Kentucky Law Survey: Corporations

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INTRODUCTION

The format for this year's Survey will follow that used in previous Surveys. Developments in corporation law at the federal level will be discussed first. This will be followed by review of a group of selected cases dealing with corporate law principles under state law.

Discussion of federal developments will begin with analysis of a significant decision by the United States Supreme Court relating to the constitutionality of state takeover legislation. This analysis will be followed by a discussion of a case from the Seventh Circuit Court of Appeals dealing with the recovery of short-swing profits under the Securities Exchange Act of 1934. The discussion will conclude with considerations of two additional federal cases, one from the Fourth Circuit Court of Appeals and one from the Ninth Circuit Court of Appeals, dealing with the requirements for maintaining suits under Securities and Exchange Commission (SEC) rule 10b-5.

Developments in corporation law at the state level will begin with a discussion of a recent decision by the Kentucky Court of Appeals dealing with the elements of valuation to be considered in determining the fair value of stock under the appraisal provi-
sions of the Kentucky Business Corporation Act. This discussion will be followed by an analysis of a decision by the Supreme Judicial Court of Massachusetts dealing with the enforceability of stock transfer restrictions and a decision by the Supreme Court of Idaho dealing with the enforceability of buy-out arrangements. The discussion will conclude with an analysis of a decision by the Supreme Court of Alabama dealing with the enforceability of supermajority quorum and voting requirements for board and shareholder action.

I. FEDERAL CORPORATION LAW

A. Tender Offers

No doubt one of the most significant decisions handed down by the United States Supreme Court in the corporate and securities area during the present Survey period was its decision in Edgar v. MITE Corp.,\(^2\) involving the constitutionality of the Illinois Business Take-Over Act.\(^3\) The constitutionality of state takeover legislation has been the subject of debate since the advent of state takeover statutes in the late 1960s.\(^4\) Attack on the constitutionality of such state legislation has customarily been under either the supremacy\(^5\) or commerce\(^6\) clauses of the United States Constitution. Both of these constitutional issues were before the Supreme Court in MITE, as well as a jurisdictional issue of mootness. Due to the differing opinions held by the members of the Court on these issues, the only issues resolved by the Court, as a Court, were that the case before them was not moot\(^7\) and that the Illinois Business Take-Over Act was unconstitutional under the commerce clause of the United States Constitution because the local interests it served were outweighed by the substantial burden it imposed on interstate commerce.\(^8\)

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\(^2\) 102 S.Ct. 2629 (1982).
\(^3\) ILL. ANN. STAT. ch. 121 1/2, § 137.51-.70 (Smith-Hurd Supp. 1982-83).
\(^5\) U.S. Const. art. VI, cl. 2.
\(^6\) U.S. Const. art. I, § 8, cl. 3.
\(^7\) See Part II of the opinion written by Justice White. 102 S.Ct. at 2635.
\(^8\) See Part V-B of the opinion written by Justice White. 102 S.Ct. at 2641-43.
The litigation in MITE resulted from a cash tender offer which MITE Corporation, a corporation organized under the laws of Delaware with its principal executive office in Connecticut, initiated on January 19, 1979, for all the outstanding shares of Chicago Rivet and Machine Co., a publicly held Illinois corporation. MITE initiated its tender offer by filing a Schedule 14D-1 with the Securities and Exchange Commission as required by the Williams Act, which regulates tender offers at the federal level. MITE, however, made no effort to comply with the Illinois Business Take-Over Act, but instead filed an action in the United States District Court for the Northern District of Illinois, seeking a declaratory judgment that the Williams Act preempted the Illinois Act and that the Illinois Act violated the commerce clause of the United States Constitution. MITE also sought a temporary restraining order, as well as preliminary and permanent injunctions, prohibiting enforcement of the Illinois Act by the Illinois Secretary of State. Shortly thereafter, Chicago Rivet sought unsuccessfully to bring a suit in Pennsylvania, where it did most of its business, to enjoin MITE from continuing with its tender offer on the ground that the offer violated the Pennsylvania Takeover Disclosure Law. The Illinois Secretary of State thereupon announced his intention to issue a cease and desist order requiring MITE to abandon its plans to make a tender offer for the shares of Chicago Rivet, and Chicago Rivet announced its plans to seek an injunction in the Illinois state courts to prevent MITE's proposed tender offer. At this point, MITE renewed its request for injunctive relief in federal district court.

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9 102 S.Ct. at 2633.
10 Williams Act, 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1976).
11 102 S.Ct. at 2634.
12 Id.
13 Id. Appellant James Edgar, as the Illinois Secretary of State, was charged with the administration and enforcement of the Illinois Act. Id. at 2633.
14 Id. at 2634. Chicago Rivet also tried to get the Pennsylvania Securities Commission to enforce the Pennsylvania Act against MITE but was unable to do so. Id. at 2634 n.3. In the meantime, Chicago Rivet had removed its state court action to the United States District Court for the Western District of Pennsylvania. This latter court denied Chicago Rivet’s motion for a temporary restraining order. Id.
15 Id. at 2634.
16 Id.
On February 2, 1979, the United States District Court for the Northern District of Illinois issued a preliminary injunction prohibiting the Illinois Secretary of State from enforcing the Illinois Business Take-Over Act against MITE.\(^1\) MITE then proceeded to make its tender offer to the shareholders of Chicago Rivet.\(^1\) On February 9, 1979, the district court entered its final judgment permanently enjoining enforcement of the Illinois Act against MITE on the ground that the Illinois Act was preempted by the Williams Act and violated the commerce clause of the United States Constitution.\(^19\) The United States Court of Appeals for the Seventh Circuit affirmed the decision of the district court.\(^20\) Subsequently, the United States Supreme Court noted probable jurisdiction.\(^21\)

A preliminary issue considered by the Supreme Court was whether the case had become moot as a result of MITE having entered into an agreement with Chicago Rivet shortly after the district court entered final judgment.\(^22\) The court of appeals thought this action had not rendered the case moot since, if the court was to reverse the judgment of the district court enjoining action against MITE, MITE would be exposed to both criminal and civil liability for having made a tender offer in violation of the Illinois Business Take-Over Act.\(^23\) Writing for a majority of the Supreme Court on this issue, Justice White, in Part II of his opinion, agreed with this position taken by the court of appeals.\(^24\)

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\(^1\) Id.
\(^1\) Id. The tender offer took the form of an offer, published in the February 5, 1979, issue of the Wall Street Journal, to all shareholders of Chicago Rivet wherever residing in the United States. Id. In its Schedule 14D-1 filed with the Securities and Exchange Commission (SEC), MITE had indicated that it was willing to pay $28.00 per share for the outstanding shares of Chicago Rivet, a premium of approximately $4.00 per share above the then market price. Id. On the same day that MITE published its tender offer, Chicago Rivet made an offer to buy approximately 40% of its own shares at $30.00 per share. Id.
\(^19\) Id.
\(^21\) Edgar v. MITE Corp., 451 U.S. 968.
\(^22\) 102 S.Ct. at 2635. Under the agreement between MITE and Chicago Rivet, MITE was either to make a tender offer of $31.00 per share for Chicago Rivet shares before March 12, 1979, or forego acquiring Chicago Rivet's shares or assets. MITE decided not to make a tender offer. Id. at 2634.
\(^23\) Id. at 2635.
\(^24\) Id.
Justice White pointed out that since any suit brought by the Illinois Secretary of State to charge MITE with a violation of the Illinois Act would be foreclosed if the Court were to agree with the court of appeals that the Illinois Act was unconstitutional, the case was not moot.25

In Part III of his opinion, Justice White considered the charge that the Illinois Business Take-Over Act violated the supremacy clause of the United States Constitution.26 Determinations such as this, he said, have been held by the Court to turn on whether the state statute actually conflicts with the federal statute or whether, if there is no direct conflict, the state law obstructs the fulfillment of the purposes and objectives of Congress in enacting the federal statute.27 Noting that the provisions of the Securities Exchange Act of 1934, of which the Williams Act is a part, do not expressly prohibit states from regulating takeovers28 and that there was no conflict between the provisions of the Illinois Act and the Williams Act that would make it impossible to comply with both acts,29 Justice White directed his inquiry to whether the Illinois Act frustrated the aims and objectives of the Williams Act.30 In this respect, he agreed with the court of appeals that Congress, in enacting the Williams Act, had sought not only to provide investors with full information regarding tender offers but also had sought to maintain the balance between management and tender offerors so as not to frustrate the exercise of an informed judgment by investors.31 He further agreed,

