THE DISSENTER’S APPRAISAL REMEDY*

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INTRODUCTION***

Nowhere are the virtues and vices of the form of California’s new corporation law as apparent as in the area of reorganization transactions and appraisal procedures. Those readers who have followed Mr. Small in his voyage through the maze of the reorganization chapters need no further proof of this point.1 Though intended to be general law for a sizeable and variously affected population, the new law reads like a term loan agreement between an aggressive banking consortium and a sophisticated major borrower. That even the California legislature silently accepted this approach says much about the capacity of any law-making body to cope with complex civil transactions.

The following analysis will concentrate on the changes from current law introduced by the new law, and will not provide a comprehensive description of the appraisal process as such. The complicated procedure for submitting stock for legending,2 the crediting of dividend payments on shares being appraised toward the later appraisal price,3 and particularly the deficiencies of current appraisal procedures, conceptual and practical, in determining fair prices4 have not changed and will not be commented upon here.

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*** Certain citation conventions are employed throughout this Symposium. These conventions are presented at page vii.
1 Small, Corporate Combinations Under the New California General Corporation Law, 23 UCLA L. REV. 1190 (1976).
3 NEW CODE § 1307; CAL. CORP. CODE § 4314 (West 1955).
4 For a recent analysis of the manner in which post-merger events inadequately feed into the appraisal process—the most significant defect, especially in “freeze-out” cases in which the pre-merger value of minority shares is depressed by the dominating enterprise structure—see Brudney, A Note on “Going Private,” 61 VA. L. REV. 1019, 1023 (1975).
I also do not discuss the valuation question, though attention should be called to the new distinction between the (undefined) “fair market value” measure of section 1300 and the (partially defined) “fair value” measure of section 2000. Compare the old distinction between the undefined terms contained in CAL. CORP. CODE §§ 4301, 4658 (West 1955).
I. THE ELIGIBLE TRANSACTIONS

Only short-form mergers and certain types of defined reorganizations lead to appraisal rights for dissenters. Short-form mergers involve the merger of a controlled subsidiary into its parent. The overall term "reorganization" includes merger reorganizations, exchange reorganizations, and sale-of-assets reorganizations.

For reorganizations, the right to vote on the specific transaction is a necessary condition of the right to demand appraisal. The first type of reorganization, the merger, is itself left undefined except by reference to chapter 11, which deals with mergers; the shareholders of each participating entity are entitled to a vote on the merger, and therefore to the dissenters' appraisal remedy.

The second type, the exchange reorganization, is defined so as to suggest that only voluntary exchanges are intended; consonant with that suggestion is the limitation of the appraisal remedy to dissenting shareholders of the acquiring corporation. The sale-of-assets reorganization, the third type, is defined as a reorganization in which the consideration tendered for assets by the purchaser is stock of itself or its parent, or inadequately secured or long-term debt securities. Shareholders of the purchasing as well as of the selling corporation are entitled to the appraisal. Sale-of-assets transactions for cash (defined to include adequately secured short-term debt) are treated less rigorously for voting purposes and do not generate the appraisal option.

The described shareholders do not always have a right to vote on these three types of reorganization transactions, and therefore are not always entitled to the appraisal remedy. Section 1201(a) of the new law cuts back the voting right of preferred shareholders

Concerning the change of the date as of which value is to be determined, see Report of the Assembly Select Committee on the Revision of the Corporations Code 96 (1975) [hereinafter cited as Select Committee Report].

§ 1201(a).
of the surviving, acquiring, or parent corporation if the rights, preferences and privileges of such shares remain unchanged.\(^1\) A more important removal of voting rights results from section 1201(b) of the new law. It realigns form and fact to eliminate the need for approval by shareholders of a constituent corporation in a merger, or of shareholders in either corporation in a purchase-of-assets transaction, who, alone or with their corporation, thereafter own more than five-sixths of the voting power of the surviving or acquiring entity or its parent.\(^1\) The upshot of this march up and down the hill is to catch de facto and upside-down mergers in the vote and appraisal net, there to join reorganizations that were not so tortuously structured.\(^1\)

Though the transaction is an included transaction and the shareholders have the necessary voting rights, these may not be sufficient conditions of the right to appraisal, even at this preliminary level of transaction definitions. Only if the voting right generated by the reorganization transaction is derived from section 1201(a), (b) or (e) does it also generate the dissenters' appraisal remedy.\(^1\) Shareholders of a dominant merger party (the "five-sixths" type), who vote under section 1201(c) only because an amendment to their corporation's articles of incorporation itself requiring their vote is incident to the transaction, do not enjoy the appraisal remedy. Similarly, shareholders of a dominant but disappearing corporation in an upside-down merger, who receive new shares with different rights, preferences or privileges, or shares of a foreign issuer, and who for that reason only may vote on the transaction under section 1201(d), do not obtain the remedy.\(^1\)

Finally, three-party transactions create complications for the application of the appraisal remedy which are a function of the definitional convolutions they create within the reorganization chapters.\(^1\) The shareholders of a corporation in control of the

\(^{1}\) Id. §§ 1201(a), 1300.

\(^{13}\) Amendment of the articles of the surviving corporation would trigger preferred voting rights under section 1201(c), and therefore under section 1201(a), only if amended as to a matter that in its own right would trigger such a voting right.

\(^{14}\) See Small, note 1 supra. Any value judgment of such structures of course depends on the motive for choosing this circuitous form. I have ignored here the statutory regime applied to close corporations. For consideration of close corporations, see Jordan, The Close Corporation Provisions of the New California General Corporation Law, 23 UCLA L. REV. 1094 (1976); O'Neal & Magill, California's New Close Corporation Legislation, 23 UCLA L. REV. 1155 (1976); Wang, Pooling Agreements Under the New California General Corporation Law, 23 UCLA L. REV. 1171 (1976).

\(^{15}\) TECHNICAL AMENDMENTS BILL § 1300(a).

\(^{16}\) On the reorganization aspects of these transactions, see Small, note 1 supra.

\(^{17}\) See Small, supra note 1, at 1192.
following entities may vote on the reorganization transactions if the parent’s equity securities are involved in the attendant exchange: (1) a constituent party of a merger, (2) an acquiring party in an exchange, and (3) an acquiring party in a sale-of-assets reorganization. The paradigm case which this provision is intended to reach is the reverse triangular merger: The “acquiring” company bootstraps itself into the position of a parent by forming a paper subsidiary. The paper subsidiary is merged into the company to be “acquired”, through a statutory merger procedure which brings with it, however, the conversion of the shares of the temporarily surviving company into shares of the parent company (a conversion effected by a separate agreement between the three parties).

The purpose of this roundabout maneuver, and of the more direct forward triangular merger, is to combine tax advantages, creditor insulation, and protection against loss of regulatory entitlements with majoritarian decision-making advantages. By tying the parent company shareholders’ voting rights and thus the dissenters’ appraisal remedy into these three-party procedures, the new statute properly makes these rights available to the real shareholders of the acquiring or affected company, in a sense piercing the corporate veil of the ephemeral paper subsidiary.

In addition, however, this reorganization procedure is available to corporate structures that antedate the transaction and reflect real hierarchies. So long as the parent company owns 50 percent or more of the participating subsidiary, and so long, of course, as its shares are being used in the “acquiring” transaction, its shareholders enjoy the voting and thus the appraisal rights just outlined. Why this 50 percent test was specially chosen, instead of the general and factual test of control applicable elsewhere, is a mystery. Questioning of the drafting committee has elicited no

18 For detailed and clear but not totally consonant descriptions of this sophistry, whose alleged statutory basis in California, CAL. CORP. CODE § 4103 (West Supp. 1976), is rather shaky, see Zeiter, A Comparison of the Pennsylvania Business Corporation Law and the New Delaware Corporation Law in Light of the 1968 Revision of the Pennsylvania Law, 74 DICK. L. REV. 1, 29-35 (1969) and Note, Three-Party Mergers: The Fourth Form of Corporate Acquisition, 57 VA. L. REV. 1242 (1971).

