Recent Development

Security Regulation—SEC RULE 10B-5—Where allegations are made that the majority shareholders of a corporation have breached their fiduciary duty to deal fairly with the minority, through use of a Delaware short-form merger without any justifiable corporate purpose, a claim under rule 10b-5[1] exists. *Green v. Santa Fe Industries, Inc.*, 533 F.2d 1283 (2d Cir. 1976).

Even the most liberal commentators would not have guessed in 1934 that the Securities Exchange Act of that year[2] would evolve into an almost all-pervasive part of securities law. The scope of the 1934 Act was further broadened by the promulgation of rule 10b-5 by the Securities and Exchange Commission (SEC). Rule 10b-5 has created a duty upon corporate directors and majority shareholders to act fairly in matters concerning the sale or exchange of securities.[3] The recent case of *Green v. Santa Fe Industries, Inc.*[4] is yet another example of the rule being given an expansive reading in order to protect the interests of minority shareholders.

In *Green,* Santa Fe Industries, Inc. (Santa Fe) wholly owned Santa Fe Natural Resources (Resources), which in turn owned 95 percent of the capital stock of Kirby Lumber Co., a Delaware corporation.[5] During July of 1974, Resources considered a plan to effectuate a "short-form merger" pursuant to Delaware corporation law.[6] After deciding to proceed with the plan, Forest Products,

[1]15 U.S.C. § 78j (1970); 17 C.F.R. 240.10b-5 (1972) [hereinafter cited as rule 10b-5].

[2]The Securities Exchange Act of 1934, 15 U.S.C. § 78 (1970).

[3]*See, e.g.,* Affiliated Ute Citizens v. United States, 406 U.S. 128 (1972); Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6 (1971); SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968), *cert. denied,* 394 U.S. 976 (1969); Birnbaum v. Newport Steel Corp., 193 F.2d 461 (2d Cir. 1952), *cert. denied,* 343 U.S. 956 (1952). *But cf.* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975); Lanza v. Drexel & Co., 479 F.2d 1277 (2d Cir. 1973).

[4]533 F.2d 1283 (2d Cir. 1976), *petitions for cert. filed,* 44 U.S.L.W. 3730 (U.S. May 14, 1976), 44 U.S.L.W. 3743 (U.S. June 2, 1976).

[5]*Id.* at 1288.

[6]Delaware corporation law allows a parent corporation to merge the parent and a subsidiary where the parent owns at least 90 percent of the capital stock of the subsidiary and the approval of the parent's board of directors and shareholders is received. No prior notice is required and no statement of justifiable corporate purpose for the merger is needed. The only

Inc. (F.P.I.) was organized as a Delaware corporation.[7] Resources then agreed to transfer its 95 percent of the capital stock of Kirby to F.P.I. together with cash and assumption of certain liabilities. F.P.I., in turn, transferred all of its capital stock to Resources.[8]

Subsequently, the F.P.I. Board of Directors[9] passed a merger resolution which provided that F.P.I. would be merged into Kirby, with Kirby surviving as "new" Kirby.[10] The resolution stipulated[11] that the minority shareholders[12] of "old" Kirby could either receive $150 per share or the appraised value of their stock as was permitted by Delaware law.[13] On July 13, 1974, the merger became effective. After the merger, "new" Kirby sent to the 5 percent minority shareholders of "old" Kirby notification of the merger and an explanation of their rights, along with a detailed financial information statement regarding Kirby.[14]

The plaintiffs never tendered any of their stock of "old" Kirby and on August 21, 1974, they demanded appraisal of their stock. On September 9, 1974, the plaintiffs withdrew their demand and the next day, September 10, 1974, a lawsuit was commenced.[15]

The plaintiffs, in their complaint, sought the rescission of the merger and damages.[16] Their theory was that the short-form merger plan used by F.P.I. resulted in the minority stock of "old" Kirby

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remedy for the objecting minority shareholder is a demand for judicial appraisal. DEL. CODE ANN., Ch. 8, § 253 (Revised 1974). For a review of the Delaware law on both long- and short-form mergers, see 533 F.2d at 1289.

[7]*Id.* at 1288.