25 Id.
26 Id.
28 Section 28 of the Securities Exchange Act of 1934 provides: "Nothing in this chapter shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any State over any security or any person insofar as it does not conflict with the provisions of this chapter or the rules and regulations thereunder." 15 U.S.C. § 78bb(a) (1976).
29 102 S.Ct. at 2635.
30 Id.
31 Id. at 2636-37. The Senate Committee Report which accompanied the Williams Bill stated:
The committee has taken extreme care to avoid tipping the balance of regulation either in favor of management or in favor of the person making the takeover bid. The bill is designed to require full and fair disclosure for the
in Part IV of his opinion, that there were three provisions of the Illinois Act which interfered with this congressional objective: 1) the precommencement notification provisions requiring the Illinois Secretary of State to be notified twenty business days before a tender offer becomes effective;\(^{32}\) 2) the hearing provisions of the Illinois Act allowing the Secretary of State to hold hearings with respect to tender offers covered by the Act;\(^{33}\) and 3) the provisions of the Illinois Act permitting the Secretary of State to pass on the fairness of a tender offer.\(^{34}\)

As to the precommencement notification provisions, Justice White agreed with the position of the court of appeals, stating:

\[B\]y providing the target company with additional time within which to take steps to combat the offer, the precommencement notification provisions furnish incumbent management with a powerful tool to combat tender offers, perhaps to the detri-

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\(^{32}\) See Part IV-A of Justice White's opinion. 102 S.Ct. at 2637-38. The Illinois Business Take-Over Act required that a takeover offer for the shares of a target company as defined by the Act be registered with the Secretary of State. ILL. ANN. STAT. ch. 121 11/2, § 137.54.A. (Smith-Hurd Supp. 1982-83). Before a takeover offer could become registered under the Act, the offeror was required to file with the Secretary of State a registration statement containing the information prescribed by the Act. Id. § 137.54.B. Registration became effective 20 business days after the date the registration statement was filed. Id. § 137.54.E. In the meantime, the offeror could not make the takeover offer to the shareholders of the target company. Id. § 137.54.A. The offeror, however, was required to deliver a copy of the registration statement to the target company and was required, not later than the date of the filing of the registration statement, to publicly disclose its intent to make a takeover offer and the material terms of the proposed offer. Id. § 137.54.B.

\(^{33}\) See Part IV-B of Justice White's opinion. 102 S.Ct. at 2638-39. The Illinois Business Take-Over Act provided that the Secretary of State was to call a hearing if it was deemed necessary for the protection of Illinois offerees, or if within 15 days after the filing of the registration statement, a written request for a hearing was submitted to the Secretary by a majority of the directors of the target company who were not officers and employees of the target company or by persons residing in Illinois who owned at least 10% of the outstanding shares of any class of equity securities which were the subject of the takeover offer. ILL. ANN. STAT. ch. 121 1/2, § 137.57.A. (Smith-Hurd Supp. 1982-83).

\(^{34}\) See Part IV-C of Justice White's opinion. 102 S.Ct. at 2639-40. Under the provisions of the Illinois Business Take-Over Act, if the Secretary of State found, among other things, that the takeover offer was inequitable or would work or tend to work a fraud or deceit upon the offerees, the registration of the takeover offer could be denied. ILL. ANN. STAT. ch. 121 1/2, § 137.57.E. (Smith-Hurd Supp. 1982-83).
Similarly, Justice White agreed with the court of appeals position that "the hearing provisions of the Illinois Act frustrate the congressional purpose by introducing extended delay into the tender offer process," thereby upsetting "the balance struck by Congress by favoring management at the expense of stockholders." As to the authority granted to the Illinois Secretary of State under the Illinois Act to pass on the substantive fairness of a tender offer, Justice White agreed with the position of the court of appeals that giving the Secretary of State such authority would conflict with the intent of Congress in passing the Williams Act to recognize investor autonomy by providing investors with the information needed for them to make their own decisions.

Turning to the charge that the Illinois Business Take-Over Act violated the commerce clause of the United States Constitution, Justice White reasoned, in Part V of his opinion, that the Act did so violate the commerce clause for two reasons: 1) the act purported to regulate interstate commerce directly, including commerce outside the state; and 2) the burden imposed on in-

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35 102 S.Ct. at 2637.
36 Id. at 2638.
37 Id. at 2639.
38 Id. at 2639-40. Justice White referred to both the House and Senate reports accompanying the Williams Bill which had emphasized the aim of the bill to protect investors by providing them with full information regarding cash tender offers. Id. The Senate Committee on Banking and Currency had remarked in its report: "The bill is designed to require full and fair disclosure for the benefit of investors while at the same time providing the offeror and management equal opportunity to fairly present their case." S. REP. NO. 550, 90th Cong., 1st Sess. 3 (1967).
39 See Part V-A of Justice White's opinion. 102 S.Ct. at 2640-41. Justice White believed that the Illinois Business Take-Over Act differed from state blue sky laws which relate to the disposition of securities within a state and affect interstate commerce in securities only incidentally. By way of contrast, he noted that application of the Illinois Act would necessarily involve interstate commerce since by their very nature tender offers for securities of publicly held corporations require communication with shareholders scattered across the country. Id. at 2641. Referring to the Illinois Act, he remarked: Indeed, the Illinois law on its face would apply even if not a single one of Chicago Rivet's shareholders were a resident of Illinois, since the Act applies to every tender offer for a corporation meeting two of the following conditions: the corporation has its principal executive office in Illinois, is organ-
terstate commerce by the Illinois Act, even if it be treated as regulating interstate commerce only indirectly, outweighed any local interests served by the statute.\footnote{40}

In a dissenting opinion which Justice Brennan joined, Justice Marshall argued that the case should have been dismissed as moot.\footnote{41} His position was that the preliminary injunction issued by the district court restraining the Illinois Secretary of State from enforcing the Illinois Act against MITE should be presumed as intended to provide permanent protection to MITE against any later attempted enforcement suits for actions of MITE during the period of the injunction whether or not the Illinois Act was considered to be unconstitutional.\footnote{42} He contended that “[u]nder the circumstances, it would be improper to permit the State to penalize action taken while the injunction was in ef-

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ized under Illinois laws, or has at least 10\% of its stated capital and paid-in surplus represented in Illinois. 102 S.Ct at 2641. Thus, he concluded, “the Illinois law, unless complied with, sought to prevent MITE from making its offer and concluding interstate transactions not only with Chicago Rivet’s stockholders living in Illinois, but also with those living in other states and having no connection with Illinois.” \textit{Id.} at 2641.

\footnote{40} See Part V-B of Justice White’s opinion. \textit{Id.} at 2641-43. Commenting that “[w]hile protecting local investors is plainly a legitimate state objective,” but noting that “the state has no legitimate interest in protecting non-resident shareholders,” Justice White added:

The effects of allowing the Illinois Secretary of State to block a nationwide tender offer are substantial. Shareholders are deprived of the opportunity to sell their shares at a premium. The reallocation of economic resources to their highest-valued use, a process which can improve efficiency and competition, is hindered. The incentive the tender offer mechanism provides incumbent management to perform well so that stock prices remain high is reduced.

\textit{Id.} at 2642.

\footnote{41} \textit{Id.} at 2648 (Marshall, J., dissenting).

\footnote{42} \textit{Id.} at 2648-50 (Marshall, J., dissenting). Justifying this position, Justice Marshall added:

[T]he preliminary injunction does not expressly state that it provides permanent immunity from penalties for violations of the Illinois Act that may occur during its effective period . . . . However, I see no reason why the presumption in favor of permanent protection should not be applied here. In this context, as the District Court must have recognized, permanent protection was needed. Mite sought an injunction, not just because it desired protection from enforcement actions during the period it was actually making the tender offer, but also because it desired protection from such actions in the future.

