Kentucky Law Survey: Corporations

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Since developments at the federal level continue to dominate corporation law, the approach taken in the present Survey will parallel that taken in previous Surveys. A group of four federal cases will be discussed first. Discussion of those cases will be followed by analysis of four state court decisions, including two cases decided by the Kentucky Court of Appeals.

The federal cases include a recent decision by the United States Supreme Court involving the scope and application of section 17(a) of the Securities Act of 1933, two decisions by the Second Circuit Court of Appeals involving actions brought under Securities and Exchange Commission (SEC) rule 10b-5, and a decision by the Fifth Circuit Court of Appeals dealing with the effect the presence of express civil liability provisions in the federal securities acts has on actions brought under SEC rule 10b-5.

Developments in corporation law at the state level begin with discussion of a decision by the Supreme Court of Delaware involving application of the business judgment rule to the dismissal of derivative actions. This will be followed by analysis of a decision by the Supreme Court of Delaware dealing with the revocability of a shareholder's demand for the appraisal remedy in a merger. The discussion will conclude with analysis of two recent decisions by the Kentucky Court of Appeals involving the consti-
tutionality of the Kentucky Take-Over Act and the presence of a registered office as a source of venue for suits against corporations in the Kentucky courts.

I. FEDERAL CORPORATION LAW

A. Stock Pledges

The federal securities acts contain a number of antifraud provisions, one of which is section 17(a) of the Securities Act of 1933. This section broadly condemns fraudulent conduct in the "offer or sale" of securities. Recently, in Rubin v. United States, the Supreme Court of the United States had an opportunity to consider whether the pledge of stock to a bank as collateral for a loan constitutes an "offer or sale" of a security within the meaning of those terms as used in section 17(a).

In the Rubin case, Rubin, after becoming vice-president of Tri-State Energy, Inc., a corporation representing itself as engaged in energy exploration and production but experiencing financial problems, assisted Tri-State in obtaining loans totaling $475,000 from Bankers Trust Co. As security for the loans, Tri-State pledged stocks represented to be worth approximately $1.7

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3 The full text of § 17(a) reads as follows:
   It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—
   (1) to employ any device, scheme, or artifice to defraud, or
   (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or
   (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.
5 For another recent Supreme Court case interpreting the scope and application of § 17(a) of the Securities Act, see United States v. Naftalin, 441 U.S. 768 (1979). In the Naftalin case, the Court upheld the conviction of Naftalin under a criminal indictment charging him with participating in a fraudulent short-selling scheme against a group of brokers in violation of § 17(a). The Court treated Naftalin's fraudulent conduct as occurring in the "offer or sale" of securities as required by that section. 441 U.S. at 773.
million but which were in fact practically worthless. Upon default by Tri-State in repaying the loans, Bankers Trust Co. sued not only Tri-State but also Rubin personally as a guarantor of the loans. The bank recovered only about $2,500, plus interest and expenses. Rubin was then indicted for violating or conspiring to violate several of the federal antifraud statutes, including section 17(a) of the Securities Act. He was convicted on the conspiracy charges in the United States District Court for the Southern District of New York. On appeal to the Court of Appeals for the Second Circuit, Rubin raised the question whether a pledge of stock as collateral for a loan could be treated as an "offer or sale" of a security under section 17(a) of the Securities Act, but the court of appeals affirmed the decision of the district court, rejecting Rubin's argument regarding the scope of section 17(a) without comment. The Supreme Court granted certiorari, limiting review to the question whether a pledge of stock can be treated as an "offer or sale" of that stock.

In an opinion written by Chief Justice Burger, the Court held that the pledges involved in the Rubin case constituted "offers" or "sales" under section 17(a). Justice Burger considered this conclusion to be consistent with the language of the Securities Act, its legislative history, and its purpose. As to the language of the Act, Justice Burger referred to the broad manner in which the terms "offer" and "sale" are defined in the Act. He noted

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7 Id. at 426. Although the stocks were represented by Rubin as being "good, markable, and unrestricted," some of the shares were issued by "shell" companies, others were "rented" or otherwise restricted, and Rubin arranged for fictitious quotations and advertisements. Id. at 426-27.
8 Id. at 427.
9 Id.
10 Id.
11 Id. at 427-28.
12 Id. at 428 n.5.
14 449 U.S. at 431.
15 Id. at 429-30. Rubin had argued that deposits of stock with a bank as collateral security for a loan could not be considered as constituting a transfer of title to the stocks at that time, and that such a transfer of title could only occur by foreclosure of the pledges after default on the loans. Id. at 429.
16 The terms "offer" and "sale" are defined by the Securities Act as follows:

   The term "sale" or "sell" shall include every contract of sale or disposi-
the reference to the term “sale” as including not only every disposition of a security but also every disposition of an “interest in a security,” and the term “offer” as including not only every offer to dispose of a security but also every offer to dispose of an “interest in a security.” From this Justice Burger reasoned that “[i]t is not essential under the terms of the Act that full title pass to a transferee for the transaction to be an ‘offer’ or a ‘sale.'” Therefore, he concluded that “[a]lthough pledges transfer less than absolute title, the interest thus transferred nonetheless is an ‘interest in a security.’”

Turning to the legislative history of the Securities Act, Justice Burger noted that Congress had taken the definition of “sale” from the Uniform Sale of Securities Act, which had been construed as embracing a pledge, and that there was no evidence that Congress did not intend the broad scope thus given to the definition of “sale.” Finally, Justice Burger indicated that he felt such an interpretation of the term “sale” comported with the purpose of the Securities Act whose “provisions were enacted to protect against fraud and promote the free flow of information in the public dissemination of securities.” As he viewed the nature of a security or interest in a security, for value. The term “offer to sell,” “offer for sale,” or “offer” shall include every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value. 15 U.S.C. § 77b(3) (1976).

17 Rubin v. United States, 449 U.S. at 429.
18 Id.
19 Id. at 430.
20 Id. at 429. To the argument made by Rubin that the implied power possessed by pledgees to dispose of stock held by them could ripen into title only upon foreclosure of the pledges, Justice Burger answered that it was enough that “[t]he pledges contemplated a self-executing procedure under a power that could, at the option of the pledgee (the bank) in the event of a default, vest absolute title and ownership.” Id.
21 See NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS, HANDBOOK AND PROCEEDINGS OF THE 39TH ANNUAL CONFERENCE 174 (1929). The Uniform Sale of Securities Act was approved for adoption in the several states by the National Conference of Commissioners on Uniform State Laws and the American Bar Association in 1929. It was an early attempt to provide a model “blue sky” statute for use by states in monitoring the sale of securities within the state. In 1956, a new Uniform Securities Act was approved by the same two groups. See 7A U.L.A. 561 (1978).
22 See Cecil B. De Mille Prods., Inc. v. Woolery, 61 F.2d 45 (9th Cir. 1932).
23 Rubin v. United States, 449 U.S. at 430.
24 Id. at 431.
of pledges, "[t]he economic considerations and realities present when a lender parts with value and accepts securities as collateral security for a loan are similar in important respect to the risk an investor undertakes when purchasing shares."25

These latter observations by Justice Burger as to the economic realities of pledges may well give the Rubin decision an importance beyond the context of section 17(a) of the Securities Act, since a similar problem has arisen in connection with the treatment of pledges as "sales" in actions brought under section 10(b) of the Securities Exchange Act of 1934,26 and SEC rule 10b-5 promulgated thereunder.27 In 1977, the Second Circuit Court of Appeals ruled, in Mallis v. Federal Deposit Insurance Corp.,28 that a pledge of stock as collateral security for a loan could be

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25 Id. In a separate opinion, Justice Blackmun, while concurring in the judgment that a pledge of stock to a bank as collateral security for a loan should be treated as an "offer or sale" under § 17(a), stated that he would reach such a conclusion more directly by treating a pledge of stock as the "disposition" of a security rather than the "disposition of an interest" in a security, as held by the majority of the Court. Id. at 432 (Blackmun, J., concurring in the judgment).