19 The essential point is to preserve the target entity once it is wholly owned by the acquiring entity. Absent these triangular transactions, that could only be accomplished by a totally successful voluntary exchange offer and each shareholder of the target company would have a veto power. Recognizing and sanctifying these roundabout procedures, the Model Business Corporation Act has just been amended to provide for a direct share exchange that can be effected by majority vote. Model Bus. Corp. Act §§ 72 et seq., in ABA, Report of Committee on Corporate Laws: Changes in the Model Business Corporation Act, 31 BUS. LAW. 1747 (1976).

20 For the purposes of all sections other than 181 and 1200, “control” means possession of the power to direct the corporation. TECHNICAL AMENDMENTS BILL § 160(a).
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explanation whatsoever. The fear of factual gray areas by counsel rendering formal opinions cannot be the answer, since the parent voluntarily enters these transactions by making its stock available. The transaction protected by this general provision cannot be a common one since the tax advantages usually needed to justify such a reorganization are not available unless the parent company ends up owning 80 percent of the acquired company. Perhaps the selection of the 50 percent test was intended to insulate the "autonomously" acting partial subsidiary, which already owns an appropriately usable block of the parent's shares, from the requirement of approval by a less dominant parent company's board and shareholders. This would be based on the analogy to the 50 percent test for defining a partly owned subsidiary that is allowed to vote shares of a parent held by it, originally contained in section 703(b) of the new law.21 Since that test, however, has now been reduced to the more realistic 25 percent level,22 this special "parent-control" test should also be reduced.23 To shortcut this wearisome minor digression, it may be appropriate to suggest that the drafting committee should have either identified the transactions which are protected from shareholders' voting and appraisal rights by this 50 percent test, or eliminated the special arrangement.

II. THE ELIGIBLE SHARES

A complicated formula for defining the classes of stock which are eligible for appraisal is contained in section 1300(b)(1) of the new law.24 "Unlisted" shares are eligible. Shares listed on a national exchange certified by the Commissioner of Corporations25 or on the list of over-the-counter margin stocks issued by the Board of Governors of the Federal Reserve System are not eligible.26 Even such shares, however, revert to being eligible for appraisal if they are subject to certain transfer restrictions (imposed by the corporation or by law) or if demands for payment (the preliminary step to appraisal) are filed with respect to five percent or more of

21 The argument of certainty was used to avoid subjecting section 703(b) (the cross-voting prohibition) to the functional definition of control in section 160(a) and led to the special percentage-of-ownership definition in section 189. See note 22 & accompanying text infra.
22 TECHNICAL AMENDMENTS BILL § 189(b).
23 Small, supra note 1, at 1222 refers to this variant control situation but without reviewing its purpose.
24 TECHNICAL AMENDMENTS BILL § 1300(b)(1).
25 Certification is pursuant to CAL. CORP. CODE § 25100(o) (West Supp. 1976). See TECHNICAL AMENDMENTS BILL § 1300(b)(1).
26 TECHNICAL AMENDMENTS BILL § 1300(b)(1). I use "unlisted" and "listed" hereafter as terms of art defined by this subsection. For the newly revised and newly relaxed OTC margin-stock eligibility regulations, see FRB Release, July 1, 1976, 6 CCH FED. SEC. L. REP. ¶ 80,616 (1976).
that class of shares. Finally, even unqualified listed shares may be eligible, apart from the mentioned cases, in one unusual situation. The subsection qualifies the stock exchange and margin list exception by adding a requirement that the notice of meeting of shareholders to vote on the transaction summarize the shareholders' chapter 13 rights and obligations. It seems, therefore, that a failure to do this, whether inadvertently or because of the use of the section 603 procedure, lifts those shares into eligible status.

The original draft contemplated a total "listed stock" exemption, in a complete turnabout from the old law which contained no limitation on eligible shares in this context. After some discussion the present compromise was adopted. The new approach comes at a time, after the stock market debacle of recent years, when California's old statute looks more and more sensible to law revision groups. Even the ABA Committee on Corporate Laws, the parent of the Model Business Corporation Act, has decided to reconsider the merits of its listed stock exemption from appraisal. It is ironic indeed that California, long in the vanguard in this regard, now leaps backward to join the stragglers.

III. PRELIMINARY OBLIGATIONS OF THE DISSENTING SHAREHOLDER

Exquisite and basically unnecessary problems, particularly of timing, are created because the already complex structure of eligible shares is subjected to a series of requirements that differ

27 Id.

28 At first glance this construction may sound too literal: Can the drafters really intend that holders of listed shares be instructed in the details of provisions not applicable to them? The answer is yes. All shares, listed or not, are potentially the subject of appraisal, if the holders of five percent thereof dissent and seek appraisal. Therefore the instruction is relevant, and the section appropriate. The only alternative construction leads to the absurd result that management may eliminate the appraisal even in the case of unlisted shares by the simple expedient of failing to instruct holders about the remedy. On the significance of instruction, compare Gruss v. Curtis Pub. Co., 534 F.2d 1396 (2d Cir. 1976).

29 This requires some elaboration. The requirement precludes recourse to the section 603(a) procedure of procuring written consent of the requisite majority in lieu of a meeting, under pain of making even the listed stock of such a company eligible for appraisal; after all, in that case there exists no notice of a meeting in which that description of dissenters' appraisal rights can be summarized. That these holders may be sent, gratuitously and before the event, a notice of the company's intention to procure the needed written consent from a control group, and that this may contain the summary, is irrelevant. Section 1300(b)(1) refers to a meeting of shareholders, and the section 603(a) procedure is the opposite of that.

30 More exactly, it contemplated a certified exchange or a National Daily List exemption (with no exception for restricted or bloc shares). First Exposure Draft § 1300(a).

depending on the nature of these shares. These are the obligations to dissent, to demand payment, to propose a purchase price, and to submit the shares for preliminary cancellation.

A. Disapproval of the Transaction

The shareholders' obligation to dissent in order to be eligible to demand appraisal is a composite of specific modes of dissent, which in turn depend upon the structure of the shareholders' approval transaction and on the nature of the shares involved. Current law is satisfied with the simple condition that the holder of the shares not have taken the inconsistent step of voting in favor of the now challenged transaction.\(^{32}\) In contrast, the new law imposes a positive, prior condition of dissent, but only on certain shares. Unlisted shares are still subject only to the less rigorous condition of abstention. Listed shares—and that only refers to such as are transfer-restricted or five percent of whose class will turn out to have been the subject of a demand for payment—must be voted against the reorganization.\(^{33}\) Only if the section 603(a) procedure of obtaining the written consent of the requisite majority was used are listed shares excused from the active dissent requirement.\(^{34}\) This is understandable, since they will not have been invited to vote. The same applies, of course, to the minority shareholder who disagrees with the terms of a short form merger.\(^{35}\)

This may have been the drafters' intention.\(^{36}\) Read literally, however, subsection 1300(b)(2)(ii) does not accomplish this at all. By referring to what is "described" in section 1300(b)(i) in disregard of the provisos there, it cross-references its "active dissent" requirement to what remains in that description—unlisted stock, and ordinarily ineligible listed stock now eligible only because the corporation failed to send out a notice of meeting not summarizing the chapter 13 consequences properly. That in turn would mean that it is the holders of this unlisted stock and of this rare set of listed stock who would have to dissent to be eligible for appraisal; transfer-restricted and "five percent" blocs of listed stock would only have to abstain.