\textit{Id.} at 2650 (Marshall, J., dissenting).
fect." Therefore, he concluded, no live controversy existed between the parties to give the Court jurisdiction to hear the case.\textsuperscript{44}

In a separate dissenting opinion, Justice Rehnquist agreed with Justice Marshall that the case did not present a justiciable controversy, but differed with Justice Marshall as to the reason for its mootness.\textsuperscript{45} Justice Rehnquist took the position that the case was moot because of the fact that after the district court issued its permanent injunction prohibiting the Illinois Secretary of State from enforcing the Illinois Act against MITE, MITE announced its decision not to pursue its tender offer.\textsuperscript{46} He said that since MITE was not presently engaged in activity covered by the Illinois statute and since there was no indication that MITE intended to pursue such activity in the future, the facts giving rise to the present controversy no longer existed.\textsuperscript{47} Thus, the controversy before the Court no longer being live, the complaint should be ordered dismissed.\textsuperscript{48}

Chief Justice Burger, Justice Stevens and Justice O'Connor joined in Part II of Justice White's opinion in which he treated the case as not moot, and in Part V-B of his opinion in which he treated the Illinois statute as violating the commerce clause of the

\textsuperscript{43} Id. (Marshall, J., dissenting).
\textsuperscript{44} Id. at 2652 (Marshall, J., dissenting). In concluding that no live controversy existed between the parties, Justice Marshall reasoned:
There is a live controversy in this case only if the State could seek penalties from Mite. Here, the state could not seek penalties from Mite. It may be true that the State could file a complaint if this Court were to lift the permanent injunction. However, this fact is not enough to keep the case alive where, as a matter of federal law, the complaint \textit{must} be dismissed. If the action that the State plans to commence in state court lacks any merit—if Mite has an automatic defense to that action—then there simply is no controversy.

\textsuperscript{45} Id. at 2652-54 (Rehnquist, J., dissenting).
\textsuperscript{46} Id. at 2653 (Rehnquist, J., dissenting).
\textsuperscript{47} Id. (Rehnquist, J., dissenting).
\textsuperscript{48} Id. at 2654 (Rehnquist, J., dissenting). Pointing out that the Court had no power over a suit not pending before it, Justice Rehnquist reasoned:
As the tender offer has met its demise for reasons having nothing to do with the validity of the Illinois statute, the injunction is no longer necessary to accomplish the purposes for which it was obtained. Mite no longer needs an injunction in order to effect a tender offer for the shares of Chicago Rivet or any other corporation subject to the Illinois Act. Nor does Mite need the injunction in order to preclude the Secretary from rescinding a completed tender offer.

\textsuperscript{45} Id. at 2653 (Rehnquist, J., dissenting).
United States Constitution because it imposed an excessive burden on interstate commerce. Justice Blackmun joined Justice White's opinion on the mootness issue, but not as to his position that interstate commerce was unduly burdened by the Illinois statute. Justice Powell, in a separate opinion, joined part V-B of Justice White's opinion treating the Illinois Act as an undue burden on interstate commerce but not in Justice White's position as to the mootness issue in Part II of his opinion, agreeing with Justice Marshall on that issue. Of the three Justices writing separate concurring opinions (Justices Powell, Stevens, and O'Connor) only two (Justices Stevens and O'Connor) specifically spoke to the preemption issue. In her opinion, Justice O'Connor stated that because it was unnecessary to reach the preemption issue she was joining only Parts I, II and V of Justice White's opinion. Justice Stevens, however, openly disagreed with Justice White's position on the preemption issue, stating that although he agreed with Justice White's assessment of the impact of the Illinois statute and therefore joined in Part V of his opinion, he did not join his preemption holding.

The effect of MITE on the judicial attitude toward state takeover legislation is already being felt. Nevertheless, in view of the fragmented nature of the Supreme Court opinion in MITE, the total impact of the decision on the constitutionality of state takeover legislation may not turn out to be quite as sweep-

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49 Id. at 2633 n.*. Justice O'Connor, in a separate concurring opinion, agreed with Justice White that portions of the Illinois Act were invalid under the commerce clause. Id. at 2643 (O'Connor, J., concurring).
50 Id. at 2633 n.*.
51 Id. at 2643 (Powell, J., concurring). Justice Powell stated that he joined Part V-B of Justice White's opinion because it left some room for state regulation under the commerce clause, which Justice Powell believed was important because the disparity of resources between a tender offeror and a takeover target can often work to the disadvantage of a small target corporation. Id. (Powell, J., concurring).
52 Id. (O'Connor, J., concurring).
53 Id. at 2647-48 (Stevens, J., concurring).
54 See, e.g., Bendix Corp. v. Martin-Marietta Corp., [Current Binder] FED. SEC. L. REP. (CCH) ¶ 98,821 (D.C. Md., Sept. 3, 1982), in which the United States District Court for the District of Maryland, in declaring the Maryland Corporate Take-Over Law unconstitutional, invoked the commerce clause reasoning of MITE; Esmark, Inc. v. James C. Strode, 639 S.W.2d 768 (Ky. 1982), in which the Supreme Court of Kentucky relied on MITE in striking down the Kentucky Take-Over Act.
ing as Justice White's opinion might suggest, particularly if state legislation was framed in such a manner as to avoid the charge of creating an excessive burden on interstate commerce.\[55\] Justice Powell acknowledged this possibility when, in his concurring opinion, he said, "I agree with Justice Stevens that the William Act's neutrality policy does not necessarily imply a congressional intent to prohibit state legislation designed to assure—at least in some circumstances—greater protection to interests that include but often are broader than those of incumbent management."\[56\]

**B. Insider Trading**

Trading on the basis of material inside information was early deemed to come within the broad prohibitions of section 10(b) of the Securities Exchange Act of 1934\[57\] and SEC rule 10b-5,\[58\] which condemn fraudulent practices in connection with the purchase or sale of securities.\[59\] Actually, however, although Congress was well aware of the evils of insider trading when it enacted the Securities Exchange Act,\[60\] it was not section 10(b) that was aimed at the evils of insider trading but rather section

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\[56\] 102 S.Ct. at 2643 (Powell, J., concurring). By agreeing with Justice Stevens, Justice Powell appears to have thereby also agreed with the position of Justice Stevens on the preemption issue for, in refusing to join Justice White's holding on the preemption issue, Justice Stevens had stated that he was not persuaded "that Congress' decision to follow a policy of neutrality in its own legislation is tantamount to a federal prohibition against state legislation designed to provide special protection for incumbent management." Id. at 2648 (Stevens, J., concurring).


\[58\] 17 C.F.R. § 240.10b-5 (1981). For the text of this rule, see note 87 infra.


\[60\] The Senate Committee Report which accompanied the hearings that led to the passage of the Securities Exchange Act of 1934 had commented:

Among the most vicious practices unearthed at the hearings before the subcommittee was the flagrant betrayal of their fiduciary duties by directors and officers of corporations who used their positions of trust and the confidential information which came to them in such positions, to aid them in their market activities. Clearly allied to this type of abuse was the unscrupulous employment of inside information by large stockholders who, while not directors and officers, exercised sufficient control over the destinies of
16(b), the short-swing trading provision of the Act. The scope of section 16(b) in reaching insider trading activity is not as broad as that now recognized under section 10(b) and SEC rule 10b-5; nevertheless, section 16(b) remains a potent weapon for dealing with insider trading activities and continues to spawn its share of litigation in the securities fraud area.

A recent case from the Court of Appeals for the Seventh Circuit, CBI Industries, Inc. v. Horton, raised the question as to how direct the pecuniary benefit realized by a corporate insider must be to bring such insider under the prohibitions of section 16(b). In this case, Horton, a director of CBI Industries, Inc.,
served, along with a bank, as a co-trustee of trusts created by his mother for the benefit of his two adult sons, both of whom were full-time students living apart from Horton. In 1980, Horton sold on the open market 3,000 shares of CBI stock which he owned, and within six months bought on the open market for the trust 2,000 shares of CBI stock at a lower price. The difference in price amounted to $25,000. CBI Industries, Inc. sued Horton to recover this amount on the basis it constituted short-swing profits realized by Horton in violation of section 16(b). The United States District Court for the Northern District of Illinois entered judgment in favor of CBI Industries, Inc.

The district court took the position that the purpose of section 16(b)—to prevent insiders from violating their fiduciary duties by trading in the stock of their corporations on a short-term basis—is violated “if an insider trades under the name of a family member and, thereafter, realizes some direct or indirect benefit.” The court said that in the case of short-swing profits involving family members, one must look to the degree of control possessed by the insider and the extent of the benefit enjoyed by the insider from the profits realized. The court found these two elements present in the case of Horton, since he, as co-trustee of his sons' trusts, jointly exercised control over all investments made by the trusts and realized benefit from his operation of the trusts by being spared the need to make gifts to the trusts in order to provide for the economic security of his sons. The court remarked that, in this context, “benefits for the purposes of sec-

his “profit” on the transaction (more realistically, the loss he averted by selling when he did). We have to decide in this case whether the “him” includes his grown children, when they are beneficiaries of a trust of which the director is a co-trustee.

