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DISSENTING STOCKHOLDERS' RIGHTS IN VIRGINIA: EXCLUSIVITY OF THE CASH-OUT REMEDY AND DETERMINATION OF "FAIR VALUE"

Howard T. Macrae, Jr. *

Until relatively recent times, the generally accepted rule was that a corporation could not merge, consolidate or sell all of its assets without the unanimous consent of its stockholders.[1] Each stockholder was accordingly vested with an individual right of veto over any such corporate action from which that stockholder might dissent. In order to eliminate this shackle on corporate activity, state legislatures enacted legislation permitting corporations to enter into such so-called "extraordinary transactions" as mergers, consolidations and sales of all or substantially all of the corporate assets upon some specified majority vote of all of its stockholders. The price extracted for this accommodation is the ability of dissenting stockholders to perfect a right to object that would enable their stock interests to be repurchased by the corporation for the value of that interest.

Virginia has recognized since 1903[2] the right of stockholders in corporations organized and existing under the laws of Virginia, to dissent and demand receipt of the "fair value" of their stock, rather than be compelled to participate in their corporation's extraordinary transactions, which have the effect of fundamentally altering its identity.[3] This right is now embodied in two sections of the Vir-

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1. *See* 13 FLETCHER CYC. CORP. (Rev. Vol. 1970) § 5906.1; E. L. FOLK, III, THE DELAWARE GENERAL CORPORATION LAW, 321 (1972) [hereinafter cited as FOLK]; Note, *Corporations—Rights of Dissenting Stockholders Pending Statutory Appraisal Proceedings,* 21 VA. L. REV. 825, 829 & n.17 (1935).

2. 1903 Va. Acts, Ex. Sess., ch. 270 at 437.

3. The term "dissenters' rights" properly should apply to the right of a stockholder dissenting from approval of his corporation's extraordinary transaction to obtain as payment for his, shares, their "fair value." In this sense, the right might be denominated as "cash-out rights." The term "appraisal rights," while often used interchangeably with the aforementioned terms (perhaps with justification inasmuch as the corporation must "appraise" the "fair value" of shares), in this article will be used to describe a dissenter's ability to seek a judicial determination of "fair value" where agreement cannot be reached between the corporation and the dissenter. *See Changes in the Model Business Corporation Act Affecting Dissenters' Rights,*

ginia Stock Corporation Act: (1) section 13.1-75 which applies to mergers, consolidations, or to the exchange of any class of stock pursuant to certain specified plans of exchange;[4] and (2) section 13.1-78 which extends the right to "sale or exchange of all or substantially all of the property or assets of a corporation otherwise than in the usual and regular course of its business . . . ."[5] Although the provisions describing the rights of dissenting stockholders are set out in two separate sections of the Code, this package of statutory rights should be considered a unitary concept because the language of these sections and the remedy conferred by each are virtually identical.

In inquiring into this remedy, the first question that arises is whether it constitutes the exclusive remedy to the dissenting stockholder who is dissatisfied with the terms of an "extraordinary" transaction. If answered in the affirmative, then just how is this "fair value" to be determined? Accordingly, the purpose of this discussion is first to examine the circumstances under which this right is available, and to what extent this right to demand "fair value" is the exclusive remedial procedure under Virginia law.[6] In addition, an analysis is set forth of how "fair value" is determined under Virginia law.

I. The Statutes

Broadly speaking, under these two sections, the corporation, whether it be the selling, surviving or consolidated corporation, is required to make a "good faith" offer to each dissenting stockholder who has perfected his right to "fair value" (which offer is to be uniform with regard to all dissenters of the same class of stock and to be accompanied by certain current financial information),[7] and

A Report of the Committee on Corporate Laws, 32 Bus. Law. 1855, 1856 (1977) [hereinafter cited as *Changes*].

4. The "plans of exchange" specified are those pursuant to Va. Code Ann. § 13.1-2(c) (Repl. Vol. 1973).

5. Although the language of § 13.1-78 applies to "a corporation" affecting a sale of all or substantially all of its assets, without specifically limiting the section's applicability to a corporation organized and existing under the laws of Virginia, that is the interpretation to be accorded it. *See* Va. Code Ann. § 13.1-2(c) (Repl. Vol. 1973).