Thus the reader of the statute is left to guess at its intention on a significant point. The first approach may seem clearly preferable, yet it, equally with the second, leads to unacceptably absurd results. Consider the five percent bloc situation under the first-described approach. The eligibility of holders of that class for

\(^{32}\) CAL. CORP. CODE § 4303(a)(1) (West 1955).
\(^{33}\) TECHNICAL AMENDMENTS BILL § 1300(b)(2).
\(^{34}\) Id.
\(^{35}\) Id.
\(^{36}\) This assumption is stated, in conclusory fashion, in the Select Committee Report, supra note 4, at 97.
appraisal depends upon the receipt of demands for payment in that height. As described in more detail below, these demands must be received by the time of the shareholders' meeting. This is hard to envisage if receipt of the five percent demands is a necessary condition to eligibility for appraisal in the first place. In theory it creates the anomaly of contingent demands; in practice it makes the provision useful only to single or affiliated shareholders who know that their position suffices to trigger appraisal. This practical limitation is compounded by the obligation to propose a buy-out price, discussed below, which generates its own uncertainties for the potential dissenter.

The alternative reading, however, leads to a totally absurd result. Read as described, abstention and delay in demanding payment would be available to the transfer-restricted and five percent blocs of listed stocks; but immediate dissent and worse, immediate demand for payment, would be required not only of holders of unlisted shares but, more poignantly, of listed-stock shareholders who, unadvised as to their lack of dissenters' rights under chapter 13, are therefore granted them. Since the first reading correlates with the basic listed-unlisted distinction in granting more generous treatment to the latter, it seems on balance to be the preferred approach.

The whole structure supports a policy of staggering insignificance. The purpose of putting the shareholder to the more stringent obligations of early dissent and early demand for payment (and at a named price) is to give management early warning of the size and cost of impending dissension. It is achieved at substantial procedural (and tactical) cost to the shareholder. The old law made do with the more generous approach in all cases, and without complaint; as explained below, proponents of the transaction do not need this early warning system. The new approach, under whichever interpretation, can be understood only as symptomatic of a general effort to lessen the attractiveness of the appraisal procedure.

Though it goes without saying, it is specified that disfranchised owners of shares in the disappearing corporation in a short-form merger are subject to no condition of either sort and, as already pointed out, where shareholders' approval is sought not at a meeting but by written consent under section 603, it is sufficient for

37 See text accompanying note 45 infra.
38 See text accompanying note 50 infra.
40 See text accompanying note 104 infra.
41 TECHNICAL AMENDMENTS BILL § 1300(b)(2).
42 It is an interesting but separate question whether the conditions under
eligibility that the shareholders did not consent.

**B. Demand for Payment**

In addition to these strictures on the voting process, a demand for payment is required of a shareholder as a condition of eligibility to use the appraisal mechanism. In a major deviation from current law, this demand for payment in cash now is to be made (presumably in writing) not later than the date of the meeting, again provided that proper notice and legal warning were had and that shares involved are listed but transfer-restricted or are part of a class for which five percent of the shares have sought payment. As to unlisted (and uninstructed listed) shares, and as to short-form and written-consent cases, a demand filed within 30 days of the mailing by the corporation of the required notice of approval of the reorganization transaction suffices to preserve this eligibility. The old law, again, makes do with the second, less onerous requirement; what perceived shortcoming in the current situation dictated this change is, again, unknown.

which the Federal Reserve System OTC margin stock lists are compiled permit a corporation issuing an eligible stock to utilize section 603(a).

43 *Id.* It seems that section 603(a) only requires that owners of the number of shares sufficient to effect the transaction be contacted. This at least is one negative inference of section 603(b), which specifies a prior notice requirement in certain cases when the prior consent of all shareholders has not been solicited.

44 Section 4301 of the old law only required the demand to be made within 30 days after mailing of the notice of approval. **CAL. CORP. CODE** § 4301 (West 1955).

45 **TECHNICAL AMENDMENTS BILL** § 1301(b). Actually, the same drafting ambiguity discussed in the text plagues this provision, since the same ambiguous cross-reference is used. It is, however, both appropriate and necessary to assume congruent results in each case in order to analyze the problem in the first place.

46 *Id.* § 1300(b)(1).

47 Those holders, even of listed shares, who were not advised because management chose to act without a meeting pursuant to section 603(a), are granted the more generous option of abstention and delay in having to demand payment because of a specific provision to that effect in section 1301(b)(2).

48 **CAL. CORP. CODE** § 4301 (West 1955).

49 As to both dissent versus abstention and early versus late demand alternatives, the benign version available to five percent blocs in practice, of course, benefits only large owners or owner-affiliates. It is true that section 1300(b)(1) is not phrased in single-owner terms but contemplates aggregate holdings as well. It would be an odd gamble, however, for small shareholders to risk these procedures in the hope that similarly-minded owners will dissent and demand payment in sufficient numbers to aggregate five percent.

From the standpoint of management it may seem anomalous to allow just the one type of shareholder whose disagreement might scotch the transaction (see text accompanying note 104 *infra*)—the large-bloc minority shareholder—to play this waiting game. Viewed transactionally, however, it may make sense to allow for a negotiation period with major outside holders before they are frozen into dissent. Whether such holders can be given sweetened “counteroffers” is another matter. See Hetherington, *The Minority's Duty of Loyalty in Close Corporations*, 1972 Duke L.J. 921, 941 *passim*. Certainly one of the major problems of negotiated appraisal settlements is the variation in prices reached. See Miller v.
The procedure thereafter is as under the old law with one critical exception: The demand for payment shall contain the shareholder's offer of a selling price. This innovation may curtail some unnecessary litigation, but whether it puts the burden of coming forward with a settlement offer on the party most likely to be informed as to the underlying values is doubtful. Recalling the partial listed-stock exemption from appraisal, it is expected that in a majority of cases the dissenting minority—and probably outside—shareholder will not be in a position to take even an educated guess. The corporation may not be obligated to respond with any counter-offer of fair market value, let alone make such an offer known first as under the old law.

On the other hand, the high safe demand tactically dictated in this condition of ignorance is not penalized even if the eventual recovery is much less. Section 1305(e) of the new law permits imposition of attorneys' fees, in the discretion of the court, only upon the corporation, and even then only if the award is more than 125 percent of any offer made by the corporation. Nevertheless,

Steinbach, 268 F. Supp. 255 (S.D.N.Y. 1967), as reviewed in W. Blum & S. Kaplan, Corporate Readjustments and Reorganizations (1976). That, in turn, raises interesting problems of disclosure, at least by management, at a time when the fiduciary relation between management and outside shareholders is in the process of dissolving. See Pierre J. LeLandais & Co., Inc. v. MIDS-Atron, Inc., 387 F. Supp. 1310 (S.D.N.Y. 1974) (analogous "estoppel" argument rejected). The matter will change if and when a most-favored-nations clause is put into the law, giving non-disputing or earlier-settling claimants the benefit of a higher price negotiated by another shareholder with the corporation. This is under consideration by the ABA Committee on Corporate Laws for the Model Act. See note 31 supra.

50 Technical Amendments Bill § 1301(c). Cal. Corp. Code § 4301 (West 1955) only required demand of "a fair market value."

51 I do not say this because the statute is unclear on this point. Section 1301(a) plainly requires the corporation to advise certain shareholders of its offer within 10 days after approval of the reorganization. Rather, the problem is one of confusion of the timing mechanism in the interchange between dissenter and corporation. The message is to be sent only to shareholders having a right to the appraisal remedy, yet that right exists only following the shareholder's dissent (or abstention) and submission for endorsement. Read literally, this is circular. It cannot be meant literally, as section 1302 alone demonstrates: That section requires submission for endorsement within 30 days after receipt of the corporation's section 1301(a) notice of approval.