Id. at 664.
67 Id.
68 Id.
69 Id.
70 Id.
72 Id. at 785.
73 Id. at 785-86.
74 Id. at 786-87.
tion 16(b), need not be 'direct' in order for an insider to be held liable under the section."\textsuperscript{75}

The Seventh Circuit Court of Appeals differed with the district court's opinion that indirect benefit was enough to bring an insider within the proscriptions of section 16(b),\textsuperscript{76} and held that profit realized by a corporate insider must consist of direct pecuniary benefit.\textsuperscript{77} The court said that "it is not enough that ties of affinity or consanguinity between the nominal recipient and the insider make it likely that the insider will experience an enhanced sense of well-being as a result of the receipt, or will be led to reduce his gift-giving to the recipient."\textsuperscript{78} The court believed, therefore, that the case should be remanded to the district court to allow that court to decide whether CBI Industries, Inc. should be given an opportunity to show liability on the part of Horton under the "direct benefit" standard.\textsuperscript{79} However, the court of appeals did agree with an alternative contention of Horton that even if he derived sufficient benefit from the $25,000 profit made by the trust to have violated section 16(b), he should not be held liable for the entire profit.\textsuperscript{80} The court rejected "the view that the profit nominally received by a third party must be attributed to the insider either entirely or not at all."\textsuperscript{81} The standard of direct pecuniary benefit, according to the court, "does not exclude an attempt to measure any direct pecuniary benefit that he may have received from the transaction even if that benefit was less than $25,000."\textsuperscript{82}

Although section 16(b) has long been noted for its automatic nature, eliminating any need for a showing of intent to trade on

\textsuperscript{75} Id. at 786.
\textsuperscript{76} 682 F.2d at 646.
\textsuperscript{77} Id.
\textsuperscript{78} Id.
\textsuperscript{79} Id. at 647. The court said:
To prevail in this case, CBI therefore would have to show that the trust was a sham; that despite its terms Horton was able to use income or assets of the trust to pay his personal expenses. CBI has made no effort to prove a direct pecuniary benefit to Horton. But we shall leave it to the district judge to decide, in the first instance at least, whether it should be given a chance to try to prove liability under the standard adopted in this opinion.
\textsuperscript{80} Id.
\textsuperscript{81} Id.
\textsuperscript{82} Id.
inside information, the *Horton* case should dispel some of the concern that the section operates as a “trap for the unwary.” As the court of appeals remarked in *Horton*, to permit indirect benefits resulting from emotional relationships within the family to be the basis of liability under section 16(b) would “make an already Draconian strict liability statute still more Draconian.”

C. Standing To Sue

Litigation involving section 10(b) of the Securities Exchange Act of 1934, and SEC rule 10b-5, continues unabated despite

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85 682 F.2d at 647. In a separately written opinion, Judge Wood said that although he concurred in the analysis of the majority on the pecuniary benefit issue, he believed that he needed to dissent on the beneficial ownership issue since he preferred “to read 16(b) a little more broadly so as to include ‘immediate family’ in its proscriptions.” Id. at 648 (Wood, J., dissenting).
86 This section reads:

> 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—

> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.


87 The full text of the rule reads as follows:

> 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,

> (a) To employ any device, scheme, or artifice to defraud,

> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

recent efforts on the part of the United States Supreme Court to limit the scope of these provisions. A number of the recent cases brought under those provisions have raised questions relating to the exact nature and scope of the limitations imposed by these Supreme Court decisions. One such recent case was the Fourth Circuit case of Gurley v. Documation, Inc., involving the purchaser-seller standing requirement, popularly known as the Birnbaum rule, approved by the Supreme Court in Blue Chip Stamps v. Manor Drug Stores. It has been clear since the decision of the Supreme Court in Blue Chip Stamps that persons claiming they were fraudulently induced not to purchase securities have no standing to bring a private damage suit under rule 10b-5. In Gurley, the court was faced with the question of whether persons claiming that they had deferred sales of stock as a result of fraudulent misrepresentations made to them were similarly barred from maintaining such suits.

The plaintiffs in Gurley, Michael L. Gurley and David W. Davis, had become shareholders in Documation, Inc. soon after its incorporation. They alleged that they had been persuaded to buy the Documation stock on the basis of a promise made to them by S. Ray Halbert, a major shareholder and president of

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89 See, e.g., United States v. Newman, 664 F.2d 12 (2d Cir. 1981), involving the implications of the Chiarella decision as to a criminal indictment charging misuse of nonpublic information regarding proposed mergers or take-overs. In Chiarella v. United States, 445 U.S. 222 (1980), the Supreme Court had held that trading on nonpublic market information by the employee of a printer did not constitute a violation of § 10(b) of the Securities Exchange Act of 1934 and SEC rule 10b-5.
90 674 F.2d 253 (4th Cir. 1982).
93 The Blue Chip Stamps case was such a case, involving a complaint by nonshareholder customers of Blue Chip Stamp Company who complained that they had been discouraged from buying stock in the company by an overly pessimistic prospectus issued by the company. Id. at 726-27.
94 674 F.2d at 256. Delayed sales present a somewhat different problem from that in which no sale at all takes place, because in the case of the delayed sale, a sale does ultimately take place. The Supreme Court made it clear in its Blue Chip Stamps decision that its decision was intended to cover the "no-sale" cases. 421 U.S. at 737-38.
95 674 F.2d at 255.
Documation, as well as its chairman and chief executive officer, that they could “piggyback” future sales of their stock on any public offering that might be made by the company. Nevertheless, the plaintiffs alleged that Halbert—with the help of Richard J. Testa and members of the law firm of Testa, Hurwitz, and Thibault, who were serving as general counsel for Documation and who were made defendants in the plaintiffs’ suit—had made plans for a public offering of the company’s stock without disclosing this to them and without revealing to them that Halbert and other shareholders of Documation would be piggybacking their stock. Instead, the plaintiffs claimed, Halbert and Testa informed them that they would not be permitted to piggyback on any possible future public offering by Documation and that under SEC rule 144 they could not sell their unregistered shares for ninety days after the company commenced a registered public offering, whereas in fact, as the defendants knew, they were entitled to sell their stock under other SEC rules. The plaintiffs claimed that the purpose of these misrepresentations and omissions was to support the price of Documation’s publicly held shares by keeping the plaintiffs’ stock off the market.

In reliance on these claimed misrepresentations and omissions, Gurley sold 3,900 shares of Documation stock to an employee of the company for $6.50 per share. Subsequently, 474,000 Documation shares were sold to the public at a price of $17.00 per share on the basis of a registration statement filed with the SEC. These shares consisted of 300,000 new shares, 100,000 shares owned by Halbert and 34,000 shares held by other piggybacking shareholders. During the ninety day period following the public offering, Gurley, who owned 19,900 shares

96 Id.
97 Id.
98 Id.
100 674 F.2d at 255. Moreover, the plaintiffs claimed that the defendants knew that rule 144 did not apply to the plaintiff’s shares which were issued before the rule took effect. Id.
101 Id.
102 Id.
103 Id.
104 Id.
of Documation stock, and Davis, who owned 46,900 shares of such stock, attempted to sell their shares through stockbrokers. They were unsuccessful in doing so, however, because the defendants, purporting to follow SEC rule 144, refused to make any transfer of the plaintiffs' shares until ninety days after the public offering.\textsuperscript{105} After the ninety days expired, the plaintiffs sold their stock over an extended period at prices ranging from $7.00 per share to $10.54 per share.\textsuperscript{106} The plaintiffs then brought suit against Halbert, Testa and the Testa law firm, charging securities fraud in violation of section 10(b) and SEC rule 10b-5.\textsuperscript{107} The district court dismissed the section 10(b) claims for failure to state a cause of action upon which relief could be granted,\textsuperscript{108} relying on the \textit{Blue Chip Stamps} case.\textsuperscript{109}

The Fourth Circuit Court of Appeals determined that the plaintiffs' section 10(b) claims should be separated into three categories: 1) their claim that they were wrongfully prevented from piggybacking their stock; 2) their claim that the defendants' wrongful conduct prevented them from selling their stock for ninety days after the public offering; and 3) Gurley's claim that he sold 3,900 shares of Documation stock prior to the public offering as a result of deliberate misrepresentations by the defendants.\textsuperscript{110}

The court had no difficulty with the first and third claims, holding that the first claim was not actionable under a straightforward application of \textit{Blue Chip Stamps} since no sale of securities had taken place\textsuperscript{111} and that the third claim was actionable because the \textit{Blue Chip Stamps} purchaser or seller requirement was clearly satisfied since an actual sale had taken place in reliance on the defendants' alleged misrepresentations.\textsuperscript{112} As to the second claim, the court, although recognizing that the Sixth Cir-
cuit Court of Appeals had held “that a deferred sale is actionable under § 10(b) if the sale took place sufficiently soon after the alleged fraud to support an inference that the seller acted in reliance on the fraud,” nevertheless believed that an analysis of the policies underlying the Blue Chip Stamps decision persuaded them “that one who claims that he was fraudulently induced to delay a sale of securities must, like a nonseller, be denied standing under § 10(b).” Referring to the central concern expressed by the Supreme Court in Blue Chip Stamps to reduce the incidence of nuisance suits under section 10(b) and also to concerns about the ease with which parties could manufacture deferred sales claims sufficiently plausible to survive summary proceedings, the court believed that the deferred sales claims raised “a high risk of the kind of spurious litigation which the Blue Chip court sought to weed out.” Accordingly, the court concluded: “[W]e therefore hold that a plaintiff who claims he was fraudulently caused to delay the sale of securities lacks standing to sue under § 10(b) of the 1934 Act.”