[8]*Id.*

[9]The members of the board of directors of F.P.I. were the same persons who comprised the board of directors of Resources. *See* 342 BNA SEC REG. & L. REP. A-1 (Mar. 3, 1976).

[10]533 F.2d at 1288.

[11]Under Delaware corporation law, a merger resolution of this type may provide that, without any prior consent of the minority, all shares held by the minority shareholders will be purchased for cash. DEL. CODE ANN., Ch. 8, § 253 (revised 1974).

[12]The minority shareholders were the other five percent shareholders of "old" Kirby, of which the plaintiffs were members.

[13]533 F.2d at 1288.

[14]Accompanying the statutorily required notice was:

> [A] statement (some 57 pages of the Appendix) which, in addition to setting forth extensive financial data, included: (1) the Morgan Stanley stock value based largely upon the price ranges for the Kirby stock freely traded on the market; (2) the Appraisal Associates' appraisal of physical assets of $320,000,000; and (3) an appraisal by Riggs and Associates of Kirby's oil, gas and mineral property interests.

533 F.2d at 1301.

[15]*Id.* at 1288.

[16]*Id.*

being acquired at a "grossly undervalued price."[17] The plaintiffs' lack of knowledge of the merger until after its completion, the lack of any business purpose for the merger and the purported undervaluation of the minority shareholders' stock constituted the basis for the plaintiff's allegations that the merger existed as a manipulative and deceptive device in breach of both rule 10b-5 and the common law fiduciary duty owed by the majority shareholders to "old" Kirby and its minority shareholders.[18] The District Court for the Southern District of New York dismissed the plaintiffs' complaint for failure to establish subject matter jurisdiction and failure to state a claim for which relief could be granted.[19] The plaintiffs appealed the order and judgment.

The majority opinion of the appellate court decided two crucial points of law before addressing the precise issues presented on appeal. First, compliance with all aspects of the Delaware law concerning short-form mergers was found to be no defense to a 10b-5 action.[20] The court noted that no state can preempt Congress' power to create substantive rights and remedies stemming from purchases or sales of securities in interstate commerce.[21] While a state may choose to create a particular right or remedy,[22] that will not preclude the federal courts, or Congress, from providing other forms of relief to redress violations of the Securities Exchange Act.[23]

The second point decided was that there does not have to be a showing of misrepresentation or lack of disclosure in order to state a claim under 10b-5.[24] Only subdivision (2) of 10b-5 deals with nondisclosure and misrepresentation. The court observed that subdivisions (1) and (3) of 10b-5 state explicit examples of other

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[17]Plaintiffs contended that due to the opinion of Appraisal Associates, which valued the land and timber of "old" Kirby at $320 million, their minority shares should have been at least $772 per share, as opposed to the $150 per share offered by "new" Kirby, in reliance on the opinion of Morgan Stanley & Co. *Id.* at 1288.

[18]*Id.*

[19]Green v. Santa Fe Industries, Inc., 391 F. Supp. 849 (S.D.N.Y. 1975).

[20]533 F.2d at 1286. The court noted that it previously ruled in Popkin v. Bishop, 464 F.2d 714 (2d Cir. 1972), that "where Rule 10b-5 properly extends it will be applied regardless of any cause of action that may exist under state law." *Id.* at 718. *See also* Vine v. Beneficial Finance Co., 374 F.2d 627 (2d. Cir.), *cert. denied*, 389 U.S. 970 (1967); Levine v. Biddle Sawyer Corp., 383 F. Supp. 618 (S.D.N.Y. 1974).

[21]533 F.2d at 1286.

[22]In the present case, the state remedy provided was the right of an objecting minority shareholder to demand judicial appraisal.

[23]533 F.2d at 1286.