Therefore, the section 1301(a) reference should be understood to mean "eligible shareholders"; purely and simply, all shareholders having appropriate voting rights and owning the right kind of unlisted or transfer-restricted stock get the notice. If, however, some of these owners had to notify the company of their appraisal demand and their price demand before then—according to section 1301(b), by the date of the meeting—is the corporation's 10-day notice still required? Finally, what of the holders of listed stock who enjoy the appraisal remedy because uninstructed under section 1300(b)(1)?

52 Appraisers' compensation may be assessed against either party as the court deems equitable, if the appraisal does not exceed the corporation's offer. If it does, they shall be assessed against the corporation. Only if it is above
it seems far better, if such a mandatory negotiating gesture is deemed appropriate policy, to make it a clear mutual obligation and to require the corporation, which probably has done some homework if only to permit a board of directors' determination that the reorganization offer is fair, to come forward with the first offer in all instances. The new procedure, mixing corporate tactical advantage with a disingenuous disavowal of fiduciary obligations to these shareholders, is not nice and is not common elsewhere.\textsuperscript{53}

IV. THE DISSENTER'S SUBORDINATED POSITION

The emphasis on creditors' remedies apparent throughout the statute is reflected in the new concept of section 1306.\textsuperscript{64} This section subordinates the ex-shareholder's judgment claim to those of all other creditors in the event the financial strictures of chapter 5, applicable to distributions to shareholders, are effective at the time. The section applies "to the extent" these financial provisions "prevent the payment to any holders of dissenting shares . . . ." Chapter 5 applies its prohibitions to distributions as defined in section 166, and this definition in its relevant part covers "the purchase . . . of its shares for cash."\textsuperscript{55} The subordinated debt status is an anomalous one, for at the same time section 1308 strips the holders of these shares of all the rights and privileges of shareholders once judgment is entered or agreement reached on the fair market value of the shares.\textsuperscript{56}

If the subordination provision were only that, it might be acceptable by analogy to the subordinated position of voluntarily selling shareholders who accept an installment note from the purchasing corporation.\textsuperscript{57} Such creditors are not entitled to payment

\textsuperscript{125} percent of the offer may attorneys' fees, expert witness fees, and judgment-rate interest be assessed against the corporation. \textit{Technical Amendments Bill} § 1305.

\textsuperscript{53} \textit{See} 2 \textit{Model Act}, supra note 31, § 81, at 451; \textit{id.} § 81, at 371 (Supp. 1973).

\textsuperscript{64} \textit{New Code} § 1306.

\textsuperscript{55} The utility of negotiable debt securities in putative payment may be questioned. Under section 166 of the new law, the date of the corporation's acquisition of the shares is the date of distribution for purposes of chapter 5 limits. If the company is shaky, the payment is not feasible on that date, either. I assume, therefore, that a negotiable debt security cannot be issued in these circumstances.

\textsuperscript{56} \textit{New Code} § 1308.

of a given installment if, at that later time, the corporation's surplus position would not authorize current distributions to shareholders, and other creditors would be affected thereby. If, however, no creditor interests were involved, they could pursue the claim at that time, even to the point of forcing liquidation. Section 1306, unfortunately, contains an undebated sleeper in its last clause: "such debt to be payable when permissible under the provisions of chapter 5."58 This clause strongly suggests that dissenters' rights to payment are even more limited than simple subordination would imply.

Chapter 5, concerning dividends and reacquisitions of shares, is reviewed elsewhere in this symposium.59 For present purposes it suffices to note that repurchases are prohibited not only when equitable insolvency threatens,60 but also when neither historical earned surplus nor minimum asset-liability ratio tests can be met.61 While the latter two criteria are creditor-oriented, that is so only in the indirect sense of being geared to the general preservation of a cushion for creditors. That a corporation might be precluded from making distributions though having no currently maturing debt is uninteresting because unrealistic. That the dissenting ex-shareholder now may be unable to force liquidation, and thus payment, even though creditors could be paid off fully at the same time, unless the financial ratios are above the level necessary for distributions to shareholders, is more disturbing.62 In short, the ex-corporation initially is below the line but improves by the time payment is due—essentially our case—there should of course be no doubt about the validity of payment.

58 NEW CODE § 1306.
60 For the equitable insolvency limitation, see NEW CODE § 501 and Ackerman & Sterrett, note 59 supra.
61 See TECHNICAL AMENDMENTS BILL § 500.
62 The authorities cited in note 57 supra, authorizing liquidation of a company to meet an ex-shareholder's payment demands if no creditors are injured, do not distinguish between demands arising from appraisal and claims arising from other reacquisitions. It may well be that under neither the old nor the new law is there any difference in the treatment of repurchases plain or upon appraisal. As an original proposition, a marginal case might be made for placing appraisal claimants on a par with other creditors. Cf. note 70 infra.

There is, however, one critical difference. Under the old law appraisal claimants could be paid even if capital was totally impaired thereby, subject only to equitable insolvency. The additional requirement of healthy asset-liability ratios in the new law, part of the general increase in creditor protection, may so erode the appraisal remedy as to make its usefulness questionable. In other words, it should be asked whether the asset-liability ratio test might be eliminated at least for appraisal. In numerical terms, this means removing the 125 percent current asset-current liability ratio for these events, leaving only the one-to-one asset-liability requirement.

As for the difference between an insolvency test and a surplus test, see generally Herwitz, supra note 57, at 314.
shareholder's claim is not only subordinated to creditors, but is also stripped of protection in circumstances in which subordination is not needed.

The practical impact of denying to dissenters the right to force liquidation is, luckily, minimal, in light of the ability and duty of the surviving corporation to provide either the funds for, or a balance sheet structure permitting, appraisal payments. This is best demonstrated by focusing on the consequences of subordination separately for each mode of reorganization. In a voluntary exchange reorganization the issue generally is moot, because the acquiring corporation, whose dissenting shareholders are the beneficiaries of the appraisal remedy, as a rule will not be in these straitened circumstances. Shaky companies will go either the statutory merger or sale-of-assets route, and it is these that require more extended comment.

In the statutory merger, the target company, whose shares are cancelled when its shareholders receive their consideration, disappears and becomes an unincorporated segment of the surviving company, which assumes the former's liabilities, including appraisal claims. It is the surviving company's financial condition that is relevant under section 1306. If the surviving company's condition is not shaky the problem again is moot. If it is shaky, subordination may occur, and may be legitimate.

Triangular mergers create possibilities of abuse on this point, but abuse that can be handled easily under traditional legal principles. In a regular triangular merger the target company disappears into a special shell subsidiary of the acquiring corporation. If the latter is capitalized below the level needed to satisfy the in-

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63 A separate issue is whether the prohibition against distributions to junior shareholders if the senior shareholders' liquidation preference margin is impaired thereby (section 502) also is picked up in the subordination concept of section 1306. The latter section seems, in this case, to distinguish between deferral of payment, which is required, and subordination to preferred shareholders on liquidation, which is not required, as evidenced by the language: "subordinate to all other creditors in any liquidation proceeding."

Not only does this seem to create an anomalous version of the preferred-common relation, but it may even override the more general subordination rules and permit appraisal payments to be made though liquidation preferences thereby are impaired. Whether this result, suggested by the force of the specific negative inference in the quoted phrase, is a happy one is another matter.