One thing seems evident from holdings such as that reached by the court in Gurley—the admonition of the Supreme Court in Blue Chip Stamps for the lower federal courts to give “a straightforward application” to the purchaser-seller standing requirement is having its effect in reducing the earlier tendency of the federal courts to adopt a liberal and expansive attitude toward the scope and application of section 10(b) and rule 10b-5. As

113 Id. The Gurley court was referring to the decision in Marsh v. Armada Corp., 533 F.2d 978 (6th Cir. 1976), cert. denied, 430 U.S. 954 (1977).
114 674 F.2d at 257.
115 Id.
116 Id.
117 Id. The court further remarked that “[a] deferred seller’s allegations, like those of a nonseller, are likely to rest in large part on his own oral testimony” and that “[t]he timing and volume of sales he would have undertaken but for the alleged fraud are almost inevitably matters of speculation.” Id.
118 Id. While disagreeing with the district court that the plaintiffs failed to state a cause of action on their § 10(b) claims, the court agreed with the position of the district court that the statute of limitations provided by Virginia’s blue sky law should apply to the plaintiffs’ § 10(b) claims. Id. at 259.
119 This earlier tendency was no doubt encouraged by the liberal attitude adopted by the Supreme Court in Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6 (1971), in which the Court had spoken of the need to read § 10(b) “flexibly, not technically and restrictively.” Id. at 12.
the court said in Gurley: "[S]ince private rights of action under § 10(b) arise by implication rather than by express congressional directive, judicial resort to a restrictive rule of standing is appropriate to guard against abuse of the litigation process."\(^{120}\)

D. Manipulative Conduct

The effect of recent Supreme Court decisions on the attitude of lower federal courts toward the scope of section 10(b) and rule 10b-5 was further underscored by the recent decision of the Ninth Circuit Court of Appeals in Shivers v. Amerco,\(^{121}\) involving the type of conduct covered by these provisions.\(^{122}\)

The plaintiffs in Shivers were minority shareholders of Amerco, the parent company of the nationwide U-Haul businesses.\(^{123}\) The minority shareholders, who were mainly U-Haul employees, freely traded their Amerco stock among themselves at approximately 120\% to 130\% of its book value.\(^{124}\) In addition, Amerco followed a policy of repurchasing stock from shareholders upon request at book value.\(^{125}\) The plaintiffs alleged that certain individuals, named as defendants in the action, who owned some ninety-four percent of Amerco’s stock and who were also directors and officers of Amerco, determined to eliminate the informal market in Amerco stock so as to enable Amerco to acquire stock from the minority shareholders at a low price.\(^{126}\) It

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\(^{120}\) 674 F.2d at 257.

\(^{121}\) 670 F.2d 826 (9th Cir. 1982).

\(^{122}\) The Supreme Court in Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976), stressed the importance of the words "manipulative or deceptive device or contrivance" as used in § 10(b). In holding that mere negligent conduct alone is insufficient to sustain a private damage suit under § 10(b) and rule 10b-5, the Court remarked that "[t]he words 'manipulative or deceptive' used in conjunction with 'device or contrivance' strongly suggest that § 10(b) was intended to proscribe knowing or intentional misconduct." \(\text{Id.}\) at 197. Furthermore, the court held that the broader "fraud" language of rule 10b-5 could not expand the conduct proscribed by Congress in § 10(b) since rule 10b-5 was adopted by the Securities and Exchange Commission through authority granted to it under § 10(b). \(\text{Id.}\) at 212-14. The Court commented that "[t]he rulemaking power granted to an administrative agency charged with the administration of a federal statute is not the power to make law." \(\text{Id.}\) at 213.

\(^{123}\) 670 F.2d at 828.

\(^{124}\) \(\text{Id.}\)

\(^{125}\) \(\text{Id.}\)

\(^{126}\) \(\text{Id.}\)
was claimed that to accomplish this these individual defendants called a special shareholders' meeting at which they voted their stock so as to enable Amerco to declare a 100-for-1 stock split.\textsuperscript{127} Amerco then announced that in the future it would buy back the stock of minority stockholders at only fifty percent of book value.\textsuperscript{128} The plaintiffs also were denied permission to advertise stock sales in \textit{Amerco World}, Amerco's in-house newsletter.\textsuperscript{129} This conduct resulted in some of the plaintiffs selling their stock back to Amerco at substantially less than book value.\textsuperscript{130} The plaintiffs filed suit alleging, \textit{inter alia}, violations by the defendants of section 10(b) and rule 10b-5.\textsuperscript{131} The district court dismissed the federal securities claims.\textsuperscript{132}

On appeal, the plaintiffs argued that the district court erred in dismissing their rule 10b-5 claims on the ground that defendants had violated rule 10b-5 "by failing to disclose material facts in connection with plaintiffs' sale of Amerco stock, and by employing manipulative devices in connection with plaintiffs' sale of stock."\textsuperscript{133} The Ninth Circuit Court of Appeals held that the plaintiffs' federal claims had been properly dismissed since, in its opinion, none of the plaintiffs met the purchaser-seller requirement for standing under rule 10b-5.\textsuperscript{134} In addition, however, the court indicated that it doubted whether the defendants' actions

\textsuperscript{127} Id.
\textsuperscript{128} Id.
\textsuperscript{129} Id.
\textsuperscript{130} Id.
\textsuperscript{131} Id. at 828 n.1. The suit was filed in the United States District Court for the District of Oregon but later transferred to the United States District Court for the District of Arizona. Following transfer of the original complaint to the District of Arizona, an amended complaint was filed adding a claim under the blue sky laws of Washington. Originally, the plaintiffs had alleged violations of the blue sky laws of Arizona, Nevada, New York and Oregon and breach of fiduciary duties. Id.
\textsuperscript{132} Id. The district court also dismissed the state blue sky laws claims and granted defendants summary judgment on the claim based on breach of fiduciary duties. Id.
\textsuperscript{133} Id. at 829.
\textsuperscript{134} Id. The court treated the plaintiffs as in the category of shareholders who had suffered loss in the value of their investment as a result of the conduct of the defendants and thus precluded from having standing to sue under the decision of the Supreme Court in \textit{Blue Chip Stamps}. Id. The court believed this standing deficiency applied not only to those plaintiffs who still held their stock in Amerco but also to those plaintiffs who had sold their stock back to Amerco since by the time these latter defendants sold their stock the effects of any deception perpetrated by the defendants had ceased. Id. at 829-30.
in regard to the Amerco stock constituted the manipulative or deceptive conduct required to sustain a complaint under rule 10b-5 as established by the United States Supreme Court in Sante Fe Industries, Inc. v. Green.\textsuperscript{132} The court pointed to the fact that "[t]he nature of the reverse stock split and the basic facts surrounding it" had been fully revealed to the Amerco shareholders, thus eliminating the charge of deceptive conduct.\textsuperscript{138} As to the claim of manipulative conduct, the court noted that the plaintiffs had not alleged "that defendants misled investors by artificially depressing the price of Amerco stock."\textsuperscript{137}

The approach taken by the Ninth Circuit in Shivers that "plaintiffs can state a claim for manipulation only by alleging that defendants artificially affected market activity in order to mislead investors"\textsuperscript{138} is particularly significant because it reflects the position taken by the Supreme Court in Sante Fe Industries that the term "manipulation" as used in section 10(b) of the Securities Exchange Act should be treated as a word of art to refer to such practices as "wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity."\textsuperscript{139}

\section*{II. State Corporation Law}

\textbf{A. Appraisal Remedy}

One of the most difficult problems in connection with the appraisal remedy afforded minority shareholders when they dissent

\textsuperscript{132} 430 U.S. 462 (1977). In Sante Fe Industries, the Court, speaking through Justice White, remarked that "[t]he language of § 10(b) gives no indication that Congress meant to prohibit any conduct not involving manipulation or deception." \textit{Id.} at 473.