26 15 U.S.C. § 78j(b) (1976). The 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.

Id.

27 17 C.F.R. § 240.10b-5 (1981). 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.

Id.

28 568 F.2d 824 (2d Cir. 1977). For a discussion of the subsequent disposition of Mallis, see the text accompanying notes 31-33 infra.
treated as a “purchase” and “sale” within the meaning of those terms as used in the Exchange Act, remarking that “[a] pledge which occurs pursuant to a loan contract is just as concrete a transaction as is a normal transfer of title.” The Supreme Court granted certiorari in the Mallis case, but later, after oral argument, concluded that certiorari had been improvidently granted, thereby leaving the substantive issue undecided. Since the Court in Rubin seemed to accept the economic argument as to the nature of a pledge which the Second Circuit Court of Appeals voiced in Mallis, this suggests that the Court should likewise be receptive to the treatment of pledges as “sales” within the context of rule 10b-5 under the Exchange Act.

Such possible extension of the Court’s reasoning is admittedly left in some doubt by the emphasis which Justice Burger placed on the words “interest in a security” in his opinion in Rubin, since those words do not appear in the Exchange Act. There is also the further problem of the restrictive interpretations which the Supreme Court has been giving to section 10(b) and rule 10b-

29 568 F.2d at 830. But see National Bank of Commerce v. All Am. Assurance Co., 583 F.2d 1295 (5th Cir. 1978) (pledge of securities to secure a commercial bank loan is not a “purchase” of a security within the meaning of the securities laws).
30 568 F.2d at 829.
33 The change in the Court’s attitude toward certiorari resulted when plaintiff, on oral argument, urged a different theory for affirming the judgment of the court of appeals and conceded that a pledge was not a sale. Id. at 388.
34 Such an extension of the Court’s economic reasoning would appear to be strengthened not only by the Court’s citation to its opinion in the Naftalin case under the Securities Act, but also by its citation to its opinion in Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976), under the Exchange Act, which it used as support for its statement in Rubin that “[w]e frequently have observed that these provisions were enacted to protect against fraud and promote the free flow of information in the public dissemination of securities.” 449 U.S. at 431. In the Hochfelder case, the Court imposed a scienter requirement for the maintenance of private damage suits under § 10(b) of the Exchange Act and rule 10b-5.
35 The difficulty thus posed of adapting the reasoning of the Court to the Exchange Act could be eliminated by emphasizing the language “disposition of a security” used in the definition of “sale” in the Exchange Act rather than “disposition of an interest in a security,” as Justice Blackmun did in his concurring opinion in Rubin. See note 25 supra for a discussion of Justice Blackmun’s concurring opinion in Rubin.
5 since its decision in *Blue Chip Stamps v. Manor Drug Stores*, where it had spoken of “a straightforward application” of the requirement that, for plaintiffs to have standing to bring civil actions for damages under section 10(b) and rule 10b-5, such plaintiffs must be purchasers or sellers of a security. The *Rubin* case, of course, was a criminal action and not a civil action for damages.

B. Reliance

Despite the restrictive interpretations given to section 10(b) and rule 10b-5 by the Supreme Court, litigation under these provisions in the lower federal courts continues unabated. In a recent case considered by the Court of Appeals for the Second Circuit, *Panzirer v. Wolf*, the court had occasion to look once again at the proper role of “reliance” as a factor in private damage suits under rule 10b-5.

In *Panzirer*, the plaintiff, Zelda Panzirer, had purchased stock in Allied Artists Industries, Inc., after having read a favorable article on Allied which had appeared in the “Heard on the Street” column of *The Wall Street Journal*. Plaintiff had first

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37 421 U.S. at 755.

38 This may also explain the liberal attitude taken by the Court in *Naftalin*, which involved a criminal prosecution under § 17(a) of the Securities Act. United States v. Naftalin, 441 U.S. 768. One commentator has suggested that “[t]he primary significance of the ruling in *Rubin* would appear to be the Court's refusal to take a narrow view of the scope of coverage of the securities acts,” and that “[a]s was the case in *Naftalin*, the Court is willing to continue the vitality, and perhaps even the expansion, of the antifraud remedies, at least when applied in the appropriate context.” Hazen, *Symposium Introduction—The Supreme Court and the Securities Laws: Has the Pendulum Slowed?*, 30 Emory L.J. 5, 21 (1981).

39 It has been pointed out that “even in its most recent limiting decisions, the [Supreme] Court bypassed the opportunities to foreclose the expansive readings that have flourished in the circuit courts and that seem certain to continue.” Hazen, *supra* note 38, at 34.


41 For an earlier decision in which the Second Circuit Court of Appeals had occasion to consider the element of “reliance” in the context of impersonal market transactions, see Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 495 F.2d 228 (2d Cir. 1974).

42 663 F.2d at 366. The column, which in that particular day's issue of *The Wall
contacted her broker, Michael Blum, at the local office of the E.F. Hutton brokerage firm to ascertain whether there was any negative news about Allied. Blum, relying on a tear sheet from Standard & Poor, had reported no negative news. Standard & Poor's tear sheet had abstracted information from Allied's annual report, which "allegedly contained numerous misrepresentations and omissions." Although plaintiff admitted she had never seen the annual report and could not therefore have relied directly on the misrepresentations and omissions contained in the report, she claimed that the report had affected the market in Allied stock and that she had relied indirectly on the report through her reliance on the integrity of the market. When Allied filed a petition in bankruptcy, plaintiff sued Allied officers and Allied's accountant, Price Waterhouse & Co., in the United States District Court for the Southern District of New York under section 10(b) and rule 10b-5. The district court granted summary judgment against plaintiff, reasoning that plaintiff had relied primarily on the Wall Street Journal article in making her purchases and only secondarily on the integrity of the market, and finding that secondary reliance was insufficient to support a rule 10b-5 claim.

The Second Circuit Court of Appeals reversed the decision of the district court, stating that it could not find any support in

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Street Journal covered the video cassette market, had stated that several analysts were of the opinion that Allied was in a good position to take advantage of the growing video tapes market. Id.

43 Id.

44 Id.

45 Id. The principal misrepresentation related to a report of profits for the previous fiscal year. In fact, Allied had to split certain receipts from a film it had made, Allied had actually lost money during the fiscal year. The principal omission related to a failure of the annual report to reveal a qualification by Allied's accountants, Price Waterhouse & Co., to their certification of Allied's financial statements that they doubted Allied's ability to function as a going concern. Id.

46 Id. at 367. Plaintiff argued that "if Allied's report had been accurate, the stock analysts interviewed by the Journal would not have mentioned the company favorably, the Journal would not have devoted two paragraphs to Allied's prospects in the video cassette market, and plaintiff would not have been led by the article to buy her stock." Id.

47 Id. at 366.

48 Id. at 367.

49 Id. The district court also denied a request by plaintiff that she be allowed to represent the class of investors who purchased Allied stock after release of the annual report. Id. at 366.