64 For a description of the transaction (albeit in a short-form merger context), see United States v. Hilton Hotels Corp., 397 U.S. 580, 584 (1970). The fact that both old and new law—CAL. CORP. CODE § 4300 (West 1955) and TECHNICAL AMENDMENTS BILL § 1300(a)—specify that the duty lies on the old corporation has no bearing here. For the type of transaction to which that specification is relevant, see Gallois v. Stauffer Chemical Co., 221 Cal. App. 2d 328, 34 Cal. Rptr. 411 (1st Dist. 1963).

65 Subordination is legitimate only if the "shakiness" is severe enough to jeopardize even creditors' full recovery. If one assumes, as I do above, the
choate appraisal demands of the target company's former dissenting shareholders, the simplest alter ego concepts will suffice to force appropriate payment out of the parent.\(^{66}\) In a reverse triangular merger, the target company survives after the merger of the acquiring company's ephemeral shell subsidiary into it, but as a wholly-owned subsidiary of the parent, which somehow picked up its shares in the course of the transaction.\(^{67}\) There the problem of inadequate assets for appraisal claims is a touch more tricky, but only a touch. It is not beyond the capacity of the courts to imply a duty to stoke the new subsidiary's capital structure adequately as a condition of their recognition of the target company as a surviving subsidiary, with the commensurate benefits that recognition of this continuing separate entity status provides.\(^{68}\)

The problem is most frequently relevant only in the sale-of-assets reorganization transaction. Here, it seems to me, traditional principles of creditors' remedies in the fraudulent conveyances field will have to—and should—govern: A total transfer of assets, for consideration inadequate to satisfy debts, implies a transfer of satisfaction of these claims, so that only the effect of the 125 percent test of section 500(b)(1) on these appraisal-creditors remains at issue, then the argument for immediate payment of the liability by the surviving entity remains valid.

\(^{66}\) This is confirmed rather than contradicted by a case like In re Beck Industries, Inc., 479 F.2d 410 (2d Cir.), cert. denied, 414 U.S. 858 (1973), in which the trustee of a parent company in a Chapter X reorganization unsuccessfully asserted alter ego arguments in an attempt to prevent former shareholders of a healthy subsidiary (merged into the parent via a regular triangular merger) from asserting rescission and damage claims against the subsidiary based on the latter's breach of certain covenants in the merger agreement. While the separate status of the subsidiary there was honored, the effect thereof was to permit persons in a situation analogous to that of appraisal claimants preference over other claimants of the surviving entity (even debt claimants). This goes beyond the priority proposed in the text. Compare this with the inability of defrauded purchasers of a partnership to prevail against creditors of the partnership. See, e.g., Legate v. Maloney, 334 F.2d 704 (1st Cir. 1964).

\(^{67}\) See the authorities cited in note 18 supra.

\(^{68}\) The appraisal claimant is a creditor, not an owner, under section 1306; therefore, the alter ego claim is available. Cf. Long v. McGlon, 263 F. Supp. 96 (D.S.C. 1967). Though a contract, not tort, claimant, the appraisal claimant should have no difficulties with the equitable grounds, such as lack of reliance, occasionally and desultorily used to bar contract claimants. See generally N. Lattin, R. Jennings & R. Buxbaum, CORPORATIONS—CASES AND MATERIALS 156-57 (4th ed. 1968).

Finally, the threshold requirements of commingling and formal confusion, if needed at all in the fact of specific and knowing undercapitalization—see Minton v. Cavaney, 56 Cal. 2d 576, 364 P.2d 473, 15 Cal. Rptr. 641 (1961)—are not needed here because this is more the classic situation of not allowing separate entity status to evade statutory obligations, justify wrong, and protect fraud, to use the general phrasing of cases like United States v. Milwaukee Refrigerator Transit Co., 142 F. 247, 255 (C.C.E.D. Wis. 1905). See Horowitz, Disregarding the Entity of Private Corporations, 14 Wash. L. Rev. 285 (1939), in which, either under general equitable principles or under notions of statutory interpretation, the formal elements of the disregard doctrine themselves are disregarded. See generally N. Lattin, R. Jennings & R. Buxbaum, supra at 169-70.
liabilities. Accordingly, appraisal claims may have to be satisfied out of the (stock or defined-debt) consideration received by the target company before these are distributed to its assenting shareholders as the liquidating dividend, or out of monies especially held back by the target company or separately later supplied to it by the purchaser. Alternatively, and particularly if liquidation was voted simultaneously and the consideration channeled directly to assenting shareholders as part of the plan, the acquiring company will be deemed to have acquired the liability of paying these remaining appraisal claims. In short, the matter falls comfortably within the traditional fraudulent conveyances doctrine. Only, therefore, in the rare case of substantial but partial sale-of-assets reorganizations may there be significant subordination problems to which the anomalous treatment provided by section 1306 applies.

These two subordination situations—the normal as well as the unnecessary one—now need to be viewed in the procedural setting in which the dissenting shareholders make their basic decisions. As already indicated, the shareholder not only must first dissent or abstain, but also must demand appraisal, in many instances before the results of the shareholders’ vote are known; already at that early stage a selling price must be set. The corporation’s offer of a fair market price, assuming one must be made under section 1301(a), can await the shareholder’s first move, one that may well have to be made before that shareholder has a clear picture of the corporation’s financial position, and thus of the probability that a section 1306 subordination may result. Finally, once having demanded payment, the dissenting shareholder cannot reverse field and join the majority in the exchange offer without the corporation’s consent. Subject only to the bad faith threshold (and sanctions) of section 1305(e), the corporation, depending on the price it picks, can easily steer the dissenting shareholder into an irreversible, high-risk and long-term gamble, and at a time when in fact, if not in law, the fiduciary relation of management towards

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70 This comports with existing doctrine moving appraisal claimants ahead of ex-fellow shareholders upon liquidation. Florsheim v. Twenty Five Thirty Two Broadway Corp., 432 S.W.2d 245 (Mo. 1968); cf. In re Beckman [Mortgage Bldg. & Loan Ass’n Case], 334 Pa. 81, 5 A.2d 342 (1939).

71 See N. LATTIN, R. JENNINGS & R. BUXBAUM, supra note 68, at 1472-73.

72 See Small, supra note 1, at 1213. What are “substantially all” but not “all” assets may well be only an academic problem.

73 NEW CODE §§ 1308, 1309(d).

74 TECHNICAL AMENDMENTS BILL § 1305(e).
the dissenter is strained. In short, the combination of these procedures loads the dice against the dissenter to a degree new to California law and unknown to other leading statutes.

V. THE EXCLUSIVE NATURE OF THE APPRAISAL REMEDY

Section 1312(a) of the new law expresses the general rule that the appraisal remedy is exclusive. While it basically restates old section 4123, the overall impact of the new reorganization law and of other new provisions upon this limitation results in a somewhat different picture than before.

The source of this exclusivity provision lies in the peculiar approach taken in the old law to a false problem—that of strike suits. It would extend this discussion unduly to review the anachronistic assumptions that motivated Professor Ballantine to take what was for him an uncharacteristic position in 1931 and that led to this unique provision; a reference to his and co-commentator Sterling's extended and heated attack on "privateers" and "strikers" should suffice. The arguments for and against making the appraisal remedy, when it is available, the exclusive means of attack upon the validity of an exchange transaction have been discussed adequately elsewhere. So far as the statutory setting goes, the only new element in the debate is the significance to the concept of exclusivity of the increased risk attendant upon the use of the appraisal remedy.