\textsuperscript{138} 670 F.2d at 829. The plaintiffs had claimed that the "disclosure" requirement involved a duty on the part of the defendants to disclose "first, that defendants' actions were part of a plan to destroy the market in Amerco stock; second, that defendants' intent was to acquire the stock at a price below its true and fair value; and third, that defendants' actions would in fact destroy the market and decrease the value of Amerco stock." \textit{Id.} This attempt by the plaintiffs to treat the defendants' failure to reveal the adverse effect of their conduct on the market for Amerco stock is reminiscent of the statement made by Judge Goettel in Goldberger v. Baker, 442 F. Supp. 659 (S.D.N.Y. 1977), that persons are not required to "'characterize' the transaction with 'pejorative' words." \textit{Id.} at 665.

\textsuperscript{137} 670 F.2d at 829.

\textsuperscript{139} Id. (citing Sante Fe Industries, Inc. v. Green, 430 U.S. at 467-77).

\textsuperscript{138} 430 U.S. at 476. For a discussion of the implications of the \textit{Sante Fe Industries}}
from certain types of corporate action has been that of valuing the dissenting shareholders’ stock. Several standards of value may be used for valuing corporate stock but in the appraisal setting the elements of market value, earnings (or investment) value and net asset value seem to predominate. All three of these elements may be used in any given appraisal proceeding and then weighed in arriving at an overall valuation. This procedure, referred to as the “Delaware block approach,” was approved recently by the Kentucky Court of Appeals in Ford v. Courier-Journal Job Printing Co.

In the Ford case, Courier-Journal Job Printing Co., a producer of lithographic and letter press materials, arranged a sale of its business to Stevens Graphics, Inc. A special shareholders’ meeting of Job Printing Company was called for the purpose of approving the sale of the company to Stevens Graphics. At this meeting, an overwhelming majority of the shareholders approved the sale. Certain minority shareholders in Job Printing Company voted against the sale and elected to avail themselves

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140 The appraisal right is a right given by modern corporation statutes to dissenting shareholders to be paid the fair value of their stock in certain cases of fundamental corporate changes. See H. Henn, Corporations § 349 (2d ed. 1970).


142 See Note, The Dissenting Shareholder’s Appraisal Remedy, 30 Okla. L. Rev. 629, 641 (1977) (contains chart showing the weights given to the elements of value used in a group of selected valuation cases).


144 739 S.W.2d 553 (Ky. Ct. App. 1982), discretionary review denied (Ky. Oct. 6, 1982). The opinion was authored by Judge Cant.

145 Id. at 553-54.

146 Id. at 554.

147 Id.

148 Id. Parties plaintiff (appellants on appeal) voted 4.9% of the company's shares against the sale, and the executors of an estate who were not parties to the appeal voted 7.9% of the outstanding stock against the sale. Id.
of the provisions of the Kentucky Business Corporation Act which permit shareholders who dissent from a sale of all or substantially all the property or assets of a corporation otherwise than in the regular course of business to demand payment of the fair value of their shares from the corporation. Job Printing Company responded with an offer of $96.70 a share for the stock, but this offer and another offer of $150.00 based on a redemption plan were rejected. Job Printing Company then filed action in Jefferson Circuit Court asking the court to determine the fair value of the shares. After the sale of certain real estate which Job Printing Company had retained, the company increased its original offer of $96.70 per share to $131.00 per share, but this offer was likewise rejected. Pursuant to the provisions of the Kentucky appraisal statute, the court then appointed two appraisers recommended by the parties. The appraisers undertook the appraisal process and arrived at a figure of $124.00 as the fair value of the stock.

The appraisers detailed in their report to the court the factors they considered in making their appraisal. These included the three elements of market value, earnings value and net asset value which the parties to the suit had agreed and which the Supreme Judicial Court of Maine has stated are the three elements to be considered in jurisdictions with statutes based on the Model Business Corporation Act. The appraisers, in arriving at

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150 639 S.W.2d at 554.
151 Id.
152 Id. See KRS § 271A.405(5).
153 639 S.W.2d at 554.
154 KRS § 271A.405(7).
155 639 S.W.2d at 554.
156 Id. at 555.
157 Id.
their ultimate figure, emphasized the net asset value of the company, which they determined to be $165.00 per share. They then applied a twenty-five percent "marketability discount" factor to arrive at the ultimate figure of $124.00 per share for the stock in recognition of, they said, the fact that Job Printing Company was not "a public company and a closely held stock is considerably less attractive to an investor than a similar stock with access to the public marketplace." The Court adopted the appraisal report, from which both an appeal and cross appeal resulted. The minority shareholders argued that they were entitled to receive the entire $165.00 per share based on the net asset approach, without the marketability discount, whereas the Job Printing Company argued that the appraisers should have used the earnings or investment approach, under which they had fixed the value of the shares at $85.00 each.

The court of appeals rejected the respective contentions of the parties as to the proper valuation approach to use and affirmed the position of the lower court. While holding that "in all appraisals or valuations of fair value of stock, pursuant to KRS 271A.405, the three elements to be considered in computation of the fair value of the shares owned by dissenting stockholders are market value, investment or earnings value, and net asset value," the court conceded that the weight to be given these component elements does not lend itself to mathematical exactness. Noting that the "marketability discount" used by the appraisers had given some weight to the market value of the stock, the court concluded that "[t]he 25 percent reduction in net asset

160 639 S.W.2d at 555.
161 Id. at 556. Speaking of the discounts for marketability applied to non-public companies, the appraisers remarked in their report that "[t]hese discounts, in general, range between 20 and 50 per cent and reflect both the nature of the public market (which was generally unreceptive to new issues at the valuation date) and the characteristics of the subject company (in this case a small regional business with no express desire to go public." Id.
162 Id.
163 Id.
164 Id.
165 Id.
166 Id.
167 Id.
value based on marketability was not an arbitrary or clearly erroneous figure."\(^\text{168}\)

In a separate portion of its opinion, the court of appeals considered an argument by the plaintiff minority shareholders that the award of eight percent interest on the appraised sum was not fair and equitable and that the approach used in Delaware of considering the rate of interest which the corporation must pay on its borrowed money should be used.\(^\text{169}\) Referring to the provisions of the Kentucky appraisal statute which provide that "[t]he judgment shall include an allowance for interest at such rate as the court may find to be fair and equitable,"\(^\text{170}\) the court stated that it was "not prepared to adopt such an approach in this case, although if it is utilized by a lower court under proper circumstances this Court might not reverse."\(^\text{171}\) The court commented that "[t]he lower court was familiar with the totality of the circumstances herein and we are not prepared to find that he abused his discretion in fixing the interest at eight per cent."\(^\text{172}\)

While the opinion of the court of appeals in Ford may not provide all the answers relating to the valuation process under the Kentucky appraisal statute, it should prove helpful in establishing guidelines as to the elements of value to be used in arriving at appropriate valuations under the statute, particularly

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\(^\text{168}\) Id. The court pointed out that "[t]he price of $124 per share herein might well have been fixed by assignment of a 57 percent figure to the net asset value and 43 percent to the market value; or the appraisers might well have assigned a 55 percent value to the net asset, 25 percent to market value, and 20 percent to investment value." Id.

\(^\text{169}\) Id. at 10-11. The appraisal provisions of the Delaware General Corporation Law provide that "[i]n making its determination with respect to interest, the Court may consider all relevant factors, including the rate of interest which the corporation has paid for money it has borrowed, if any, during the pendency of the proceeding." DEL. CODE ANN. tit. 8, § 262(h) (Cum. Supp. 1980).

The 1978 revisions of the appraisal provisions of the Model Act made the interest provision more specific by specifically defining the term "interest." See Model Act § 81(a)(4). This provision states that "'interest' means interest from the effective date of the corporate action until the date of payment, at the average rate currently paid by the corporation on its principal bank loans, or, if none, at such rate as is fair and equitable under all circumstances." Id. See generally as to the 1978 changes in the appraisal provisions of the Model Act, Conard, Amendments of Model Business Corporation Act Affecting Dissenters’ Rights (Sections 73, 74, 80 and 81), 33 BUS. LAW. 2587 (1977-78).