6. While there may, in many cases of perceived wrongs, be possible claims or remedies under the federal securities laws, a discussion of these laws is beyond the scope of this article.

7. Va. Code Ann. §§ 13.1-75(d); 13.1-78(d) (Supp. 1977).

if no offer is made, or the parties fail to agree, then there is to be an appraisal of the "fair value" of the stock by judicial determination in the appropriate Virginia circuit court.[8] This judicial appraisal proceeding is declared by the statute to be "an action against [the dissenting stockholders'] shares *quasi in rem.*"[9]

The right of a dissenting stockholder to avail himself of the Virginia dissenters' rights statutes in cases of mergers or consolidations was significantly limited in 1972[10] with the addition of the "stock market exemption,"[11] or "Wall Street Rule," which provides that in the absence of a contrary provision in the articles of incorporation, the right to demand "fair value" shall be withdrawn from holders of a class or series of stock where the class or series was, at the record date for voting on the transaction, listed on a national securities exchange or held of record by more than 2,000 persons.[12] The "Wall Street Rule" was grafted onto section 13.1-78 in 1975.[13]

The rationale behind this limitation is that the right of a dissenter to demand "fair value" for his stock holdings, in essence, requires the creation of a "forced market" for these securities, which is an unnecessary luxury where there is already a substantial public trading market for the stock.[14] The existence of such a market is presumed by the sections where the stock in question is listed for trading on a national securities exchange or held by 2,000 or more stockholders, a number of holders large enough to infer to a substantial public trading market.[15]

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8. *Id.* §§ 13.1-75(f); 13.1-78(f).
9. *Id.*
10. 1972 Va. Acts, ch. 425 at 489.
11. *See Changes, supra* note 3, at 1856.
12. VA. CODE ANN. §§ 13.1-75(i)(2); 13.1-78(i)(2) (Supp. 1977).
13. 1975 Va. Acts, ch. 500 at 921. *See* VA. CODE ANN. § 13.1-78(i)(2) (Supp. 1977).
14. *See* FOLK, *supra* note 1, at 391. The section of the Delaware Code (tit. 8, § 262) making provision for dissenters' rights (which applies only to mergers and consolidations) contains the "Wall Street Rule," and except for inclusion of a provision withdrawing such rights where vote of the stockholders is required for a merger pursuant to DEL. CODE ANN. tit. 8, § 251(f), as well as nomenclature variations, the rule is virtually identical to the Virginia version, and its interpretations may serve to provide understanding of the latter. Delaware's "Wall Street Rule" is particularly relevant in a discussion of the Virginia version inasmuch as enactment of the Delaware version provided the "catalyst" to the original adoption of the rule in § 13.1-75. *See* Note, *Seventeenth Annual Survey of Developments in Virginia Law: Business Associations,* 58 VA. L. REV. 1172, 1179 (1972).
15. Folk, *Corporation Law Development - 1969,* 56 VA. L. REV. 755, 796 (1970).

However, there is a limitation on the operation of the Rule contained only in section 13.1-75. The "Wall Street Rule" does not operate to withdraw the right to demand "fair value," where in the case of a merger, consolidation, or exchange of stock, the holders of a class or series of stock are required to accept for such stock a form of consideration other than:

> (I) shares or shares and cash in lieu of fractional shares of the surviving, new or acquiring corporation; or (II) shares or shares and cash in lieu of fractional shares of any other corporation which, at the record date fixed to determine the stockholders entitled to receive notice of and to vote at the meeting at which the plan of merger, consolidation or exchange is to be acted on; were either registered on a national securities exchange or held of record by at least two thousand stockholders; or (III) a combination of shares or shares and cash in lieu of fractional shares as set forth in (I) and (II). . . .[16]

Thus, in order for the "Wall Street Rule" to withdraw dissenters' rights from a class of stockholders in cases of mergers, consolidations and plans of exchange, the class of holders must be required to take stock ("or shares and cash in lieu of fractional shares"), so as to maintain some equity interest with the "surviving, new or acquiring corporation," or with "any other corporation" (usually the parent of a constituent corporation) whose stock in question has a substantial public trading market, as evidenced by its meeting the threshold trading requirements.[17] There is no such qualification on the operation of the "Wall Street Rule" contained in section 13.1-78.