[24]*Id.* at 1286.

forms of fraud which may also be actionable.[25] In an effort to remove "any lingering doubt on this point," the court established that it was an erroneous assumption to conclude that nondisclosure or misrepresentation are essential ingredients of a 10b-5 action.[26]

The court noted that the plaintiffs' claim, in essence, was that the short-form merger, when instituted for no justifiable corporate purpose, allows majority shareholders to fix the price that will be paid for the minority shares at a figure substantially lower than their actual value. When the shareholders turn in their stock and receive the amount stipulated by the majority, the corporation pays for the stock and the minority is "squeezed out." Consequently, the benefit from the transaction inures to the majority.[27]

The court found the main thrust of the district court's decision to be that no preliminary case under 10b-5 can be stated without some type of misrepresentation or lack of disclosure.[28] The district court was in error. While the "fraud" envisioned by 10b-5 included the classic examples of misrepresentation and nondisclosure,[29] the rule is not, according to the Second Circuit Court of Appeals, limited to those types of illegality. The court admitted that 10b-5 cannot be a "panacea for all corporate ills and management wrongdoing,"[30] but it also recognized a clear mandate to liberally construe 10b-5 so as to accomplish its intended purpose[31] to insure the integrity of the securities market.

The court relied for support of its position upon *Schoenbaum v. Firstbrook,*[32] a case in which the Second Circuit Court of Ap-

[25]*Id.* at 1287. Rule 10b-5 states:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,
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> (1) to employ any device, scheme, or artifice to defraud,
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> (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statement made in the light of the circumstances under which they were made, not misleading, or
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> (3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
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> in connection with the purpose or sale of any security.

17 C.F.R. 240.10b-5 (1951).

[26]533 F.2d at 1287.

[27]*Id.* at 1289.

[28]*Id.*

[29]*Id.* The court cited as "classic examples," Affiliated Ute Citizens v. United States, 406 U.S. 128 (1972); Ruckle v. Roto Am. Corp., 339 F.2d 24 (2d Cir. 1964). *See also* SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180 (1963).

[30]533 F.2d at 1290.

[31]*Id.* at 1287.

[32]405 F.2d 215 (2d Cir. 1968) (en banc), *cert. denied,* 395 U.S. 906

peals held affirmatively that improper self-dealing and breach of fiduciary duty by a majority, without more, could constitute a 10b-5 violation. From *Schoenbaum,* the court reasoned that controlling shareholders should not be able to force the extinction of the minority interest where their sole purpose for such a tactic is monetary gain for the majority shareholders.[33] Such conduct, in the court's opinion, fell within the language of 10b-5 as "an act, practice, or course of business which operates or would operate as a fraud . . . ."[34]

In its finding that fraud can exist inherently in the "freezing out" of a minority interest for no justifiable corporate purpose, the court felt it was not without support from both scholarly works[35] and judicial opinions.[36] Specifically, the same court's recent decision in *Marshel v. AFW Fabric Corp.*[37] was seen as further affirmative support for its position. In *Marshel,* the court was faced with a long-form merger lacking any corporate purpose. Even though the long-form merger afforded the additional remedy of pre-merger injunctive relief, the court held that a 10b-5 violation could be stated, in the absence of misrepresentation or lack of disclosure, where the corporation expends corporate funds solely to eliminate the minority stockholders with no beneficial effect upon the corporation.[38] In light of the fact that the short-form merger has even less protections for the minority shareholder, the court considered it justifiable to read 10b-5 pervasively, thus affording a remedy for fraudulent conduct.[39]

The court, along with both the plaintiffs and defendant, relied upon *Popkin v. Bishop,*[40] another Second Circuit case, for additional support. In *Popkin,* there was no showing of misrepresentation or lack of disclosure resulting from the use of a New York long-form merger statute. The court ruled that no 10b-5 violation occurred

(1969). *See also* Drachman v. Harvey, 453 F.2d 722, 737 (2d Cir. 1972) (en banc).

[33]533 F.2d at 1290.

[34]*Id.*

[35]*See* Borden, *Going Private—Old Tort, New Tort, or No Tort?,* 49 N.Y.U.L. Rev. 987 (1974); Vorenberg, *Exclusiveness of the Dissenting Stockholder's Appraisal Right,* 77 Harv. L. Rev. 1189 (1964); Note, *Going Private,* 84 Yale L.J. 903 (1975).