In any event the significance of exclusivity has been diminishing ever since federal private remedies became popular, particularly those relating to proxy violations under section 14(a) of the Securities Exchange Act of 1934. Most of the federal cases, though focusing upon disclosure, occur in the context of a conflict of interests and often involve the setting of exchange terms by the

76 TECHNICAL AMENDMENTS BILL § 1312(a).
77 CAL. CORP. CODE § 4123 (West 1955).
79 He participated in the drafting of this provision. CAL. CORP. CODE § 4123 (West 1955), formerly id. § 369.
80 See especially Ballantine & Sterling, supra note 78, at 648-51.
82 The combination of doubtful availability and inadequacy of the appraisal has implications for the role of rule 10b-5, 17 C.F.R. § 240.10b-5 (1976), in its "beyond disclosure" aspects. See authorities cited in note 96 infra.
dominant corporate owner, in its capacity as the other party to the reorganization or merger.  

It is therefore not surprising that the new law draws at least some consequences from this continuing erosion of the supposedly exclusive appraisal remedy. Section 1312(b) allows dissenting shareholders to attack the validity of such an exchange if the transaction is between a controlling and a controlled party, or to move for rescission, albeit at the cost of abandoning all right to appraisal thereafter. This exceptional remedy is both obscurely drafted and reluctantly granted. The existence of a right to sue for damages attendant upon an unfair exchange is not stated clearly enough. In addition, the corporation is given an unusual amount of time before even a provisional restraint on the consummation of the exchange transaction may be judicially imposed, and then only pursuant to the type of finding ordinarily required of juries in criminal cases. A more extended treatment of this provision is provided elsewhere in the discussion of the reorganization provisions. So far as a cash sale-of-assets transaction is concerned, there is of course no exclusivity problem since the transaction is not a reorganization and the appraisal remedy is (inadvertently?) not granted dissenters to such transactions in the first place.

It is questionable, especially given the dubious basis of exclusivity, whether any public policy is served by preserving it even for those few events that may fall between the federal remedy and the conflict of interests inhering in a parent-subsidiary exchange. Indeed, the full consequences of this problem of remedies in the case of controlled-subsidiary freeze-outs have not yet been drawn. This

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85 TECHNICAL AMENDMENTS BILL § 1312(b). This provision was amended to include short-form mergers in the exception from the appraisal remedy's exclusivity. Both reorganizations and short-form mergers then are subject to the more rigorous burden of proof of fairness by section 1312(c).
So far as the concomitant abandonment of the right to demand cash is concerned, this of course cannot be applied literally to dissenters from short-form mergers, who are entitled only to cash. Rather, it is the right to an appraisal that is abandoned if the transaction itself is attacked. Why that Hobson's choice had to be retained at all is another matter.
86 Because of this, the issue suggested above, note 82 supra, is relevant despite section 1312(b).
87 This lack of clarity seems intentional. Cf. Ballantine & Sterling, supra note 78, at 663-64, on the analogous problem in section 4123 of the old law.
88 The court . . . shall not restrain or enjoin the consummation of the transaction except . . . upon a determination by the court that clearly no other remedy will adequately protect the complaining shareholder or the class . . . .
TECHNICAL AMENDMENTS BILL § 1312(b).
89 Small, supra note 1, at 1217 passim.
90 See the telling criticism in Small, supra note 1, at 1221-22.
is not the place to elaborate on the common law or rule 10b-5 developments of recent vintage based on the traditional role of equity in controlling overriding and manipulative, as well as deceptive, transactions. There are, however, possibilities of expanding the appraisal remedy to satisfy, though indirectly, the demands of those old, here newly applied, norms. Shifts in the burden of proving fairness of price and validity of business purpose aside, it may be appropriate to allow the dissident shareholder to participate in the ongoing combined structure, as the price for allowing management, in these controlled subsidiary cases, to effect a consolidation.

One specific version of this which was proposed and has been accepted by the new law's drafters is in the case of the long-form merger. The new law provides in section 1101 that a long-form merger between affiliated entities can only be achieved if non-redeemable common shares of the surviving party or its parent are the consideration; cash freeze-out mergers, except between independent parties, are thus prohibited.

Section 1101, when coupled with the mentioned requirements of proof of fairness and of legitimacy of purpose, appropriately


92 These were originally partially introduced by section 1201(g), now section 1312(c), of the new law. Professor Jennings had proposed the following, more protective version of this subsection (and included the short-form merger therein):

(g) If one of the parties to a reorganization or short-form merger (Section 1110(b)) is directly or indirectly controlled by, or under common control with, another party to the transaction and the controlling shareholders and the outside shareholders of the acquired corporation are not treated equally with respect to any distribution of cash, property, rights or securities, the outside shareholders shall have the option, in lieu of the rights of appraisal as provided in Section 1300 to receive (1) common shares of the parent or surviving corporation as the case may be having a fair value equal to an aliquot share in the intrinsic value of the net assets of the acquired corporation, including any element of value or gain resulting from the transaction; or (2) cash, or senior securities of the parent or surviving corporation, of equal value. In any action to attack the fairness of the consideration to be received in any such reorganization or short-form merger or to have the transaction set aside or rescinded, the person asserting the validity of the reorganization or short-form merger shall have the burden of proving that the transaction is for a legitimate business purpose, and that such consideration is just and reasonable as to the outside shareholders.


93 Compare the Jennings proposal, note 92 supra.

94 TECHNICAL AMENDMENTS BILL § 1101. Whether cash freeze-out mergers in controlled-subsidiary situations already were prohibited under old law (i.e., under an appropriately restrictive reading of section 4103 of the old law) is a much debated question. Cf. the halfway regulatory approach in 10 Cal. Admin. Code 260.140.61 (1975) (non-freeze-out situations).
harmonizes the new law with basic standards of equity as to the covered, if not all, transactions. At the same time, if applicable to short-form mergers as well, it would reduce the unseemly evasive scramble to pour transactions not intended to benefit therefrom into the narrow mold of section 1110.  

VI. REFORM OPPORTUNITIES MISSED

Some policy questions should have been resolved differently. The “listed-stock” exception, even in its limited form, is a mistake; the category of events subject to the appraisal process is too limited; and the appraisal remedy is too narrowly defined for the short-form merger.

A. The Listed-Stock Exception

It is not necessary within the framework of this symposium to unroll again the basic debate over the appropriateness of an appraisal remedy; for that the Manning-Eisenberg debate still can be read with profit. If the remedy is worth having at all, however, it seems timely to reconsider the validity of any public market exception. One reason for reconsideration, of course, lies in the retreat from the sanctity of a stock exchange mechanism as a reflector of “true” values, whether because of thin volume, institutional actors' distortive effects on all markets, or general market breakdowns. The dogma that money recouped from a “depressed” stock after all can be reinvested in other equally depressed stocks is heard less and less often. Its lack of persuasive force is demon-

95 E.g., when a 90 percent-plus shareholder pours his holdings into a personal holding company which then avails itself of the short-form procedure. While Jones v. H.F. Ahmanson & Co., 1 Cal. 3d 93, 460 P.2d 464, 81 Cal. Rptr. 592 (1969), presumably would block such a misuse of the procedure, straightforward legislative control of the cash-out in all its forms, defended in more detail elsewhere, would be welcome. See text accompanying note 113 infra; Small, supra note 1, at 1217.

96 I do not discuss the basic appraisal process itself, under California's fair market value yardstick, since this has not changed. For a measure of the room for improvement, see Green v. Santa Fe Indus., Inc., 533 F.2d 1283, 1294 (2d Cir. 1976) (Mansfield, J., concurring). See also Gallois v. West End Chem. Co., 185 Cal. App. 2d 765, 8 Cal. Rptr. 596 (1st Dist. 1960).