50 Id. at 366.
the law for drawing a distinction between primary and secondary reliance.\textsuperscript{51} As viewed by the court of appeals, the reliance requirement in rule 10b-5 cases is a means of confirming that the plaintiff’s injury was “caused” by the alleged fraud,\textsuperscript{52} but, as the court noted, “[p]roving reliance is necessarily difficult where the fraud has affected the market and damaged the plaintiff only through its effect on the market.”\textsuperscript{53} Pointing out that the Second Circuit,\textsuperscript{54} as well as other circuits,\textsuperscript{55} had dispensed with the requirement of direct reliance where investors had relied on the integrity of the market price of stocks,\textsuperscript{56} the court reasoned that the same position was justified in cases such as the one before it in which the plaintiff, while not relying on the integrity of the market price, did rely on the integrity of the market as reported in The Wall Street Journal.\textsuperscript{57} As the court remarked, “[j]ust as a material misrepresentation or omission is presumed to affect the price of the stock, so it should be presumed to affect the information ‘heard on the street’ which led Zelda Panzirer to make her losing investment.”\textsuperscript{58} Therefore, the court concluded, “[p]laintiff has on this record stated a sufficient connection between her loss and the allegedly fraudulent annual report to withstand a motion for summary judgment.”\textsuperscript{59}

In extending the “presumption of reliance” approach to cases involving “secondary reliance,” where a requirement of direct proof of reliance would impose a difficult evidentiary burden on plaintiffs,\textsuperscript{60} the Second Circuit Court of Appeals would appear to

\textsuperscript{51} Id. at 367. The court, however, affirmed the denial of class certification, stating that the district court had acted well within its discretion in concluding that plaintiff lacked sufficient credibility to be a fit class representative in view of her conflicting versions of her conversation with her broker. Id. at 368.

\textsuperscript{52} Id. at 367. For a discussion of the concept of causation in rule 10b-5 litigation and the role reliance plays in establishing causation, see Crane, An Analysis of Causation Under Rule 10b-5, 9 SEC. REG. L.J. 99 (1981).

\textsuperscript{53} 663 F.2d at 368.

\textsuperscript{54} See Ross v. A.H. Robins Co., 607 F.2d 545, 553 (2d Cir. 1979), cert. denied, 446 U.S. 946 (1980).

\textsuperscript{55} See Blackie v. Barrack, 524 F.2d 891, 906-07 (9th Cir. 1975), cert. denied, 429 U.S. 816 (1976).

\textsuperscript{56} 663 F.2d at 368.

\textsuperscript{57} Id.

\textsuperscript{58} Id.

\textsuperscript{59} Id. at 367.

\textsuperscript{60} In this regard, see the comments by the Ninth Circuit Court of Appeals in Blackie
have reached a result consistent with the reasoning of the Supreme Court in its decision in Affiliated Ute Citizens v. United States.\textsuperscript{61} In Affiliated Ute, the Court adopted a presumption of reliance approach to establishing proof of "transaction" causation in cases involving failure to disclose material information.\textsuperscript{62}

C. Insider Trading

As last year's Survey pointed out, one of the most significant recent decisions handed down by the Supreme Court under the securities laws was Chiarella v. United States,\textsuperscript{63} in which the Court rejected the position that trading on nonpublic market information could constitute a violation of section 10(b) and rule 10b-5.\textsuperscript{64} The fallout from this decision is now beginning to be felt as evidenced by the recent decision of the Second Circuit Court of Appeals in United States v. Newman.\textsuperscript{65} In the Newman case,
the court was called upon to determine whether a criminal indictment charging employees of an investment banking firm and a securities trader with misappropriation of confidential takeover information could be sustained in view of the Chiarella decision.\textsuperscript{66}

The indictment in \textit{Newman} charged that two individuals, Courtois and Antoniu, employees of the investment banking firms of Morgan Stanley \& Co. and Kuhn Loeb \& Co.,\textsuperscript{67} during a period between January 1, 1973 and December 31, 1978, had misappropriated confidential information concerning proposed mergers and acquisitions entrusted to their employers and had surreptitiously conveyed this information to Newman, a securities trader, who, with two confederates, purchased stock in companies targeted for takeover.\textsuperscript{68} It was charged that they all had then shared in the profits reaped when the market price of the stocks in the target companies rose after the mergers or takeovers were announced.\textsuperscript{69}

The facts in \textit{Newman} paralleled closely those in \textit{Chiarella}, where Chiarella, a mark-up man in a printing establishment, after deciphering the names of acquiring and target companies in takeover bids from copy submitted by clients to his employer for printing, purchased stock in the target companies before final printing and then, after the takeover bids were publicly announced, sold the stock at a profit.\textsuperscript{70} In \textit{Newman}, however, the Government framed its indictment on a different theory than

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\textsuperscript{66} The United States District Court for the Southern District of New York did not believe the indictment could be sustained against Newman under \textit{Chiarella}, stating:

In the case at bar, it could not be alleged that Newman was a corporate insider acting on inside information. Rather, he was a peripheral figure, privy by virtue of the conspiracy to "market information"—that is to say, "information about events or circumstances which affect the market for a company's securities but which do not affect the company's assets or earning power," and which emanates from sources other than that company.


\textsuperscript{67} The two investment banking firms involved in the alleged conspiracy, Morgan Stanley \& Co. and Kuhn Loeb \& Co., have since joined to become Lehman Brothers Kuhn Loeb, Inc. 664 F.2d at 15.

\textsuperscript{68} \textit{Id.}

\textsuperscript{69} \textit{Id.}

\textsuperscript{70} \textit{Chiarella v. United States}, 445 U.S. at 224.
that which it had used in Chiarella in an effort to avoid the deficiency which led to the reversal of Chiarella's conviction. The indictment against Chiarella had been framed on the theory that Chiarella had violated section 10(b) and rule 10b-5 by failing to disclose material, nonpublic market information to the purchasers from whom he purchased stock. The Supreme Court rejected this theory of insider trading as too broad and adopted the position that actionable fraud based on nondisclosure under section 10(b) exists only where there is "a duty to disclose arising from a relationship of trust and confidence between parties to a transaction," a relationship which it did not find to exist in the Chiarella case.

In his opinion written for a majority of the Court in Chiarella, Justice Powell referred to an alternative theory which had been offered by the Government to support Chiarella's conviction: the argument that Chiarella had committed actionable fraud under section 10(b) by breaching a duty owed to the acquiring corporations not to misuse confidential information submitted by those corporations to his employer. Justice Powell refused to consider the merits of this approach in Chiarella because the jury had not been instructed on such a theory. In Newman, the Government framed the indictment on this basis, charging that Courtois and Antoniu had breached the trust and confidence placed in them by their employers and their employers' employers.

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72 445 U.S. at 225.
73 Id. at 230.
74 Speaking of the need for the existence of a "duty to disclose" and applying it to Chiarella, who had petitioned the Court from his conviction in the lower federal courts, the Court remarked:

No duty could arise from petitioner's relationship with the sellers of the target company's securities, for petitioner had no prior dealings with them. He was not their agent, he was not a fiduciary, he was not a person in whom the sellers had placed their trust and confidence. He was, in fact, a complete stranger who dealt with the sellers only through impersonal market transactions.

Id. at 232-33.
75 Id. at 235-36.
76 Id. In refusing to consider the Government's alternative theory, Justice Powell said: "[W]e will not speculate upon whether such a duty exists, whether it has been breached, or whether such a breach constitutes a violation of § 10(b)." Id. at 236-37.
clients and charging Newman, along with his confederates, with facilitating Courtois and Antoniu in violating those fiduciary duties. Justice Stevens, concurring in *Chiarella*, recognized the possible merits of such a theory, but pointed out the additional barrier to recognition of the theory resulting from the purchaser-seller standing requirement imposed on plaintiffs in section 10(b) suits by the Supreme Court in the *Blue Chip Stamps* case. As he noted, if the employer's clients would not be able to recover damages for violations of rule 10b-5 because they were neither purchasers nor sellers of the target company securities, then it could be argued that there was no actionable violation of rule 10b-5.