\(^\text{170}\) KRS § 271A.405(8).

\(^\text{171}\) 639 S.W.2d at 557.

\(^\text{172}\) Id.
since, as the court remarked, this was a case of first impression under Kentucky law.\textsuperscript{173}

\textbf{B. Stock Transfer Restrictions}

Among other recent cases of interest involving state corporation law, the decision of the Supreme Judicial Court of Massachusetts in\textit{Durkee v. Durkee-Mower, Inc.}\textsuperscript{174} illustrates the care needed in drafting stock transfer restrictions to use language that will cover all possible types of transfers.\textsuperscript{175}

The specific issue in\textit{Durkee} was whether a transfer order pursuant to a divorce decree was within charter restrictions on the transfer of stock.\textsuperscript{176} Durkee-Mower issued Allen Bruce Durkee 323 shares of Class A and Class B stock which were placed in a revocable trust for his benefit.\textsuperscript{177} The articles of incorporation of Durkee-Mower contained a provision requiring any holder of the Class A or Class B stock of the corporation, the executor or administrator of any such holder, or the grantee or assignee of any Class A or Class B shares sold on execution who desired to sell his or her Class A or Class B shares to offer such shares to the directors of the corporation.\textsuperscript{178} Patricia C. Durkee obtained a divorce decree in probate court against Bruce Durkee on grounds of "desertion."\textsuperscript{179} The divorce decree ordered that Bruce Durkee assign and deliver to Patricia Durkee 200 shares of Class A and Class B stock that Bruce Durkee owned or controlled in Durkee-Mower.\textsuperscript{180} Patricia Durkee then filed a complaint in the superior court against Bruce Durkee, Durkee-Mower and the Durkee trust to enforce the divorce decree and to require transfer of the stock to her.\textsuperscript{181} Durkee-Mower moved for summary judgment on

\textsuperscript{173} Id. at 556. For a criticism of the use of weighted averages in valuing corporate shares, see Schaefer, \textit{The Fallacy of Weighting Asset Value and Earnings Value in Appraisal of Corporate Stock}, 55 S. CAL. L. REV. 1031 (1982).

\textsuperscript{174} 428 N.E.2d 139 (Mass. 1981).

\textsuperscript{175} See 2 F. O'NEAL, \textit{CLOSE CORPORATIONS: LAW AND PRACTICE} § 7.18 (2d ed. 1971).

\textsuperscript{176} 428 N.E.2d at 141.

\textsuperscript{177} Id.

\textsuperscript{178} Id.

\textsuperscript{179} Id. at 140.

\textsuperscript{180} Id.

\textsuperscript{181} Id.
the ground that Patricia Durkee was obligated under the terms of
the stock transfer restrictions contained in the articles of incorpo-
ration of Durkee-Mower to offer to sell the stock to Durkee-
Mower before the company was obligated to transfer the shares
into her name on the corporate records.\textsuperscript{182} The superior court
judge denied the motion of Durkee-Mower,\textsuperscript{183} taking the position
"that the restrictions on stock transfer did not apply to assign-
ments by order of the Probate Court because the transfer was not
a 'sale.'"\textsuperscript{184}

The Supreme Judicial Court of Massachusetts affirmed the
trial judge's ruling.\textsuperscript{185} Commenting that restrictions on stock
transfer were enforceable in the Commonwealth of Massachu-
setts unless "'palpably unreasonable,'"\textsuperscript{186} the court nevertheless
pointed out that "the restrictive provision is inoperative as to a
particular transfer unless the restriction specifically applies to the
transfer."\textsuperscript{187} The court reasoned that the transfer restriction in
Durkee covered voluntary sales and sales upon execution but not
court-ordered assignments.\textsuperscript{188} Therefore, the court concluded,
since Durkee-Mower failed to include language in the stock
transfer restrictions that would cover "'a court-ordered assign-
ment pursuant to a judgment of divorce,'"\textsuperscript{189} it would not "expand
the clear and unambiguous language of the corporate stock re-
striction and hold it applicable to a situation not provided for
when drafted."\textsuperscript{190}

The decision of the Massachusetts court in \textit{Durkee} typifies
the judicial attitude of giving a strict construction to stock trans-
Corporations

C. Buy-Out Arrangements

Closely allied to first option restrictions such as those involved in Durkee are buy-out arrangements whereby the corporation or other shareholders in the corporation are obligated to purchase the stock of a shareholder upon the occurrence of a stipulated event or events. A recent case from the Supreme Court of Idaho, Rowland v. Rowland, illustrates the latitude courts allow parties in setting the price to be paid for transfers of stock under buy-out arrangements or first option restrictions. 

191 See 2 F. O'Neal, supra note 175, at § 7.18.
192 Taylor's Adm'r v. Taylor, 301 S.W.2d 579 (Ky. 1957).
193 Id. at 583.
194 For a criticism of the prevailing judicial attitude of giving strict construction to stock transfer restrictions, see Bradley, Stock Transfer Restrictions and Buy-Sell Agreements, U. Ill. L.F. 139, 174.
195 Buy-out arrangements differ from first-option restrictions in making definite the commitment of the corporation to purchase the shareholder's stock, whereas first-option restrictions simply provide the corporation with the first opportunity to buy the stock before it is sold or transferred to someone else. First option and buy-out arrangements are frequently combined as a means of protecting the estate of a deceased shareholder. See 2 F. O'Neal, supra note 175, at § 7.23.
197 As to setting the transfer price of shares, see 2 F. O'Neal, supra note 175, at § 7.24.
Rowland's Inc. was a closely held corporation organized in 1962 under the laws of Idaho to engage in the dairy business. V.C. Rowland and his son, Tom Rowland, together owned 70,000 shares of stock in the corporation. Ben Rowland, a brother of V.C., owned 70,000 shares of the corporation's stock and Margaret Rowland, a sister of V.C., owned 35,000 shares. At a board of directors meeting held on April 12, 1972, V.C. and his son, Tom Rowland, were displaced as officers of the corporation and thereafter ceased to participate actively in the management of the business. Subsequently, V.C. and Tom sought to force the sale of the assets of the corporation and to have the proceeds from the sale distributed to the shareholders. The other shareholders countered with an offer to purchase the stock interest of V.C. and Tom at book value. These offers were declined by V.C. and Tom, who then sought a dissolution of the corporation. The district court found no conduct which would justify a dissolution of the corporation, concluding that the only recourse available to V.C. and Tom was to have the corporation buy their stock in accordance with provisions in the corporation's bylaws, which provided that if a shareholder desired to sell his or her stock in the corporation, and a market existed for the stock, the shareholder was obligated to offer the shares of stock to the corporation upon terms equal to those offered by the third party. If there was no outside market for the sale of the stock, the shareholder could require the corporation to purchase the stock at book value. V.C. and Tom contended that this latter provision of the bylaws should be declared unenforceable on the

198 633 P.2d at 601.
199 Id.
200 Id.
201 Id. at 602.
202 Id.
203 Id.
204 Id.
205 Id. at 602-03.
206 Id. at 603.
207 Id. at 606.
208 Id. The bylaws further provided that the book value of the stock was to be the certified book value of the stock as determined at the annual meeting of the board of directors. Id. The board of directors had established the book value of the corporation's shares at their meeting of April 12, 1972, as $1.93 or $1.934 per share. Id.
ground that it would be inequitable to require them to give up their stock at book value when the book value did not reflect the true value of the corporation.\textsuperscript{209}

The Supreme Court of Idaho rejected the argument of the Rowlands,\textsuperscript{210} following the general rule, as stated in \textit{American Jurisprudence},\textsuperscript{211} that if a restriction on the alienability of stock is reasonable, it should be sustained, particularly as against shareholders who had assented to, or participated in, the adoption of the bylaws.\textsuperscript{212} Referring to the Rowlands, the court observed that, "[a]t the time the bylaws were originally adopted, appellants assented to the inclusion in the by-laws of the provision empowering Rowland's Inc. to purchase the stock at book value from a shareholder where there exists no outside market for the sale of the stock."\textsuperscript{213} The court also noted that the restriction served "the salutory [sic] purpose of giving those who own stock in the corporation the right to have control of the corporation maintained in the Rowland family."\textsuperscript{214} Accordingly, concluded the court, the bylaws were "valid and binding on the shareholders of the corporation."\textsuperscript{215}