It is interesting to note that the Delaware legislature, indirectly chided by Green, already has responded with an act meeting several of the deficiencies collected in that footnote. Delaware House, Bill No. 916, effective May 1, 1976, as amended (for typographical errors only) by House Amendment No. 1, effective July 1, 1976. The Delaware judiciary also is responding: Compare Raab v. Villager Indus., Inc., — Del. Ch. —, 355 A.2d 888 (Sup. Ct. 1976) with F.S. Moseley & Co. v. Midland-Ross Corp., 40 Del. Ch. 245, 179 A.2d 295 (Sup. Ct. 1962). See generally Comment, The Second Circuit Adopts a Business Purpose Test for Going Private, 64 CALIF. L. REV. 1184, 1201 (1976).

strated by the frequent public announcements of incumbent man-
gagements urging shareholders to resist takeover bids which, it is
argued, fail to reflect the true value of temporarily depressed
shares. Again, the problem of restricted stock ownership, with
shares that cannot benefit from the market's expression of values,
and the related problem of dissenting owners of blocs large enough
to depress the market price, which for different reasons reduce the
utility of the market price, are both recognized in the new law as
grounds for not permitting such shares to benefit from, or be
subject to, the market price limit.98

Other reasons militate against the public market exception in
a more profound way. Many of these transactions involve self-
interested parties: typically, partly owned subsidiaries being
fused into a dominant parent in exchange for that parent's securi-
ties. This prior part ownership of the parent and inhibiting effects
thereof generally will have distorted the market value of the public
float.99 The most progressive legal rules preventing arrogation of
the values inherent in control cannot prevent manifold and perhaps
nonactionable forms of exploitation of control from inhibiting the
functioning of the market place in this normative sense.100 Here
the appraisal remedy should be available to dissenters. Section
1312(b), allowing direct attacks upon the validity of a fusion in
these cases, is not the whole answer.101 On the contrary, helpful as
such a remedy is for extreme cases of overreaching or faithlessness,
it is absurd to require an all-or-nothing battle in less flagrant
situations. The appraisal remedy, allowing a full inquiry into the
implications of such dominance without requiring rescission of
dominated transactions, offers an attractive middle solution. All
in all, given the shaky legitimacy of the public market mechanism
and the prevalence of situations not fairly measured by the market,
it seems a better policy to scrap the listed stock exception in its
entirety. That the appraisers could rely totally or in large part
upon market prices when appropriate goes without saying;102 that

98 See the excepting proviso of TECHNICAL AMENDMENTS BILL § 1300(b)(1).
99 This was clearly recognized in Tanzer v. Haynie, 405 F. Supp. 650
(S.D.N.Y. 1976); Merrit v. Libby, McNeill & Libby, 533 F.2d 1310 (2d Cir.
1976).
100 The conceptual debate over the sale of control stock at a premium
offers indirect evidence in support of this proposition. See Perlman v. Feldmann,
219 F.2d 173 (2d Cir.), cert. denied, 349 U.S. 952 (1955), and the contradictory
glosses thereon in Essex Universal Corp. v. Yates, 305 F.2d 572, 576 (2d Cir.
1962) and Norte & Co. v. Huffines, 416 F.2d 1189, 1190-91 (2d Cir. 1969),
101 TECHNICAL AMENDMENTS BILL § 1312(b).
102 The excessive deference paid the market value concept in Gallois v.
West End Chem. Co., 185 Cal. App. 2d 765, 8 Cal. Rptr. 596 (1st Dist. 1960),
should be a warning even here.
they should do so even when in their judgment it is not appropriate is wrong.

B. The Range of Eligible Transactions

The second major policy issue concerns the range of transactions fairly subject to the appraisal remedy; it is my opinion that the range is pitched too narrowly in the new statute.

1. Sales of Assets for Cash

In the area of reorganizations itself, the failure to reach sale-of-assets-for-cash transactions stands out. Another problem lies in the definition that permits short-term debt securities of the purchaser to qualify as cash in order to avoid the exchange reorganization regime. Whether proper or not in its basic purpose, which is to avoid class voting and voting of otherwise nonvoting shares in these cases, it is improper to the degree that it results in avoidance of the appraisal remedy, at least for those who may vote and do dissent. That aside, however, the major question is why true cash transactions in sales of assets should escape the appraisal obligation.\footnote{See Small, supra note 1, at 1212-13. The recent compromise requiring 90 percent approval in controlled-subsidiary cases, note 11 supra, removes much of the sting from this problem. The next logical and sound step, however, is to allow the appraisal remedy, and the benefits of sections 1312(b) and 1312(c), to dissenters.}

The basic difference between these cash sales and most reorganization transactions is a formal one: The transacting party is the corporation, not its shareholders in their individual or collective capacities. Thus the consideration received, if subject to potentially higher claims of some shareholders as the result of a successful appraisal procedure, is reduced to the detriment of the other shareholders—perhaps to the point of vitiating their original consent based upon a different expectation as to the proceeds ultimately receivable.

A further distinction lies in the consideration received: Since only cash is offered in the first place, of what use is an alternative remedy also involving only cash? This proves too much, for short-form mergers are subject to the same argument. What the appraisal remedy provides in both cases is another calculation of that cash consideration. If legitimate in the one instance, it is legitimate in the other.

It should be apparent that the first, too, is an unconvincing distinction. First of all, certain events identical in their form—sale-of-assets reorganizations—are subject to the appraisal remedy. Yet there, as here, the consideration flows to the corporation and
successful appraisals equally could diminish the prorata share of
the majority, possibly again to the point of vitiating their under-
lying consent.

In the second place, the basic dilemma is false, or rather, is
resolved by the terms of the typical instruments shaping these
transactions. The board of each transacting party—certainly of
the seller—reserves the right of termination, primarily because it
needs to gauge the significance of the aggregate appraisal de-
mands. In all reorganizations, moreover, the consideration
needed to satisfy appraisal judgments or settlements is supplied by
the purchasing or surviving entity. In sale-of-assets reorganiza-
tions, which leave the selling corporation a hollow shell except for
the received securities, this is done directly: The purchaser sup-
plies the cash, without expectation of set-off, if this has not been
held back from the assets being sold. In merger or consolidation
cases the same result occurs indirectly: The target entity, now
owned by or fused into the acquiring company, uses its cash or is
fueled adequately by its new owner to satisfy the appraisal obliga-
tions. The critical point is that the appraisal process does not
affect the treatment of consenting shareholders, whose bargain
either recognizes and is dependent upon the appraisal process
outflow or is honored, if need be, by such unilateral collateral
transfers. If this be so, any argument against extending the benefit
of this procedure to the cash sale-of-assets transaction fails.

There is no need even to consider the half-way position,
though it may be a tactically expedient one, of extending coverage
to such transactions only when they occur between entities already
affiliated in a controlled-subsidiary context, leaving true third-party
takeovers free of the regime. If the majority shareholders are not
subject to or may not protest reduction in their promised receipts,
whether these be in the form of cash or securities, the need for such
a distinction fails. Similarly, using a listed-stock exception for this
one transaction but not for others lacks a convincing rationale. If
the stock's market does not function properly for the reasons
already described, it functions no better here. True, one indirect
purpose of an appraisal procedure—valuing the offer made—is
important only in transactions involving the exchange of securities:
Cash is cash. Its main purpose, however, is to decide what would
be a fair exchange, and that is as necessary for cash as for security
transactions.