[36]*See, e.g.,* Bryan v. Brock & Blevins Co., 490 F.2d 563 (5th Cir.), *cert. denied,* 419 U.S. 844 (1974); Voege v. American Sumatra Tobacco Corp., 241 F. Supp. 369, 375 (D. Del. 1965).

[37]533 F.2d 1277 (2d Cir. 1976), *petition for cert. filed,* 44 U.S.L.W. 3751 (U.S. June 8, 1976).

[38]533 F.2d at 1291.

[39]*Id.*

[40]464 F.2d 714 (2d Cir. 1972).

and the complaint was dismissed.[41] The *Green* majority distinguished *Popkin* on the basis that in *Popkin* a justifiable corporate purpose for the merger existed—the avoidance of the possibility of future mismanagement.[42] Further, the court reasoned that *Popkin* impliedly supported its decision since the need for misrepresentation or lack of disclosure was linked to the long-form merger requirement of shareholder approval.[43] The court viewed the implication to be that where no shareholder approval is needed, as in the short-form merger, misrepresentation or lack of disclosure will not be required to establish a 10b-5 case.[44] Full disclosure was not the crucial inquiry. The court stated explicitly: "If there is no valid corporate purpose for the merger, then even the most brazen disclosure of that fact to the minority shareholders in no way mitigates the fraudulent conduct."[45]

Since the *Green* court was here dealing with a motion to dismiss, it was required to assume the truth of the allegations in the complaint.[46] Thus, the court held that where a complaint alleges that the majority shareholders have breached their fiduciary duty to deal fairly with the minority shareholders, by effecting a merger without any justifiable business purpose, a claim under 10b-5 has been stated.[47]

Judge Mansfield, in a concurring opinion, agreed with the majority that the short-form merger, as a way of "going private," inherently has enormous potential for abuse by corporate insiders.[48]

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[41]*Id.* at 716.

[42]533 F.2d at 1291. *See* 464 F.2d at 716.

[43]533 F.2d at 1291.

[44]The court noted that the *Popkin* decision stated:

> In many, if not most, corporate self-dealing transactions touching securities, state law does not demand prior shareholder approval. In those situations, it makes sense to concentrate on the impropriety of the conduct itself rather than on the 'failure to disclose' it because full and fair disclosure in a real sense will rarely occur.

533 F.2d at 1292, *quoting from* 464 F.2d at 719.

[45]*Id.* at 1292.

[46]*Id.* at 1287.

[47]*Id.* at 1291. The court did not hold that an allegation of excessively low valuation, alone, constitutes a 10b-5 claim.

[48]Judge Mansfield noted:

> Essentially, by 'going public' when the stock market is flourishing and squeezing out the public shareholders when the market is depressed, the majority is able to manipulate the sale and purchase of stock to its benefit and to the detriment of the public shareholders, depriving the latter involuntarily of their investment in the corporation, at a buy-out price unilaterally selected by the insiders, which they have every incentive to fix below the fair value of the public shareholders' investment.

Id. at 1295. *See also* Brudney & Chirelstein, *Fair Shares in Corporate Mergers and Takeovers*, 88 HARV. L. REV. 297 (1974).

To allow such abuse to go unresolved undercuts the overriding purpose of 10b-5, which is to preserve the integrity of the securities market when potential abuse of market processes exists.[49] After a review of the Second Circuit's treatment of 10b-5 in earlier cases,[50] and an analysis of other circuits in accord with the court's position,[51] Judge Mansfield was careful to point out that where a legitimate corporate purpose exists no 10b-5 violation should result.[52] Two clear examples of such a legitimate purpose were offered. The first example is if a merger could enable a corporation to save on operating expenses. The second example is where the merger is used to dispose of an unprofitable business at a favorable price.[53] But, where a "dummy" corporation is organized only to "squeeze out" minority public shareholders, the burden should be upon the majority shareholders to show the existence of a legitimate corporate purpose.[54]

Judge Moore, in the dissenting opinion, asserted in very strong language that the majority had added a new clause to the Delaware merger statute by requiring a "justifiable corporate purpose." By so doing, it was implicit that the majority had created "an irrebuttable presumption that use of the short-form merger law amounts to a fraud *per se*."[55]

Judge Moore reasoned that the majority, by removing the requirement of misrepresentation or failure to disclose, had taken the element of fraud away from 10b-5.[56] The purpose of 10b-5, he argued, was to eliminate "fraudulent" practices. He felt the requirement of a showing of fraud must be maintained in order to give the rule its proper scope.