Generally speaking then, under Virginia law, dissenters' rights are available to the stockholders of any Virginia-domiciled corporate party in a merger, consolidation and plan of exchange, and to the stockholders of a Virginia corporation effecting a sale of all or substantially all of its assets. If a class or series of stock is not listed for trading on a national securities exchange, or not widely-held within the meaning of the "Wall Street Rule," or even if it is so actively traded but the articles of incorporation of the issuer so provide, the holders of this class or series are entitled to assert

16. VA. CODE ANN. § 13.1-75(i)(2) (Supp. 1977).
17. *See* FOLK, *supra* note 1, at 395.

dissenters' rights. The one caveat to this broadly painted summary is that a class or series otherwise qualifying under the "Wall Street Rule" whose holders dissent from a transaction contemplated by section 13.1-75 must receive stock which qualifies as discussed in the previous paragraph, and if this is not the case, such dissenters too are entitled to assert dissenters' rights. Thus, the availability of dissenters' rights can differ among the stockholders of the same corporation, depending upon which class of stock is held and what consideration is being offered therefor.

Both Code sections specifically provide that the circuit court of the city or county where the domestic corporation involved in the transaction has (or last had) its registered office or principal place of business shall be the forum where all claims for appraisal must be consolidated regardless of the claimants' place of residence, thus eliminating a possible multiplicity of actions in various courts which is harmful to both the corporation and its stockholders.[18] However,

18. VA. CODE ANN. §§ 13.1-75(f); 13.1-78(f) (Supp. 1977). The predecessor sections under the old law similarly provided that all such appraisal proceedings be brought in the one local court where the corporation had its registered office or principal place of business. *See* Adams v. United States Distributing Corp., 184 Va. 134, 34 S.E.2d 244, 250 (1945), *cert. denied,* 327 U.S. 788 (1946); O'Hara v. Pittston Co., 186 Va. 825, 42 S.E.2d 263, 274 (1947); Pittston Co. v. O'Hara, 191 Va. 886, 63 S.E.2d 34, 36 (1951). *See also* Weiss v. Routh, 149 F.2d 193 (2d Cir. 1945) (applying Virginia law); McGhee v. General Finance Corp., 84 F. Supp. 24, 25 (W.D. Va. 1949) (applying Virginia law). *But see* Poe v. Marquette Cement Mfg. Co., 376 F. Supp. 1054, 1059 (E.D. Md. 1974); Sheridan v. American Motors Corp., 132 F. Supp. 121 (E.D. Pa. 1955).

Along similar lines, Virginia vests exclusive right to administer the fundamental changes of corporate status by amendments, mergers, consolidations or sales of all assets except in cases of fraud, through her State Corporation Commission, by virtue of VA. CODE ANN. § 13.1-125 (Supp. 1977), with the right of appeal to the Virginia Supreme Court. In support of that exclusive and uniform administration, § 13.1-125 denies authority in such matters to any court within or without Virginia to enjoin any directors' or shareholders' meetings to consider such matters or to enjoin a submission to the State Corporation Commission for the entry of an order, except in cases of fraud, or to enjoin in any case the operation of an order when entered. *See* O'Brien v. Socony Mobil Oil Co., 207 Va. 707, 152 S.E.2d 278 (1967), *cert. denied,* 389 U.S. 825 (1967); Winfree v. Riverside Cotton Mills Co., 133 Va. 717, 77 S.E. 309, 312-13 (1912). The design of this section is to obligate the State Corporation Commission to issue certificates evidencing such fundamental changes of corporate status where, in the absence of fraud, all of the statutory requirements have been met, including, presumably, both substantive and procedural law. Gibson & Freeman, *A Decade of the Model Business Corporation Act in Virginia,* 53 VA. L. REV. 1936, 1404 (1967) [hereinafter cited as Gibson & Freeman]. *See* O'Brien v. Socony Mobil Oil Co., No. 17551, 63 ANNUAL REPORT OF THE STATE CORP. COMM'N OF VA. 137 (1965).

