. v.*

23. S.C. CODE § 12-20.5 (Supp. 1962) entitles [a]ny shareholder of a corporation . . . to dissent from the sale of all or substantially all of the property and assets of the corporation"

24. DEL. CODE ANN. tit. 8, § 262 (1953).

25. Shareholders of the purchaser have the least chance of success since the award of appraisal rights to shareholders of the seller arguably implies the exclusion of the purchasing corporation's shareholders. *Heilbrunn v. Sun Chem. Corp.*, 38 Del. Ch. 321, 159 A.2d 755 (Del. S. Ct. 1959), denied standing to shareholders of the purchasing corporation to raise the *de facto* merger issue, and *Orzeck v. Englehart*, 192 A.2d 26 (Del. Ch. 1963), in effect, did the same when an exchange of shares was challenged by a shareholder of the corporation initiating the exchange.

26. The conflict, scarcely irreconcilable in view of significant factual differences, is represented by *Orzeck v. Englehart* and *Applestein v. United Board & Carton Corp.*, cited in full, note 21 *supra*.

27. A third possible occasion for invoking *de facto* merger concepts is the so-called "upside-down" transaction, represented by *Farris v. Glen Alden Corp.*, 393 Pa. 427, 143 A.2d 25 (1958) (alternative holding) (sale of assets) and *Applestein v. United Board & Carton Corp.*, 33 N.J. Super. 333, 159 A.2d 146, *aff'd per curiam*, 33 N.J. 72, 161 A.2d 474 (1960) (exchange of shares). Thus, a sale of assets is said to be "upside-down" when the nominal purchaser is the "real" seller of assets. An extreme hypothetical example would be a \$100,000 corporation purchasing the assets of a \$10,000,000 corporation. "Upside-down" features have been used by courts to find a *de facto* merger, *Farris v. Glen Alden Corp.*, *supra*, or to realign the participating corporations to discover the "true" seller and purchaser, *Farris v. Glen Alden Corp.*, *supra*; *Applestein v. United Board & Carton Corp.*, *supra*. Some features of these odd transactions, heavily obscured by judicial misunderstanding, are analyzed in *Folk*, note 21 *supra*.

*Roberts Jewelers*²⁸ posed, but did not have to decide, the question whether a corporation whose charter has been canceled by the Secretary of State may survive as a *de facto* corporation, thus saving shareholders from personal liability. The holding of personal liability rested upon the fact that the "shareholder" of the dissolved corporation had not "ordered these goods as agent or representative of another."²⁹ But the court noted "grave doubt" whether the members of a corporation, whose charter has been forfeited, may continue to do business as a *de facto* corporation, especially when there is only one "shareholder" left.³⁰ *Southern Frozen Foods, Inc. v. Hill*³¹ held that the pre-existing debt of a corporation was a sufficient valuable consideration for the personal note of the principal shareholders.

III. STATUTES

The 1963 General Assembly passed a bill, prepared by the Joint Committee on Corporation Laws, amending the Corporation Act of 1962. Most of the amendments are clarifying; none of them significantly changes the basic statute. The amendments were drafted and approved by the Joint Committee, and represent an effort to perfect the statute. Most of the amendments are discussed or cited in a recent article in the Law Review's *Symposium on Corporation Law*,³² and since the bill was passed virtually

28. 240 S.C. 280, 125 S.E.2d 643 (1962). This case is also noted in the Agency section at note 1 and in the Pleading section at note 23.

29. *Id.* at 284, 125 S.E.2d at 645.

30. *Ibid.* One should note the shift in connotation in the words "*de facto*" when referring to the "*de facto* corporation" rule and the "*de facto* merger" concept. Both are, of course, judicially fashioned doctrines. But the court invokes the *de facto* corporation rule to recognize and uphold the corporate entity of a corporation which is defectively organized because of some failure to comply with the statutory incorporation procedure. See, *e.g.*, Meyer v. Brunson, 104 S.C. 84, 88 S.E. 359 (1915), applying the old South Carolina statute, S.C. CODE § 12-62 (1962), which in effect codifies the *de facto* corporation rule. For the new law, see S.C. CODE § 12-14. 5(b) (Supp. 1962). In contrast, under the *de facto* merger doctrine, a transaction complying precisely with the prescribed statutory procedures, *e.g.*, sale of assets plus dissolution, is set aside by the court, and some quite different incidents of another statutory procedure—merger—are attached to it. Thus one doctrine carries out, while the other substantially defeats, the intentions of the actors.

31. 241 S.C. 524, 129 S.E.2d 420 (1963). This case is also noted in the Commercial Transaction section at note 32.

32. See Folk, *The South Carolina Corporation Law: Reconsiderations and Prospects*, 15 S.C.L. REV. 467 (1963).

unchanged, these explanations are still applicable.³³ A schedule of fees and taxes under the new Corporation Law was also enacted.³⁴

33. The Joint Committee on Corporation Laws plans to issue an up-to-date version of the corporation statute, annotated with the Reporter's Notes which will be revised and rewritten to take account of the 1963 Amendments.

34. S.C. Acts 1963, Act No. 141.