Judge Moore attempted to show, through a review of the leading case law,[57] that the provisions of 10b-5 have historically hinged upon a showing of fraud. Of the cases involving mergers, Judge Moore noted that in *Vine v. Beneficial Finance Co.*,[58] which

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[49] 533 F.2d at 1296.

[50] *Id.*

[51] *Id.* at 1299.

[52] *Id.*

[53] *Id.*

[54] *Id.*

[55] *Id.*

[56] *Id.* at 1301.

[57] *Id.* at 1302. Judge Moore cited Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6 (1971); SEC v. Capital Gains Research Bureau, 375 U.S. 180 (1964); Popkin v. Bishop, 464 F.2d 714 (2d Cir. 1972); Drachman v. Harvey, 453 F.2d 722 (2d Cir. 1972); Shell v. Hensley, 430 F.2d 819 (5th Cir. 1970); Dasho v. Susquehanna Corp., 380 F.2d 262 (7th Cir. 1967); O'Neill v. Maytag, 339 F.2d 764 (2d Cir. 1964); Levine v. Biddle Sawyer, 383 F. Supp. 618 (S.D.N.Y. 1974); Voege v. American Sumatra Tobacco Corp., 241 F. Supp. 369 (D. Del. 1965).

[58] 374 F.2d 627 (2d Cir.), *cert. denied*, 389 U.S. 970 (1967).

implicitly recognized the validity of short-form mergers, the court required that deception be shown. While the plaintiffs and the majority opinion relied strongly upon *Schoenbaum v. Firstbrook*,[59] the dissenter pointed out that in that decision, "[t]here was more than sufficient indicia of fraudulent non-disclosure to justify denial of a summary judgment motion."[60] Judge Moore concluded his review of the federal law by noting the recent decision of *Kaufmann v. Lawrence*,[61] where the District Court for the Southern District of New York held that a preliminary injunction to halt a long-form merger could not be issued without some showing of material omission or misrepresentation.[62] Upon the strength of all these decisions, Judge Moore felt warranted in his strong disapproval of the majority action which essentially nullified the short-form merger laws of 38 states.[63]

Judge Moore also disagreed with the majority ruling that no state law may interfere with the proper application of 10b-5. The states clearly have the power to regulate corporate mergers.[64] Corporations are creatures of the state and the majority's apparent intervention into state matters was seen as "the astonishing and impermissible establishment of a federal common law of corporations."[65]

As for the specific claims made by the plaintiffs, Judge Moore concluded that they centered around the lack of prior notice and the alleged undervaluation of the plaintiffs' stock.[66] With respect to the lack of notice allegation, Judge Moore was quick to point out that Delaware law made no provision for notice to the plaintiffs. Respecting the undervaluation, a sufficient remedy existed for the plaintiffs through the state judicial process of appraisal.[67]

Finally, Judge Moore took detailed objection to the majority's test of "justifiable corporate purpose" to determine whether a 10b-5 violation had occurred.[68] Numerous examples of types of corporate purposes that would have to be classified as violative

[59]405 F.2d 215 (2d Cir. 1968).

[60]533 F.2d at 1302.

[61]386 F. Supp. 12 (S.D.N.Y. 1974).

[62]*Id.* at 17.

[63]533 F.2d at 1299.

[64]*Id.* at 1304.

[65]*Id.*

[66]*Id.* at 1306.

[67]In short, Judge Moore felt plaintiffs had "utterly failed to assert any cognizable breach of fiduciary duty; any injury entitling them to equitable relief; any fact whatsoever indicating impermissible overreaching or deception by the defendants." *Id.* at 1307.