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104 Often, alternatively or cumulatively, the merger agreement provides that
the transaction shall not be consummated if more than a stated number of shares
are submitted for appraisal.
105 See text accompanying notes 63-75 supra for a discussion of pathological
variations of this rule.
2. Changes in Rights

Whether a much wider range of transactions—basically, all shareholder-voted changes in the rights, preferences, and privileges of a stock—should be covered is a closer question. These changes rarely arise in single class situations; they generally occur in the case of preferred or other special stock. To some degree, the level of legitimate expectations for owners of preferred stock is lower than for holders of common stock, even though the right of all stockholders to fair treatment or fiduciary care, as an abstract proposition, remains the same. Further, the variability of possible triggering events is less than in the case of reorganization transactions. Basically, the catalogue of changes contained in section 25103(e) of the current corporate securities law exhausts the possibilities. These events occasion simpler exercises in the measurement of their financial effects; but more to the point here, in their very scope they have become familiar as possible events and might be said no longer to generate legitimate disappointed expectations among dissenting owners. Reorganization transactions are different in that the wide range of factual uncertainty inherent in such restructuring events is an essential component of the expectation concept and precludes any easy effort to depreciate the legitimacy of dissenting shareholders’ disappointment in the given event.

At the same time, however, the appraisal remedy—if simply structured—is a far easier remedy for dissenting preferred shareholders than the heroic one of challenging the basic fairness of the transaction. The latter remedy exists but, as the sorry history of the Delaware cases demonstrates, is almost impossible to attain. The continued viability of this fairness challenge seems desirable, and the appraisal remedy, again, may be the simple answer to assure its continued use as a check on overreaching.

106 See generally the favoring argument of H. Ballantine, Corporations 701 (rev. ed. 1946); Eisenberg, supra note 97, at 75.
109 See, e.g., Barret v. Denver Tramway Corp., 53 F. Supp. 198 (D. Del.), aff’d, 146 F.2d 701 (3d Cir. 1944). This is another reason to complain of the failure to allow the appraisal remedy for dissenting shareholders in cash sale of assets transactions.
proposed appraisal procedure, unfortunately, hardly qualifies as the ideal structure for this extended purpose, but if its awkward and aleatory aspects soon are removed in favor of a simpler structure, its use in these recapitalization situations may well be appropriate.

C. Appraisals in Short-Form Mergers

The appraisal remedy is insufficient in one other situation. As the price for preventing cash freeze-outs in California, short-form mergers now are to be permitted.\textsuperscript{111} That policy might be debated, but I accept it here as a legitimate corporate policy for purposes of argument. It does not follow, however, that limiting the objecting minority shareholder to a cash-out appraisal procedure is proper. The legitimate management motives in effecting a short-form merger are exhausted once the subsidiary entity is merged into the parent company. What consideration the minority interest should receive is another matter, and I would argue that the right not merely to payment for the shares but to participate in share ownership of the parent corporation should be honored in these cases.\textsuperscript{112} Short-form mergers are on tenuous ground at best as examples of private eminent domain.\textsuperscript{118} Managerial exigencies may dictate reluctant acquiescence in this radical solution. They cannot, however, legitimate any other than the least onerous version of that solution.

The size or closely-held nature of the parent corporation again is irrelevant. It is not the presence of an unwanted minority ownership of certain corporate affiliates as such, but its impact on the integration of those affiliates in effective, centrally managed enterprises, that underlies and justifies the short-form merger.\textsuperscript{114} Except for close corporations whose formative shareholders' agreements may and probably will include the waiver of any minority owner's right to participate in such a restructuring, all corporations

\textsuperscript{111} Technical Amendments Bill § 1110. See Small, \textit{supra} note 1, at 1208-09.


\textsuperscript{113} Such mergers have been upheld against state constitutional attack in Beloff v. Consolidated Edison Co., 300 N.Y. 11, 87 N.E.2d 561 (1949), but compare Beloff with the qualifications as to motive and necessity expressed in Teschner v. Chicago Title Trust Co., 59 Ill. 2d 452, 322 N.E.2d 54 (1974), \textit{appeal dismissed}, 422 U.S. 1022 (1975), and, more recently, in Tanzer Econ. Associates, Inc. Profit Sharing Plan v. Universal Food Specialties, Inc., N.Y.L.J. 7, Mar. 15, 1976 (N.Y. Sup. Ct.).

\textsuperscript{114} See Berle, \textit{The Theory of Enterprise Entity}, 47 \textit{Colum. L. Rev.} 343 (1947), and, specifically to these integrated-operations questions, Landers, \textit{A Unified Approach to Parent, Subsidiary and Affiliate Questions in Bankruptcy}, 42 U. Chi. L. Rev. 589 (1975).
should be obligated to offer stock in the parent as an option available in the appraisal procedure itself.\footnote{115}

Companies whose stock is publicly traded, on the other hand, need not make this option explicit, since by definition they offer it through the market. Here, and only here, does a listed-stock exception make sense. It is then not an exception from the right to an appraisal as an alternative to the corporation's offer, but from the dissenter's right to seek the appraised value directly in terms of the parent's stock rather than in cash.

The securities regulation aspects of this approach deserve a word, for though they cause no problems, they appear on the horizon as an inhibiting factor. The right to parent company stock does not imply a duty to issue registered securities to the subsidiary's minority shareholders. If only restricted stock can be made available, no more is required. When the objecting shareholders are few enough in number and appropriately sophisticated, a rule 146 issuance may be available.\footnote{116} More significantly, however, the judicial supervision of the appraisal procedure implies the availability of a section 3(a)(10) exemption from registration requirements in all cases.\footnote{117} Even if the shareholder accepts a share offer in lieu of cash without dispute as to the valuation (of both companies' stock), the judicial approval required for that transaction will ensure the exemption.\footnote{118} In fact, if the parent corporation were to make that voluntary exchange offer immediately as the alternative to a proposed cash-out offer, section 3(a)(9)\footnote{119} as well as rule 145 procedures\footnote{120} for a share issuance attendant upon a statutory merger might be used.

\textbf{CONCLUSION}

The appraisal process has been cut back, not fostered, by the new statute. Even where available, it is exceedingly technical and

\begin{footnotesize}
\footnote{115} The Drafting Committee of the State Bar Committee on Corporations, currently preparing the Technical Amendments Bill, is considering a submission that I made during the original drafting procedure and withdrew pending this technical round, proposing this change and suggesting an appropriate draft. [As of July 15, 1976, however, the submission had not been accepted.]
\footnote{116} SEC rule 146, 17 C.F.R. § 230.146 (1976). This is a safe harbor way of obtaining the section 4(2) private offering exemption under the Securities Act of 1933, 15 U.S.C. § 77d(2) (1970). This comment in the text would have continued relevance directly under section 4(2), whatever the specific fate of rule 146.
\footnote{118} Cf. Mann, The Section 3(a)(10) Exemption: Recent Interpretations, 22 UCLA L. REV. 1247 (1975). While his assertion that totally voluntary submission to such procedures achieves the exemption may go too far, the proposal in the text should fit even within a more conservative reading of the exemption. See R. Jennings & H. Marsh, Securities Regulation—Cases and Materials 539 n.14 (3d ed. 1972).
\footnote{120} SEC rule 145, 17 C.F.R. § 230.145 (1976).}
\end{footnotesize}
difficult to use. Above all, however, this and other chapters demonstrate how important it is that California courts continue their traditional role of supervising all enabling powers for possible abuse. The enormous exfoliation of the enabling structures for all possible transactions, with all their variations, has done more than produce a technically unwieldy and opaque statute. It has, almost as a law of nature, multiplied the opportunities for dubious combinations and permutations of shaping transactions while suggesting, in the very prolixity of the enabling detail, that abuses of fiduciary relations are now blocked and that the courts can relax. That is not the case. If the terms of the statute do not overrule Jones v. H. F. Ahmanson & Company, \textsuperscript{121} neither does its form.

\textsuperscript{121} 1 Cal. 3d 93, 460 P.2d 464, 81 Cal. Rptr. 592 (1969). See note 95 & accompanying text \textit{supra}.