Referring to the differences between a criminal action under section 10(b) and rule 10b-5 and a private civil suit, the Second Circuit Court of Appeals in *Newman* considered that the alleged conduct "could be found to constitute a criminal violation of section 10(b) and Rule 10b-5 despite the fact that neither Morgan Stanley, Kuhn Loeb nor their clients was at the time a purchaser or seller of the target company securities in any transaction with any of the defendants." In the court's view, the standing requirement is irrelevant to criminal suits under rule 10b-5, and thus the real issue becomes whether the alleged fraudulent conduct can be said to have occurred "in connection with" the purchase or sale of securities as required by the section and the rule.

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77 United States v. Newman, 664 F.2d at 15-16. The indictment named Newman, Courtois, and the confederates of Newman as defendants, but only Newman was within the jurisdiction of the district court. The other alleged co-conspirator, Antoniu, was not indicted. *Id.* at 15.

78 *Chiarella v. United States*, 445 U.S. at 238 (Stevens, J., concurring).

79 *Id.*

80 As the court pointed out, the purchaser-seller standing requirement is a judicial creation designed to place boundaries on the scope of implied civil suits for damages under § 10(b) and is not relevant to governmental actions brought either under § 21 of the Exchange Act, which empowers the SEC to bring injunctive suits, or § 32 of the Exchange Act, which provides criminal penalties for willful violations of the Act or the rules promulgated thereunder. United States v. Newman, 664 F.2d at 17.

81 *Id.* at 16.

82 *Id.* at 18. The court remarked:

Rule 10b-5 makes it unlawful for any person to engage in any act or practice which operates as a fraud or deceit upon any person "in connection with the purchase or sale of any security." When litigation under this Rule is instituted by the SEC under section 21 or by a United States Attorney under
Using the flexible test adopted by the Supreme Court in *Superintendent of Insurance v. Bankers Life & Casualty Co.*, in which the Court construed the phrase "in connection with" as including practices "touching" the sale of securities, the Second Circuit Court of Appeals had little difficulty finding the necessary "connection" between the misappropriation of the confidential information and the purchase of the shares of stock by the defendants in *Newman*.

While it remains to be seen whether the Supreme Court will accept the reasoning of the Second Circuit Court of Appeals as to criminal actions involving insider trading under section 10(b) and rule 10b-5, the *Newman* decision should, in the meantime, lend encouragement to the continuing efforts of the Securities and Exchange Commission to police the evils of insider trading. At least, as one commentator put it, "[r]ecognition of the correct reasons for restricting the rule 10b-5 insider trading prohibition as well as current SEC efforts to enforce the rule may prompt the reevaluation necessary to produce a more efficient and just approach to the insider trading problem."
D. Civil Liability

A problem under the federal securities laws which has plagued the lower federal courts for many years has been whether to recognize an implied private cause of action for fraudulent conduct under section 10(b) and rule 10b-5 when an express civil remedy is available under other provisions of the securities laws for the conduct involved. This issue surfaced recently in the Fifth Circuit case of *Huddleston v. Herman & MacLean*, involving alleged misrepresentations contained in a prospectus.

In that case, Texas International Speedway, Inc. filed a registration statement and prospectus with the Securities and Exchange Commission for the sale of $4,398,800 of securities, the proceeds to be used to construct an automobile racetrack. Although the company was successful in selling the entire offering, a year later the company had filed a petition for bankruptcy. Subsequently, purchasers of the company's securities filed a class action under section 10(b) and rule 10b-5, alleging that the prospectus contained misleading statements. Damages were sought from the former president of the company, who was also the treasurer as well as a director of the company; from the former executive vice-president of the company, who was also a director of the company; and from the accountants for the company who had participated in preparation of the prospectus. The trial judge submitted the case to the jury on the issue whether the prospectus was materially misleading and, if so,

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89 640 F.2d 534 (5th Cir. 1981).
90 Section 5 of the Securities Act of 1933 prohibits the public sale and distribution of securities through the mails or channels of interstate commerce unless a registration statement has been filed with the SEC as to such securities and a prospectus furnished to the purchasers of the securities at or before the sale or distribution. 15 U.S.C. § 77e (1976).
91 Huddleston v. Herman & MacLean, 640 F.2d at 539.
92 Id.
93 Id.
94 Id.
95 Id.
whether scienter was present.96 The jury found the prospectus misleading and the defendants were found to have acted "with recklessness for the truth."97 The trial judge entered judgment for plaintiffs after he determined the amount of the damages.98

The threshold question considered by the Fifth Circuit Court of Appeals was whether the plaintiffs were entitled to the benefit of an implied private cause of action under section 10(b) and rule 10b-5 when the alleged misrepresentations in the prospectus would have justified a suit under sections 1199 and 12(2) of the Securities Act of 1933.100 The court acknowledged that prior to the recent Supreme Court decisions restricting the scope of the Securities Acts, there appeared to have been general agreement among commentators and the lower federal courts that rule 10b-5 actions were not necessarily precluded by the express civil liability provisions of the 1933 and 1934 Acts.101 However, as the court remarked, "recent Supreme Court decisions curtailing the broader sweep given the Securities Acts by lower federal courts . . . give substance to the argument that no remedy should be implied for actions covered by the express liability provisions of the statutes."102 Noting, however, the fact that two circuit courts had recently addressed the question and had held that a cause of action could be implied in section 10(b) and rule 10b-5 despite the possibility of overlap with express remedies provided by other sections of the securities laws,103 the court concluded

96 Id.
97 Id.
98 Id. at 540.
99 Section 11 provides that a private civil action for damages may be brought by any person who acquired a security for which a registration statement had been filed containing material omissions or misstatements. 15 U.S.C. § 77k (1976).
100 Section 12(2) makes any person who offers or sells a security by means of a prospectus or oral communication which includes any material omission or misstatement liable to the person purchasing such security from him provided the purchaser was unaware of such misstatements or omissions and provided the person offering or selling the security fails to sustain the burden of proof that he did not know and in the exercise of reasonable care could not have known of the misstatements or omissions. 15 U.S.C. § 77(0)(2) (1976).
101 Huddleston v. Herman & MacLean, 640 F.2d at 542 n.7.
102 Id. at 541-42.
103 Id. at 542. See Wachovia Bank & Trust Co. v. National Student Marketing Corp., 650 F.2d 342 (D.C. Cir. 1980); Ross v. A.H. Robins Co., 607 F.2d 545.
that the plaintiffs in *Huddleston* should be permitted to maintain a suit under section 10(b) and rule 10b-5 "even if the deceit that is the basis for the Section 10(b) action may also be actionable under other express liability provisions of the securities law."\[^{104}\]

This decision, coupled with the other recent decisions referred to by the court, would suggest that the longstanding assumption that implied causes of action under section 10(b) and rule 10b-5 are not necessarily affected by the presence of overlapping express civil liability provisions in the securities laws will remain unimpaired absent a contrary determination by the Supreme Court.\[^{105}\] Nevertheless, it appears the lower federal courts will need to proceed with some degree of caution in recognizing implied rights of action under the federal securities laws in view of expressions by the Supreme Court in its recent opinions that extensions of the implied remedy must not be allowed to nullify the carefully drawn restrictions on express actions imposed by Congress.\[^{106}\] As one commentator has indicated, "even when an

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\[^{104}\] 640 F.2d at 543.

\[^{105}\] It is significant that in the first case which the Supreme Court considered involving rule 10b-5, SEC v. National Securities, Inc., 393 U.S. 453 (1969), the Court recognized the overlapping nature of the various provisions in the federal securities laws. In that case, the SEC charged National Securities, Inc. with violation of § 10(b) and rule 10b-5 in having solicited shareholder approval of a merger through misleading proxy material. National Securities, Inc. contended that rule 10b-5 should not be considered applicable to misrepresentations in connection with the solicitation of proxies. To this argument the Court replied:

> Respondents' alternative argument that Rule 10b-5 does not cover misrepresentations which occur in connection with proxy solicitations can be dismissed rather quickly. . . . [T]he existence or nonexistence of regulation under § 14 would not affect the scope of § 10(b) and Rule 10b-5. The two sections of the Act apply to different sets of situations. Section 10(b) applies to all proscribed conduct in connection with a purchase or sale of any security; § 14 applies to all proxy solicitations, whether or not in connection with a purchase or sale. The fact that there may well be some overlap is neither unusual nor unfortunate.

