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ALTERNATIVE RELIEF AVAILABLE TO DISSENTING SHAREHOLDERS OF A CASH-OUT MERGER

by

EDWIN DAVILA*

This article relates to the standing and right of a minority shareholder, who has dissented from a cash-out merger and commenced an appraisal proceeding, to pursue a separate individual claim of fraud in the merger through an action for rescissory damages against the participants for breaches of fiduciary duties to the shareholder. This issue arises from a cash-out merger of the minority shareholder. The situation encompasses two suits: a first filed statutory appraisal proceeding (the "Appraisal Action"); and a later filed shareholder's individual suit for damages for alleged fraud, conspiracy, self-dealing and waste of corporate assets (the "Fraud Action").

The Appraisal Action arises under the authority of Ohio Revised Code Section 1701.85. The requirements of that statute are: (1) the shareholder is one of record; (2) the shares were not voted in favor of the merger at a meeting held concerning the merger; (3) a written demand be served by the shareholder on the company within a specified period of time; and (4) the shareholder deliver to the company his certificates for the endorsement of a legend thereon within fifteen (15) days from the request. After complying with these requirements, the shareholder then has a right to obtain a judicial determination of the fair cash value of his shares. In the Appraisal Action, the sole defendant is the surviving corporation of the merger.

For some period of time, it was thought that the Appraisal Action was the sole and exclusive remedy of a dissenting shareholder. However, both the Ohio Supreme Court and the Supreme Court of Delaware now agree that fiduciary duty claims can be brought in a separate action. *Armstrong v. Marathon Oil Co.*, 32 Ohio St. 3d 397 (1987), and *Cede & Co v. Technicolor, Inc.*, 542 A.2d 1182 (Del. Supr., 1988).

In *Armstrong*, the plaintiffs were minority shareholders of Marathon Oil Co. ("Marathon"), who challenged the fairness of the merger price. The case arose out of the cash-out merger between Marathon and U.S. Steel. The Ohio Supreme Court dealt with a number of issues regarding

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the appraisal remedy, including a challenge to the unfairness of the merger.

The Ohio Supreme Court dealt with the issue of whether the appraisal remedy was the exclusive remedy available in the final portion of the opinion. Specifically, one plaintiff sought to join her appraisal claim with other claims for breach of fiduciary duty. The Court held that the fiduciary duty claims could not be brought in the appraisal proceeding. However, the Court held that a shareholder could seek to recover "provable injury" for such claims in a separate proceeding. *Id.* at 422. The Ohio Supreme Court clearly recognized that separate actions for breaches of fiduciary duties may exist, but these may be limited to challenges of the procedural fairness of the transaction or to recovery of the fair cash value in accordance with the standard enunciated in *Armstrong*.

In arriving at its holding, that the fiduciary duty claims could be brought in separate proceedings, the Ohio Supreme Court analyzed the decisions of the Supreme Court of Delaware. Specifically, the Ohio Supreme Court reasoned:

[the fiduciary duty claims] arise out of the actions of the Marathon board of directors in structuring and consummating the tender offer-merger transaction before us. *The essence of these claims, primarily equitable in nature, is that the board of directors and controlling shareholders of their company breached their fiduciary duties in connection with the initiation, timing, negotiation, structure, approval, etc., of that merger. Consequently, plaintiffs and amici would require an inquiry into the entire fairness of the transaction and, presumably, allow whatever inquiry is necessary on the issue of the value of the corporation in light of the price offered to the dissenting shareholders for their stock, citing Weinberger v. UOP, Inc. (Del. 1983), 457 A. 2d 701, and Rabkin v. Philip A. Hunt Chemical Corp. (Del. 1985), 498 A. 2d 1099. See also, Singer v. Maganwox Ca (Del. 1985), 380 A. 2d 969; Tanzer v. International General Industries, Inc. (Del. 1977), 379 A. 2d 1121. [Emphasis supplied.]*

Id. at 421.