Use of "book value" is not the only pricing formula that may be used in formulating a stock transfer restriction,\textsuperscript{216} and, as a standard, it has the possible weakness of being based on historical cost rather than current value, thus leading to potential disparity between the price and the value of the shares at the time of transfer.\textsuperscript{217} Nevertheless, as Professor Henn has pointed out, "[r]ecent cases tend both to sustain the restraint as reasonable

\textsuperscript{209} Id.
\textsuperscript{210} Id.
\textsuperscript{211} See 18 AM. JUR. 2d Corporations § 384 (1965).
\textsuperscript{212} 633 P.2d at 607.
\textsuperscript{213} Id.
\textsuperscript{214} Id.
\textsuperscript{215} Id. For a Kentucky case showing a similar freedom given parties in fixing the transfer price, see Krebs v. McDonald's Ex'x, 266 S.W.2d 87 (Ky. 1953).
\textsuperscript{216} Other pricing methods include use of a fixed dollar price (subject to periodic adjustment), a price based on capitalized earnings, or a price fixed by outside appraisers. \textit{See} W. CARY & M. EISENBERG, \textit{CASES AND MATERIALS ON CORPORATIONS} 479-81 (5th ed. unabridged 1980).
\textsuperscript{217} See generally as to the use of book value for setting the transfer price, 2 F. O'NEAL, \textit{supra} note 175, at § 7.24a.
and to enforce buy-sell agreements and options despite substantial disparity between the price and the value of the shares."  

D. Shareholder Voting  

Not infrequently, members of a closely held corporation desire to offset the effects of majority rule by including provisions in the corporate structure which give them a veto power, such as through supermajority quorum and voting requirements for shareholder and director action. While use of such requirements is now generally provided for in state corporation statutes, a recent case decided by the Supreme Court of Alabama, Roach v. Bynum, illustrates the importance of placing such requirements in the articles of incorporation rather than in the bylaws when so required by the applicable statute.

In Bynum, Roach, as the sole shareholder and director of The Legal Center, Inc., adopted new bylaws establishing seventy percent quorum and voting requirements for both shareholder and director action. At this same meeting, as Legal’s sole shareholder, Roach elected himself and James Forstman to serve as the directors. At a meeting of the board of directors of Legal which followed, Roach was elected to serve as president-treasurer and Forstman as vice president-secretary. The ownership of the corporation was realigned so that Roach and Forstman would

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219 See 1 F. O’NEAL, supra note 175, at § 4.02.  
220 Id. § 4.14. At one time use of supermajority quorum or voting requirements was called into question as violative of a state policy demanding that all corporations formed under the laws of the state have a representative form of government. See, e.g., Benintendi v. Kenton Hotel, 60 N.E.2d 829 (N.Y. 1945). The New York Court of Appeals said: “But this State has decreed that every stock corporation chartered by it must have a representative government, with voting conducted conformably to the statutes, and the power of decision lodged in certain factions, always more than half, of the stock.” Id. at 831. The effects of the Benintendi case were overcome in New York by enactment of statutory provisions specifically authorizing use of high quorum and high vote requirements. The present provisions appear in N.Y. BUS. CORP. LAW §§ 616, 709 (McKinney 1963).  
221 403 So. 2d 187 (1981).  
222 See 1 F. O’NEAL, supra note 175, at § 3.79.  
223 403 So. 2d at 188-89.  
224 Id. at 189.  
225 Id.
each own 500 shares of the Legal stock. In a separate shareholders agreement, Roach and Forstman obligated themselves to vote for each other as directors of Legal and to vote for Roach as president-treasurer and Forstman as vice president-secretary. The two men then undertook to finance the construction of an office building in which they planned to maintain their separate law offices. Before completion of the building, a special shareholders meeting was held at which Bynum, another practicing attorney, was elected to serve as a third director of Legal. Bynum was issued 500 shares of Legal stock and was elected secretary of the corporation. A shareholders agreement similar to the one previously executed by Roach and Forstman was executed by the three men, each of whom now owned a one-third interest in the enterprise. Under this new agreement, the three men were to vote for each other as directors and vote for Roach as president-treasurer, Forstman as vice president and Bynum as secretary.

Soon after the office building was completed, disagreements arose among the three men as a result of which Forstman removed his law practice from the building. At a special shareholders meeting, attended by all three, each was re-elected to the position of director, but Forstman refused to vote for Roach as president-treasurer. Due to the high vote requirements of the by-laws, this left Roach as the holdover president-treasurer. Later, at the annual meeting of Legal, Forstman nominated himself and Bynum as Legal's only directors and nominated Bynum as president-treasurer, and himself as vice president-secretary. However, these nominations failed because of the inability to secure Roach's assent, and Roach again remained the

226 Id.
227 Id. at 189-90.
228 Id. at 190.
229 Id.
230 Id.
231 Id.
232 Id.
233 Id.
234 Id.
235 Id. at 190-91.
holdover president.\textsuperscript{236} Bynum and Forstman then sued for dissolution of the corporation, and Roach counterclaimed for specific performance of the shareholder agreement.\textsuperscript{237} The trial judge found the corporation hopelessly deadlocked and ordered the corporation dissolved.\textsuperscript{238}

On appeal, the Supreme Court of Alabama reversed the order of the trial judge,\textsuperscript{239} stating that even though the circumstances appeared to indicate a director deadlock, "we think that the power to break this and any other deadlock is held by Legal's shareholders."\textsuperscript{240} The court pointed to the provisions of the Alabama Business Corporation Act in effect at the time Legal was formed,\textsuperscript{241} which authorized use of high vote requirements for shareholder action through provisions contained in the certificate of incorporation.\textsuperscript{242} From this the court concluded that "[a] provision mandating a greater than majority shareholder vote is valid only if set forth in the certificate of incorporation, and a bylaw which purports to impose the same requirement is void."\textsuperscript{243} Therefore, the court said, "the shareholders themselves hold the power to break any deadlock which may have arisen from Legal's existing bylaws."\textsuperscript{244}

Since the effect of this decision by the court in Bynum would appear to have placed the control of the corporation in Forstman and Bynum to the exclusion of Roach, the seriousness of the failure to place veto provisions in the proper corporate document is evident.\textsuperscript{245} As Professor O'Neal has observed, "[w]henever a dis-

\textsuperscript{236} Id. at 191.
\textsuperscript{237} Id.
\textsuperscript{238} Id.
\textsuperscript{239} Id. at 193.
\textsuperscript{240} Id. at 192.
\textsuperscript{242} 403 So. 2d at 193. The provision, as quoted by the court, stated that "[t]he certificate of incorporation may contain provisions requiring for any corporate act the vote of a larger proportion of the stock or any class thereof than is required by this chapter." Id. (quoting ALA. CODE § 10-2-23 (1975) (repealed 1981)). The present provisions for super-majority shareholder quorum and voting requirements are contained in ALA. CODE §§ 10-2A-52, -54 (1975, repl. vol. 1980).
\textsuperscript{243} 403 So. 2d at 193.
\textsuperscript{244} Id.
\textsuperscript{245} The provisions of the present Kentucky Business Corporation Act indicate the
tinction is made in judicial decisions on the validity of a particular clause, depending on whether it is in the charter or in the bylaws, the charter clause is usually sustained and the bylaw invalidated.” 246 Therefore, as he says, it becomes evident that “the lawyer may be wise to use the approved instrument.” 247 Otherwise, the beneficial effect of provisions designed to protect minority interests may be thwarted. 248

care with which statutory language must be read. As to shareholder action, any change in quorum requirements must appear in the articles of incorporation. See KRS § 271A.160. This same section also provides that if a quorum is present, the affirmative vote of the majority of the shares represented at the meeting is sufficient unless “the vote of a greater number ... is required by this chapter or the articles of incorporation or bylaws.” Id. (emphasis added). However, if the vote requirement is to be higher than that required for designated types of corporate action by the corporation statute, then the increased requirement must appear in the articles of incorporation. Id. § 271A.655. As to director action, increases in quorum or voting requirements may appear in either the articles of incorporation or the bylaws. Id. § 271A.200.

246 1 F. O'NEAL, supra note 175, § 3.79, at 114-15.
247 Id. § 3.79, at 115.
248 As the court observed in Bynum, “The requirement of unanimity or high quorum/vote for shareholder and director action is one of the most effective methods of protecting the interests of the minority shareholders and preventing the majority from 'squeezing out' the minority.” 403 So. 2d at 192.