393 U.S. at 468.

\[^{106}\] See, e.g., Ernst & Ernst v. Hochfelder, 425 U.S. at 210. In Touche Ross & Co. v. Redington, 442 U.S. 560 (1979), the Supreme Court, in holding that § 17(a) of the Exchange Act (which imposes certain record-keeping requirements on broker-dealers) did not create a private cause of action in view of the presence of an express civil liability provision in § 18(a) of the Exchange Act, commented that "we are extremely reluctant to imply a cause of action in § 17(a) that is significantly broader than the remedy that Congress chose to provide." Id. at 574.
implied private action is deemed necessary to effectuate the legislative purpose, courts must first consider the impact the implied action will have upon those rights of action expressly included in the statutory scheme,"\textsuperscript{107} because "[a]n important aspect of this recent restrictive attitude is the Court's policy that implied actions must be harmonized with those causes of action expressly provided by the federal act."\textsuperscript{108}

II. STATE CORPORATION LAW

A. Business Judgment Rule

Perhaps the state court case which has attracted the most attention recently is Zapata Corp. \textit{v.} Maldonado,\textsuperscript{109} involving application of the business judgment rule to the dismissal of shareholder derivative suits.\textsuperscript{110} The importance of state law in this area was underscored by the decision of the Supreme Court of the United States in \textit{Burks v. Lasker}. In that case, a group of disinterested directors of an investment company determined that a shareholders' derivative suit brought against other directors of the company for violations of federal law should be dismissed in the best interest of the shareholders of the company.\textsuperscript{111} The Supreme Court held that the action of the disinterested directors should be sustained if the governing state law permitted disinter-

\textsuperscript{107} Comment, \textit{supra} note 88, at 928-29.

\textsuperscript{108} \textit{Id.} at 928.

\textsuperscript{109} 430 A.2d 779 (Del. 1981).

\textsuperscript{110} The "business judgment rule" is a judicial creation designed to insulate directors and officers from liability for losses resulting from mere errors of judgment as distinguished from negligence in the performance of their duties. \textit{See} H. Henn, \textit{Law of Corporations} \textit{§} 242 (2d ed. 1970). The rule has its origins in the provisions of state corporation statutes that place management of corporate affairs in a board of directors. \textit{See}, \textit{e.g.}, Ky. REV. STAT. ANN. \textit{§} 271A.175 (Bobbs-Merrill 1981) [hereinafter cited as KRS]. Referring to \textit{§} 141(a) of the Delaware General Corporation Law, which states that the business and affairs of a corporation shall be managed by or under the direction of a board of directors, the Delaware Supreme Court, in \textit{Maldonado}, remarked that "[t]he judicial creation and legislative grant are related because the 'business judgment' rule evolved to give recognition and deference to directors' business expertise when exercising their managerial power under \textit{§} 141(a)." 430 A.2d at 782.

\textsuperscript{111} 441 U.S. 471 (1979).

\textsuperscript{112} The directors of the investment company, along with its investment adviser, were charged with having violated their fiduciary duties under the Investment Company Act and the Investment Advisers Act. \textit{Id.} at 473 n.3.
ested directors to terminate derivative suits and if the state rule did not infringe on the policies of federal law. Thus, under Burks, even in cases involving federal statutes, the primacy of state law controls initially in arriving at the determination of the power of corporate directors to monitor shareholder litigation.

In Maldonado, William Maldonado, a shareholder of Zapata Corporation, brought a derivative action in the Court of Chancery of Delaware on behalf of Zapata against its officers and directors charging breaches of fiduciary duty. Later, the board of directors of Zapata created a special investigation committee, composed solely of two newly appointed independent outside directors, to investigate whether the chancery action and two other similar derivative actions should be continued. The committee determined that all the actions should be dismissed as not being in the best interests of the company. The company thereupon moved for dismissal or summary judgment in the three derivative

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113 Id. at 480.

114 Following the decision in Burks, and prior to the advent of the Maldonado litigation, there had been a strong tendency in the lower federal courts to assume Delaware law would apply the "business judgment rule" to derivative suits. See, e.g., Abbey v. Control Data Corp., 603 F.2d 724 (8th Cir. 1979), cert. denied, 444 U.S. 1017 (1980).

115 Maldonado did not make any appeal to the board of directors of Zapata to bring the suit, as required by Court of Chancery Rule 23.1 in Delaware, contending that such a demand would have been futile since the directors as defendants allegedly participated in the wrongdoing. 430 A.2d at 779. Court of Chancery Rule 23.1 states, in part, as to complaints filed in derivative suits: "The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action he desires from the directors or comparable authority and the reasons for his failure to obtain the action or for not making the effort." Del. Ch. Ct. R. 23.1. For a similar provision in the Kentucky Business Corporation Act, see KRS § 271A.245 (1981).

116 One such action was brought by Maldonado in the United States District Court for the Southern District of New York alleging claims under the federal securities laws as well as the common law claims made in the previous court of chancery action in Delaware. See Zapata Corp. v. Maldonado, 430 A.2d at 780. The federal district court granted a motion by Zapata for summary judgment. Maldonado v. Flynn, 485 F. Supp. 274 (S.D.N.Y. 1980). That decision was appealed to the Second Circuit Court of Appeals. However, after the Supreme Court of Delaware accepted an appeal from the decision of the Delaware Court of Chancery in the original Maldonado action dismissing Maldonado's suit, the Second Circuit appeal was stayed pending resolution of the appeal in the Delaware action. See 430 A.2d at 781. In the meantime, a third action had been brought in the United States District Court for the Southern District of Texas, where the court had denied a motion by Zapata either to dismiss or to grant summary judgment. Maher v. Zapata Corp., 490 F. Supp. 348 (S.D. Tex. 1980).

117 Zapata Corp. v. Maldonado, 430 A.2d at 781.
actions. The court of chancery denied Zapata's motions, taking the position that the business judgment rule does not extend to the dismissal of derivative actions. The court referred to the business judgment rule as a defensive rule designed to protect directors in the exercise of their managerial decisions, not a weapon to be used affirmatively to permit directors to compel dismissal of derivative suits brought as a matter of right by shareholders to rectify alleged wrongs done to the corporation and its shareholders after refusal of the directors to bring suit.