To support its conclusion that the appraisal proceedings are not the exclusive remedy available to dissenting shareholders, the Ohio Supreme Court also stated:

Although not dwelt upon in the briefs, *Rabkin, supra*, and *Singer, supra*, allow the maintenance of an alternative cause of action in addition to the Delaware statutory proceeding for the

appraisal of dissenting shareholders' stock. Del. Code. Ann. Title 8, Section 262 (1975). The Delaware statute, of course, relied specifically upon the stock market price as representing the value of the stock. *Id.* at Section 262(k), deleted by amendment (1983). By allowing the additional cause of action outside the statutory guidelines, the courts of Delaware permitted analysis of the amount offered to minority shareholders under theories of breach of fiduciary duties, lack of proper business purpose in cashing out the minority shareholder, gross inadequacy of price, misrepresentations in the proxy statement, failure to consider the "full value" of the shares, and that by breach of these fiduciary duties, the corporation failed to pay the full, fair value of the shares held. Obviously, *such causes of action, centering as they do around the issue of whether the transactions provided "entire fairness" to the dissenters, permit a full inquiry into the intrinsic value of the dissenters' stock utilizing any techniques or methods which are generally considered acceptable in the financial community and otherwise admissible in court.* [Emphasis supplied.]

Armstrong supra at 421.

Similarly in *Cede & Co.*, the Supreme Court of the State of Delaware held that a dissenting shareholder may pursue under Delaware law *both* an appraisal remedy and a separate individual action for rescissory damages.

In *Cede & Co.*, Cinerama instituted an appraisal proceeding pursuant to 8 Del. C. § 262 after voting against the proposed merger. Two years later, Cinerama discovered wrongdoing by Technicolor management associated with the merger. Cinerama then filed a separate fraud action, charging Technicolor and others with conspiracy, fraud, breach of fiduciary duty and other wrongdoing in the merger.

Technicolor and the others moved to dismiss the fraud action, asserting that Cinerama lacked standing to institute a fraud action after electing appraisal relief under Section 262. The Delaware trial court held that Cinerama was required to elect whether to pursue the appraisal proceeding or the proceeding in which it asserted claims for breaches of fiduciary duty. For the first time, the Supreme Court of the State of Delaware addressed the standing and right of a shareholder dissenting from a cash out merger to pursue both an appraisal remedy and a separate individual action for rescissory damages based on a claim of fraud in the merger.

Citing the identical cases that were cited by the Ohio Supreme Court, i.e. *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. Supr. 1983), and *Rabkin v. Philip A. Hunt Chemical Corp.*, 498 A.2d 1099 (Del. Supr. 1985), the Delaware Supreme Court distinguished the remedies of appraisal and rescissory suit. The Delaware Supreme Court stated that an appraisal proceeding is a determination of the value of the appraisal-petitioners' shares on the date of the merger; however, in contrast, a fraud action asserting unfair dealing and unfair price claims affords an expansive remedy and is brought against the alleged wrongdoers to provide whatever relief the facts of a particular case may require.

In holding that a separate cause of action could be brought based upon claims of breaches of fiduciary duties, the Delaware Court specifically stated:

based upon the appraisal/fraud distinctions found in *Weinberger* and *Rabkin*, policy concerns, and considerations of equity, as a matter of law we affirm the Court of Chancery's ruling denying defendant's motion to dismiss Cinerama's fraud action. Under the record before us, the Chancery properly allowed Cinerama to pursue both a statutory appraisal remedy and its fraud action; therefore, the defendant's cross-appeal, asserting that Cinerama lacks standing to pursue its fraud action, fails. *Cede & Co.*, *supra* at 19-20

CONCLUSION

Courts are beginning to recognize that statutory appraisal proceedings cannot be the sole and exclusive means for determining the loss incurred by a dissenting shareholder of a cash-out merger. Both Ohio and Delaware recognize that causes of action, which seek compensation other than the value of a dissenter's shares of stock, can be maintained. However, such separate and distinct theories for recovery of losses occasioned by unfair circumstances of the merger have to be maintained in separate proceedings, subject to separate applicable statutes of limitations, and the doctrines of *res judicata* and collateral estoppel.