[68]*Id.*

of the rule were given in the dissenting opinion.[69] Whatever the term "justifiable corporate purpose" may mean, Judge Moore perceived the standard as bearing "no reasonable relationship to the realities of short-form mergers."[70] In a cumulative sense, Judge Moore's position is that it is untenable to place a fiduciary duty upon the majority shareholders to show a "justifiable corporate purpose" behind their short-term merger. By so doing, the court was not providing a remedy to correct an alleged fraud. Rather, it was affording plaintiffs "an independent, substantive right totally unrelated to the anti-fraud scheme of the federal securities laws and in complete derogation of a valid state rule regulating corporate activity."[71]

While there is little doubt that the Delaware short-form merger law was a valid means of regulating corporate activity, Judge Moore's position that the federal court improperly intervened into this case seems indefensible. Clearly, the states are charged with responsibility for regulating the corporate entity. In theory, if a merger could be accomplished without the need for any securities transactions, the federal court would have no authority to take jurisdiction over a dispute which arose between the shareholders of the corporation. But, where the court is involved in a corporate activity which was effectuated through the use of the securities market, few would argue that the federal courts have no proper jurisdiction to hear alleged securities misconduct. Regardless of whether or not the plaintiffs alleged a 10b-5 violation, the majority acted correctly in stating, as a matter of law, that where a corporate merger complies with all the statutory requirements of a state, this fact will not prevent a dispute arising from alleged securities misconduct from being heard in federal court. To hold otherwise would be to approve of legislation by the states in derogation of the intent and purpose of 10b-5 and the entire body of federal securities law.

The case law examined by both the majority and dissenting opinions in some instances illustrates classic examples of the

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[69]Judge Moore noted:

> Freedom from worry about the impact of corporate decisions on stock prices; ability to take greater business risks than those sanctioned by federal securities agencies; a switch to more conservative accounting, resulting in lower taxes; the savings which result from no longer having to prepare, print and issue the myriad of documents required under federal and state disclosure laws; the removal of a pressure to pay dividends at the expense of long-term capital development or speculative capital investment . . . .

Id. at 1308.

[70]*Id.*

[71]*Id.* at 1307.

writer's reading favorable interpretations into the decisions. For example, the *Green* majority read the *Schoenbaum v. Firstbrook*[72] decision as supportive of the position that the controlling shareholders should not be able to push out the minority interests for monetary purposes alone.[73] The dissenter took the position that *Schoenbaum* represented yet another example of the requirement that some form of fraudulent nondisclosure must be present for a 10b-5 violation to exist.[74] Despite the opinion expressed by the dissenter, a more accurate reading of *Schoenbaum* is that those alleging 10b-5 violations have the right to discovery before a summary judgment motion can be lodged against them. The *Schoenbaum* opinion holds that a 10b-5 violation is cognizable where one corporation exercises controlling influence over the issuance of the stock of another corporation, at a wholly inadequate consideration.[75] The opinion impliedly supports the dissenter's position that lack of misrepresentation or nondisclosure will bar a 10b-5 violation, but only because the court failed to address that specific issue.

Essentially, in *Green,* two key differences exist between the positions of the majority and the dissent. The first is whether 10b-5 requires a material omission or nondisclosure. The second concerns the promulgation of "justifiable corporate purpose" as the test for whether or not a 10b-5 violation has occurred.

The majority relied upon the fact that only subdivision (2) of 10b-5 specifically requires material omission and nondisclosure. The dissent asserted that 10b-5 requires a showing of fraud, and none can exist without the showing of a material omission or nondisclosure. While 10b-5 clearly encompasses fraudulent conduct, the better rule would put the emphasis upon the qualitative nature of the conduct in defining fraud, rather than strictly adhering to the classic elements of common law fraud. This rule does not advocate a new definition for fraud, generally, but only the understanding that fraud, for 10b-5 purposes, may exist where only subdivisions (1) or (3) are alleged.

When the requirements of 10b-5 are applied to the corporate merger, care must be taken to determine whether the long- or short-form merger is being discussed. The *Green* majority was correct when it reviewed *Popkin v. Bishop*[76] and reasoned that simply because a long-form merger may not create a 10b-5 violation it does not follow that the same conclusion will obtain where a short-form merger is utilized. The Second Circuit's recent deci-

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[72]405 F.2d 215 (2d Cir. 1968).