In contrast with the decision reached by the Delaware Court of Chancery in Maldonado, the Court of Appeals of New York, just a year previously, had held in Auerbach v. Bennett that the

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118 Id.
119 Maldonado v. Flynn, 413 A.2d 1251 (Del. Ch. 1980). Later, however, the court of chancery dismissed Maldonado's cause of action on principles of res judicata resulting from the decision of the New York federal district court in Maldonado v. Flynn, 485 F. Supp. 274, but conditioned that disposition on the Second Circuit Court of Appeals affirming the district court decision. Maldonado v. Flynn, 417 A.2d 378 (Del. Ch. 1980). This left Maldonado in a stalemate unless the Supreme Court of Delaware acted on the appeal which it had accepted in the original Maldonado action, inducing the Supreme Court of Delaware to remark in the Maldonado case: "Thus, Zapata's observation that it sits 'in a procedural gridlock' appears quite accurate, and we agree that this Court can and should attempt to resolve the particular question of Delaware law." Zapata Corp. v. Maldonado, 430 A.2d at 781.
120 413 A.2d at 1257. The court said:
Under settled Delaware law the directors do not have the right to compel the dismissal of a derivative suit brought by a stockholder to rectify an apparent breach of fiduciary duty by the directors to the corporation and its stockholders after the directors have refused to institute legal proceedings, because the stockholder then possesses an independent right to redress the wrong.
Id. at 1262.
121 Id. at 1256. The court remarked as to the business judgment rule:
It provides a shield with which directors may oppose stockholders' attacks on the decisions made by them; but nothing in it grants any independent power to a corporate board of directors to terminate a derivative suit. The authority to terminate a derivative suit must be found—if at all—outside the rule.
Id. at 1257.
122 Id. at 1262. The court added:
Under our system of law, courts and not litigants should decide the merits of litigation. Aggrieved stockholders of Delaware corporations ought to be able to expect that an impartial tribunal, and not a committee, appointed by the alleged wrongdoers, will decide whether a stockholder's derivative suit alleging breach of fiduciary duty has any merit.
Id. at 1263.
business judgment rule applied to the dismissal of a derivative suit at the direction of a special litigation committee of the board of directors provided the members of the committee making the decision were found to be truly disinterested and independent. 124 The Supreme Court of Delaware in *Maldonado*, while agreeing with the general theory that the business judgment of independent directors as to the termination of derivative litigation rightfully brought by shareholders should be given weight, nevertheless expressed concern at an unfettered application of the business judgment rule to the derivative litigation cases. 125 What is needed, reasoned the court, is "a balancing point where bona fide stockholder power to bring corporate causes of action cannot be unfairly trampled on by the board of directors, but the corporation can rid itself of detrimental litigation." 126

To achieve this balanced approach, the court recommended that a two-step test be used 127 and remanded the case to the court of chancery for further proceedings consistent with such an approach. 128 First, the supreme court said, the court of chancery...
should inquire into the independence and good faith of the board committee and should analyze the basis used by the committee in reaching its conclusion to order dismissal of the derivative suit.\textsuperscript{129} Then, as a second step, the court of chancery should apply its own independent business judgment to whether the corporation's best interests are being served by having the suit dismissed.\textsuperscript{130} This second step, according to the supreme court, would be designed to "thwart instances where corporate actions meet the criteria of step one, but the result does not appear to satisfy its spirit, or where corporate actions would simply prematurely terminate a stockholder grievance deserving of further consideration in the corporation's interest."\textsuperscript{131}

The merits of this compromise position adopted by the Supreme Court of Delaware in \textit{Maldonado}—a compromise between outright rejection of the business judgment rule in derivative litigation and its absolute application to such litigation—will no doubt be questioned by some as undesirable or unrealistic insofar as it allows the business judgment of a court to override the business judgment of the board of directors.\textsuperscript{132} Nevertheless, if followed, it should serve to alleviate some of the concern expressed after the \textit{Burks} case that the \textit{Burks} decision would consti-

\begin{enumerate}
\item Id. at 788-789.
\item Id. at 789.
\item Id. To this statement the court added: "The Court of Chancery of course must carefully consider and weigh how compelling the corporate interest in dismissal is when faced with a non-frivolous lawsuit. The Court of Chancery should, when appropriate, give special consideration to matters of law and public policy in addition to the corporation's best interests." Id.
\item Compare, for example, the observations made by the New York Court of Appeals in \textit{Auerbach}:

\begin{quote}
It appears to us that the business judgment doctrine, at least in part, is grounded in the prudent recognition that courts are ill equipped and infrequently called on to evaluate what are and must be essentially business judgments. The authority and responsibilities vested in corporate directors both by statute and decisional law proceed on the assumption that inescapably there can be no available objective standard by which the correctness of every corporate decision may be measured, by the courts or otherwise. Even if that were not the case, by definition the responsibility for business judgments must rest with the corporate directors; their individual capabilities and experience peculiarly qualify them for the discharge of that responsibility. Thus, absent evidence of bad faith or fraud (of which there is none here) the courts must and properly should respect their determinations.

\textit{Auerbach} v. \textit{Bennett}, 393 N.E.2d at 1000.
\end{quote}
\end{enumerate}
stitute an "instrument of death" for shareholders' derivative actions. As has been perceptively observed, "the Zapata decision ushers in a new era in the eternal warfare between the corporation and the derivative plaintiff," and "[t]he only safe conclusion is that the next few years will witness decisive developments in the field of derivative actions."

B. Appraisal Remedy

Another recent case of interest decided by the Supreme Court of Delaware was Dofflemyer v. W.F. Hall Printing Co., involving the right of dissenting shareholders in a corporate merger to withdraw their demand for appraisal of their stock. Robert and Josephine Dofflemyer were owners of 700 shares of common stock in W.F. Hall Printing Co., which was merged into Mobil-Hall Corporation. Under the terms of the merger, the Hall common stockholders were to be paid $27.50 in cash for each share of Hall stock. The Dofflemyers objected to the merger and filed a petition in the Court of Chancery of Delaware for appraisal of their stock pursuant to the provisions of the Delaware appraisal statute.

Subsequently, the Dofflemyers filed another action in the Delaware Court of Chancery seeking to have the merger set aside.

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135 Id.
137 The appraisal remedy is a right given to dissenting shareholders in certain types of fundamental corporate changes to have the corporation pay them the fair cash value of their stock. See H. HENN, supra note 110, at § 349. For applicable Kentucky statutory provisions, see KRS §§ 271A.400-.405 (1981).
138 432 A.2d at 1199.
139 Id.
on the ground that the merger was fraudulent and unlawful.\textsuperscript{141} They then on three separate occasions sought by motion to have the court stay the appraisal proceeding pending a determination of their rights in the merger action, but these motions were denied.\textsuperscript{142} Just prior to the hearing date set for the appraisal proceeding, the Dofflemyers filed a motion to dismiss the appraisal action, alleging that their primary desire was to pursue the merger action.\textsuperscript{143} The court denied the Dofflemyers' motion to dismiss.\textsuperscript{144} The Dofflemyers appealed the denial of their motion.\textsuperscript{145}

The Supreme Court of Delaware affirmed the decision of the court of chancery, holding that the Dofflemyers' election to demand appraisal was irrevocable under the Delaware appraisal statute absent the consent of the corporation.\textsuperscript{146} The supreme court pointed out that, under the Delaware appraisal statute, once a dissenting shareholder has demanded appraisal he loses the incidents of stock ownership and can regain those incidents only by adhering strictly to the conditions prescribed by the appraisal statute.\textsuperscript{147} Under the provisions of the Delaware statute, a shareholder is given the right to withdraw his demand for appraisal if he seeks such withdrawal within sixty days after the effective date of the merger.\textsuperscript{148} If he waits a longer period, then he must secure the written approval of the corporation for with-

\textsuperscript{141} 432 A.2d at 1199.
\textsuperscript{142} \textit{Id.} In one of the motions, the Dofflemyers sought in the alternative to consolidate the appraisal action with the merger action, but this was likewise denied. \textit{Id.}
\textsuperscript{143} \textit{Id.} at 1200.
\textsuperscript{144} \textit{Id.}
\textsuperscript{145} \textit{Id.}
\textsuperscript{146} \textit{Id.} at 1202.
\textsuperscript{147} \textit{Id.} at 1201-02.
\textsuperscript{148} \textit{See DEL. CODE ANN. tit. 8, § 262(c) (1974 & Cum. Supp. 1980). This provision reads:}

Within 120 days after the effective date of the merger or consolidation, the corporation or any stockholder who has complied with subsections (a) and (b) of this section and who is otherwise entitled to appraisal rights under this section may file a petition in the Court of Chancery demanding a determination of the value of the stock of all such stockholders. Notwithstanding the foregoing, at any time within 60 days after the effective date of the merger or consolidation, any stockholder shall have the right to withdraw his demand for appraisal and to accept the terms offered upon the merger or consolidation.

\textit{Id.}
The Dofflemyers had filed their petition for appraisal 113 days after the effective date of the merger, which was within the 120-day limit prescribed by the Delaware statute, but at a time which placed them outside the 60-day cutoff period for withdrawal. According to the court, a shareholder, after the 60-day cutoff period, could not "withdraw from an appraisal and resume the rights to which he would have been entitled as a shareholder, without the written approval of the corporation." The court rejected an argument by the Dofflemyers that the provisions for cutoff in the appraisal statute should be construed as applicable only to stock-for-stock mergers and not cash-for-stock mergers, stating that it could find no indication of legislative intent to limit the statutory restrictions only to stock-for-stock mergers.

Although the specific provisions in corporation statutes pertaining to the appraisal remedy differ somewhat from state to state, the relevant provisions in the Delaware General Corporation Law are as follows:

- **If no petition for an appraisal shall be filed within the time provided in subsection (c) of this section, or if such stockholder shall deliver to the corporation a written withdrawal of his demand for an appraisal and acceptance of the merger or consolidation, either within 60 days after the effective date of the merger or consolidation as provided in subsection (c) of this section or thereafter with the written approval of the corporation, then the right of such stockholder to appraisal shall cease.**

*Id.* (emphasis added).


150 432 A.2d at 1200.

151 Id.

152 Id. at 1202. The court commented that, as it had observed in a previous opinion dealing with a predecessor Delaware appraisal statute, one of the principal purposes behind provisions in appraisal statutes defining shareholder status after a demand for appraisal had been made "was to settle the troublesome issue of who possessed the incidents of stock ownership after the dissenter demanded appraisal, but before the appraisal award." *Id.* The appraisal provisions applicable in Dofflemyer, as set forth in § 262(l) of the Delaware General Corporation Law, state:

Any stockholder who has demanded his appraisal rights as provided in subsection (b) of this section shall thereafter neither be entitled to vote such stock for any purpose nor be entitled to the payment of dividends or other distribution on the stock (except dividends or other distributions payable to stockholders of record at a date which is prior to the effective date of the merger or consolidation) ....

state, the statutes uniformly contain detailed requirements which a shareholder must follow to perfect the appraisal remedy or to withdraw a demand for appraisal once made. Furthermore, the courts have customarily given a strict and literal construction to appraisal statutes. The attitude of the Supreme Court of Delaware in *Dofflemyer* reflects this strict construction and emphasizes once again the need for shareholders availing themselves of the appraisal remedy in corporate mergers, or other transactions in which the appraisal remedy is made available, to exercise the utmost care to familiarize themselves with the specific requirements of the applicable appraisal statute—not only as to perfecting but also as to withdrawing their demand for appraisal.

C. *Tender Offers*

Turning to recent Kentucky cases of interest, perhaps the most notable is the decision by the Kentucky Court of Appeals in *Esmark, Inc. v. Strode*, upholding the constitutionality of the Kentucky Take-Over Act. This decision takes on added significance in light of the fact that the constitutionality of takeover

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154 See, e.g., F.S. Moseley & Co. v. Midland-Ross Corp., 179 A.2d 295 (Del. 1962). The Supreme Court of Delaware held that the requirement imposed by Delaware law that a shareholder seeking the appraisal remedy file a written objection to the proposed corporate action was not satisfied by either a letter of transmittal enclosing a proxy form containing a vote against a merger or the proxy itself. *Id.* at 296-97.

155 This, of course, assumes that shareholders are properly informed as to the nature of their appraisal rights and the formalities to be followed in exercising them. Modern corporation statutes, with increasing frequency, contain provisions requiring the corporation to provide shareholders with this information. For example, § 262(b)(1) of the Delaware General Corporation Law provides that the corporation must notify each shareholder entitled to appraisal rights, not less than 20 days prior to a meeting at which a proposed merger or consolidation is to be submitted for approval, that appraisal rights are available and include a copy of § 262 of the statute. *Del. Code Ann.* tit. 8, § 262(b)(1) (1974 & Cum. Supp. 1980). The 1981 revisions of the Delaware appraisal statute, referred to in note 140 supra, retain this requirement.


legislation in other jurisdictions has sometimes been successfully challenged. 158

In November, 1977, Esmark, Inc. began making purchases of stock in Reliance Universal, Inc., a Kentucky corporation, aimed at gaining control of Reliance. 159 By August 13, 1979, Esmark's purchases exceeded five percent of the Reliance stock. 160 Ten days later, on August 23, 1979, Esmark first publicly announced its interest in acquiring Reliance. 161 Esmark continued systematic purchases of Reliance stock thereafter until, by October 23, 1979, Esmark had accumulated 233,700 shares of Reliance stock, or approximately 11.45 percent of the outstanding Reliance shares. 162 The Director of the Kentucky Division of Securities brought suit in Franklin Circuit Court against Esmark charging the company with seeking to acquire a controlling interest in Reliance without complying with the provisions of the Kentucky Take-Over Act. 163 The Franklin Circuit Court entered judgment against Esmark, enjoining it from acquiring any further Reliance stock and ordering Esmark to divest itself of all Reliance stock it had acquired in excess of five percent. 164 Esmark appealed. 165

The constitutionality of state takeover legislation has usually been attacked either on the ground that such legislation violates the commerce clause of the United States Constitution, 166 or on the ground that it violates the supremacy clause of the Constitu-

159 28 KLS 5, at 1.
160 Id.
161 Id. Esmark filed a Schedule 13D as required by Regulation 13D (now Regulation 13D-C) promulgated by the SEC pursuant to § 13(d) of the Securities Exchange Act of 1934. Id. at 1 n.1. This was followed on August 27, 1979 by a report in The Wall Street Journal as to Esmark's interest in acquiring Reliance. Id. at 1.
162 Id. at 1. These purchases had been made on the open market and through phoning brokerage houses. Id.
163 Id. The Kentucky takeover statute provides that no offeror subject to the statute shall make a takeover bid without complying with the provisions of the statute if, as the result of the offer, the offeror will own more than 5% of any class of the target corporation's stock. KRS § 292.560 (1981).
164 28 KLS 5, at 1.
165 Id.
166 U.S. CONST. art. I, § 8, cl. 3.
The argument directed at the commerce clause has been customarily based on the extraterritorial effect of state takeover laws and their resulting burden on interstate commerce. The supremacy argument has been directed at the alleged conflict of state takeover laws with federal regulation of corporate takeovers under the Williams Act. The claim is made that, whereas Congress in enacting the Williams Act sought to adopt a neutral position as between an acquiring company and its target, state legislatures in enacting state takeover laws, with their prepublication provisions and provisions for administrative hearings, are attempting to protect local interests by strengthening the hands of the managements of target companies in their efforts to thwart takeover attempts.