[73]*See* p. 6 *supra.*

[74]*See* p. 11 *supra.*

[75]405 F.2d at 218-19.

[76]464 F.2d 714 (2d Cir. 1972).

sion in *Marshel v. AFW Fabric Corp.*[77] further established that the two forms of merger are clearly distinguishable when the potential for securities fraud is considered. With the long-form method, approval by the shareholders of a corporation to be merged is required. Even if the minority cannot stop the majority vote, the notice imparted by that event provides the minority with the opportunity to enjoin improper activity before the merger reaches conclusion. The *Marshel* case held that even with the long-form merger, a showing of nondisclosure may not be essential to 10b-5 liability. This can only be seen as affirming the majority's interpretation of *Popkin,* that the short-form method requires even closer scrutiny because of the larger potential for abuse stemming from the total lack of knowledge of the underlying circumstances on the part of the minority shareholders. The majority correctly held in *Marshel* that the important area of focus is not whether the majority shareholders told the minority what they were going to do to them[78]—made a full disclosure—but whether or not the merger itself represented a fraudulent device as contemplated by 10b-5.

The area deserving of attention is the purpose behind the short-form merger. The majority uses "justifiable corporate purpose" as the test for whether the merger technique is being used as a fraudulent device.[79] In essence, a finding of no justifiable corporate purpose results when the merger process is used solely to gain a monetary reward, or to "go private" solely because the economy makes it more desirable for a corporation to be closely held. In such situations, the merger itself represents a fraudulent device. As the concurring opinion points out, the underlying rationale for 10b-5 was to promote integrity in the securities market.[80] By requiring that a justifiable corporate purpose exist, the

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[77]533 F.2d 1277 (2d Cir. 1976).

[78]In the *Marshel* case, the majority shareholders blatantly informed the minority that it was closing them out with huge profit to the majority interest. 533 F.2d at 1280.

[79]However, the majority does not postulate what a "justifiable corporate purpose" will be. The concurring opinion supplies two examples which would meet his requirements. *See* p. 9 *supra.* The dissenter lists numerous examples, although he feels the majority decision makes them all violative of the test. *See* note 69 *supra.* At least one commentator has offered as the proper definition "a compelling corporate need to revert to a privately held status in order to function as a viable business entity." Note, *Going Private,* 84 YALE L.J. 903 (1975).

[80]Earlier, the majority opinion also noted:

> Since the time to which the memory of man runeth [*sic*] not to the contrary the human animal has been full of cunning and guile. Many of the schemes and artifices have been so sophisticated as almost to defy belief. But the run of those willing and able to take unfair advantage of others are mere apprentices in the art when com-

court is insuring that a merger involving a securities transaction cannot be used to force a sale by the minority interest solely for the monetary benefit of the majority. Whether the minority knows beforehand that such a possibility exists is not the issue. The policy behind 10b-5 is that the use of securities for such a purpose is improper.

One problem area remains: Does a 10b-5 action provide the proper forum to attack a short-form merger? Even assuming that the majority's reading of 10b-5 is an expansion of the term "fraud" to its outer borders, it does not follow that such a reading is incorrect.

The issue is one of form over substance. Is it more important that the rigid concept of fraud be maintained, or that the ends of justice be met? New rules should be passed to better reflect the purpose of the Securities Act of 1934—to "clean up" the securities market. The SEC currently is considering proposed rules which would require that a corporation have a valid corporate purpose for the use of the short-form merger.[61] This requirement would allow 10b-5 once again to regain its more conventional shape. However, until its passage, if abuses occur, it is better to have improper activities corrected by a broad interpretation of 10b-5 than to permit a strict construction of 10b-5 to serve as the vehicle for potential injustice.

Brian Schuster

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pared with the manipulations thought up by those connected in one way or another with transactions in securities.

533 F.2d at 1287.

[61]Proposed SEC Rules 13e-3A and 13e-3B, 2 CCH Fed. Sec. L. Rep. ¶¶ 23,704-05; Sec. Act. Release No. 5567. *See also* [Current] CCH Fed. Sec. L. Rep. ¶ 80,104 (1974-75).