Discovering substantial evidence in the record to support the finding of the trial court that the Kentucky takeover statute did not conflict with the Williams Act or attempt to regulate interstate commerce, the court of appeals in Esmark held that the finding of the trial court regarding constitutionality should not be set aside on appeal as erroneous. On the supremacy issue the court concluded that "Congress did not intend to preempt the entire field of securities regulation so as to preclude the states from entering the arena in order to protect its citizens from unfair

167 U.S. CONST. art. VI, cl. 2.
170 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 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 (1968).
171 See, e.g., KRS § 292.570(1) (1981) (requires person making a takeover bid to publicize its terms at least 20 days prior to the making of the bid).
172 See, e.g., KRS § 292.570(1) (1981) (Director of Securities can order a hearing, either upon his own initiative or upon request of the target company, to determine whether there has been full and fair disclosure of all material information).
173 See Moylan, State Regulation of Tender Offers, 58 MARQ. L. REV. 687 (1975).
174 28 KLS 5, at 2.
175 Id.
practices.”176 On the commerce clause issue, the court stated that it found “substantial empirical evidence in the record to support the trial court’s finding that the various take-over statutes have not interfered with interstate commerce or worked to preclude an open-market approach to take-over bids.”177 In fact, the court said, “[t]he empirical evidence . . . tends to show that state take-over statutes, rather than inhibiting or limiting the flow of interstate commerce, have substantially enhanced this flow in the form of additional premiums to the shareholders—the persons whom the Williams Act was designed to protect.”178

Although it upheld the constitutionality of the Kentucky Take-Over Act, the court of appeals did disagree with the judgment of the trial court as to ordering Esmark to divest itself of all Reliance stock it had purchased in excess of five percent, since, in the opinion of the court, the provisions of the Kentucky Securities Act, of which the take-over statute is a part, only authorized injunctive relief.179 Referring to specific language in these provisions empowering the Director of the Division of Securities to seek injunctive relief for violations of the statute,180 the court said

176 Id. Support for this position can be found in § 28 of the Securities Exchange Act of 1934, which specifically preserves the jurisdiction of states over securities issues provided state action does not conflict with the provisions of the federal act. 15 U.S.C. § 78bb(a) (1976).
177 28 KLS 5, at 2.
178 Id.
179 Id. The court considered two other contentions by Esmark regarding the judgment against it. One concerned the jurisdiction of the Kentucky courts to consider the case. The other concerned whether the Esmark purchases of Reliance stock constituted a takeover bid under the Kentucky Take-Over Act. The court had no problem with jurisdiction, pointing out that Esmark did a substantial business in Kentucky and that its activities were such as to affect many Kentuckians in a substantial way. Id. at 1. As to Esmark’s purchases of Reliance stock, the court expressed the opinion that, while Esmark’s purchases prior to the announcement of its intention to acquire control of Reliance may not have violated the law, its systematic purchases thereafter would constitute a takeover bid under the Kentucky Take-Over Act. Id. The court relied on the position taken by federal courts that open market purchases made pursuant to a publicly announced buying program can constitute a “tender offer” under § 14(d) of the Securities Exchange Act of 1934. See, e.g., S-G Securities, Inc. v. Fuqua Inv. Co., 466 F. Supp. 1114 (D.C. Mass. 1978).
180 The enforcement provisions of the Kentucky Securities Act provide:

Whenever it appears to the director that any person has engaged or is about to engage in any act or practice constituting a violation of any provision of this chapter or any rule or order hereunder, he may in his discretion bring an action in any court of competent jurisdiction to enjoin any such acts
that they could not "discern a legislative intent on the part of the General Assembly in enacting this statute to give the commissioners the broad powers to require divestiture,"¹⁸¹ and that it seemed to them that "the Kentucky Act would only permit the court to enjoin Esmark from making further open-market purchases and from making a take-over bid for Reliance shares until the expiration of the waiting period" provided by the statute.¹⁸²

Whether the position of the Kentucky Court of Appeals as to the constitutionality of the Kentucky Take-Over Act will remain intact remains to be seen.¹⁸³ Ultimately, the constitutionality of state takeover legislation will need to be resolved by the Supreme Court of the United States.¹⁸⁴ One commentator has prophesied that "[t]he Supreme Court can be expected to resolve these issues in the near future and while prophecy is always dangerous, they are likely to side with federal supremacy and preemption—but probably on the narrowest possible grounds."¹⁸⁵

D. Registered Office

Another recent case of interest decided by the Kentucky Court of Appeals was Kem Manufacturing Corp. v. Kentucky Gem Coal Co.,¹⁸⁶ raising the question whether designation of a registered office and agent as required by the Kentucky Business Corporation Act¹⁸⁷ is sufficient to confer venue in a suit brought against the corporation.¹⁸⁸

or practices and to enforce compliance with this chapter or any rule or order hereunder. Upon a proper showing a permanent or temporary injunction, restraining order, or writ of mandamus shall be granted and a receiver or conservator may be appointed for the defendant or the defendant's assets. The director may not be required to post a bond.


¹⁸¹ 28 KLS 5, at 2.
¹⁸² Id.
¹⁸³ The Supreme Court of Kentucky has granted a motion for discretionary review of the Esmark case. Strode v. Esmark, Inc., 622 S.W.2d 917 (Ky. 1981).
¹⁸⁶ 610 S.W.2d 913 (Ky. Ct. App. 1980).
¹⁸⁸ The provisions of the Kentucky Business Corporation Act pertaining to the maintenance of a registered office and registered agent state:
In the *Kem* case, Kem Manufacturing Co. made a contract in Clay County, Kentucky with Kentucky Gem Coal Co. to deliver certain goods to Kentucky Gem in Clay and Laurel Counties. Because of a dispute between the parties which arose as a result of their business dealings, Kem brought a suit against Kentucky Gem in Jefferson Circuit Court, where Kentucky Gem's registered office and agent were located. The trial court dismissed the complaint for lack of venue since the principal place of business of Kentucky Gem was in Whitley County. Under the Kentucky statutory provisions pertaining to venue in suits brought against a corporation which has an office or place of business in the state, the suit may be brought, among other possible choices, in the county in which such office or place of business is situated. The trial court determined that, since Kentucky Gem maintained no office in Jefferson County other than of its registered agent, the circumstances were insufficient to establish venue there.

The court of appeals reversed the judgment of the Jefferson Circuit Court. Noting that the provisions in the Kentucky Business Corporation Act requiring every corporation to maintain a registered office and agent and the provisions in the venue statute were both designed to insure that corporations would be accessible to litigation, the court of appeals concluded that it was "the clear intent of the Legislature that a corporation may not defeat venue in an action brought in the court in which its registered office and agent is located." Referring to a previous decision by

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Each corporation shall have and continuously maintain in this state:

(1) A registered office which may be, but need not be, the same as its place of business; and

(2) A registered agent, which agent may be either an individual resident in this state whose business office is identical with such registered office, or a domestic corporation, or a foreign corporation authorized to transact business in this state, having a business office identical with such registered office.

*Id.*

189 610 S.W.2d at 913.
190 *Id.*
191 *Id.*
192 KRS § 452.450 (1975).
193 610 S.W.2d at 913.
194 *Id.* at 914.
195 *Id.*
the Supreme Court of Kentucky in which that Court had stressed the importance of every person who deals with a corporation knowing with certainty in what county legal action may be brought against it, the court of appeals remarked that "[t]he importance of achieving this certainty in establishing where an action may be brought... cannot be underestimated," particularly in view of the abundance of corporations doing business in the state. As the court observed, "to allow the appellee [Kentucky Gem] to prevail in this action would be to defeat the purpose for which these statutes were promulgated."

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196 Job Iron & Steel Co. v. Clark, 150 S.W. 367, 369 (Ky. 1912).
197 610 S.W.2d at 914.
198 Id. The court of appeals mentioned an earlier decision by the Supreme Court of Kentucky in Hill v. Cumberland Dairies, 288 S.W.2d 341 (Ky. 1956), in which the Court had noted that the language of the venue statute referred to an office or place of business rather than the chief office and had read the statutory language as contemplating "that the corporation is doing business in the particular county to such an extent that it is actually present there." 288 S.W.2d at 343. While the court of appeals said that the opinion in this earlier Supreme Court case might suggest that some actual business would need to be conducted in the county to establish venue, they did not feel that the case was controlling since "the Court therein was not faced with a situation in which plaintiff was seeking to establish venue in the county in which the registered office and agent were located." 610 S.W.2d at 914.
199 610 S.W.2d at 914.