One of the basic purposes of the Virginia Stock Corporation Act was to proclaim exclusive the holding in one federal district court case raises the specter of a multiplicity of appraisal proceedings in federal or state courts all over the country, or possibly, one such suit in a forum outside Virginia.[19]

The statute provides that any stockholder of record who follows the prescribed statutory procedure may dissent and demand the "fair value" of his stock. This value is to be exclusive of "any appreciation or depreciation solely in anticipation of the proposed corporate action,"[20] as is required in a number of other jurisdictions.[21] In the event that a stockholder and the corporation cannot agree on the value of the shares, the corporation must commence a suit in equity praying the circuit court to determine (without a jury) their "fair value," and must join as parties all dissenting stockholders except those who have already reached agreement as to price; should the corporation fail to do so, "any dissenting stockholders may do so in the name of the corporation."[22] The circuit court is empowered to seek expert opinion in this statutory appraisal proceeding by appointing one or more appraisers, whose expenses shall be assessed against the corporation or apportioned among dissenting stockholders deemed to be acting in bad faith.[23] The Code sections allow the

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jurisdiction over such "internal affairs" of Virginia-domiciled corporations. Gibson and Freeman, *supra*, at 1405. It is one thing for a state to proclaim its exclusive jurisdiction and quite another for her sister states to recognize such a claim of authority. Indeed, at least one state supreme court has refused to recognize this claim of exclusive jurisdiction found in § 13.1-125. O'Brien v. Virginia-Carolina Chemical Co., 44 N.J. 25, 206 A.2d 878 (1965), *cert. denied*, 389 U.S. 825 (1967). When this section was grafted upon the work of the Model Business Corporation Act, it was noted that such a denial of jurisdiction to the courts of any foreign jurisdictions would be feeble if not for the fact that the subject of the regulation, the "internal affairs" of the corporation, has traditionally been held to be within the exclusive power of the state of domicile. *See* Gibson, *The Virginia Corporaton Law of 1956*, 42 VA. L. REV. 445 & 630, 623 (1956) [hereinafter cited as Gibson].

19. Poe v. Marquette Cement Mfg. Co., 376 F. Supp. 1054 (E.D. Md. 1974). *See* note 7 *supra*. The Illinois statute in question there should be distinguished because it did not provide a specific domestic forum in which to hold the appraisal proceeding. A major factor influencing the district court's decision in the *Poe* case was the expiration of the Illinois statutory period in which to bring the suit for appraisal of their shares: "Finally, the 90-day period of limitations for the bringing of this action in a state court in Illinois has now run so that if this court declines to accept jurisdiction, plaintiffs would be without remedy." 376 F. Supp. at 1059. *See also* Markham v. City of Newport News, 292 F.2d 711 (4th Cir. 1961).

20. VA. CODE ANN. §§ 13.1-75(a); 13.1-78(a) (Supp. 1977).

21. *See* note 59, *infra*.

22. VA. CODE ANN. §§ 13.1-75(f); 13.1-78(f) (Supp. 1977).

23. *Id.*

court to assess any or all of the costs against the dissenting stockholders if the court finds their failure to accept the corporation's offer to have been "arbitrary or vexatious or not in good faith." Should the court find that the value of the shares "materially exceeds" the amount offered by the corporation, or if no offer was made, the court may award to the stockholders the reasonable expenses of experts employed by them in the action. However, each party must bear the expense of counsel employed by him.[24]

Subsection (f) of both sections provides that "[t]he judgment shall include an allowance for interest at such rate as the court may find to be fair and equitable in all the circumstances from the date on which the vote was taken on the proposed corporate action to the date of payment."[25] The interest rates in Virginia have been assessed at two percent in *Lucas* v. *Pembroke Water Co.*,[26] and at six percent in both *Home Beneficial Life Insurance Co.* v. *Lawrence*,[27] and *In re Plummer*.[28]

With some slight flexibility for "inadvertance," the prescribed time periods and procedures are of the essence, and generally the stockholder will lose his right if he does not follow them strictly.[29] In addition, cases under Virginia law hold that, if the proceedings were in accord with the statutory requirements, the right to receive "fair value" is the exclusive remedy in the absence of fraud or bad faith.[30]

24. *Id. See* Note, *Twentieth Annual Survey of Developments in Virginia Law, 1974-1975: Business Associations*, 61 VA. L. REV. 1650, 1664 (1975). In this regard, Virginia has what has been classified as a "bad faith" statute. *See* Note, *The Dissenting Shareholders' Appraisal Statute: Influence of Cost and Interest Provisions on the Efficacy of the Remedy*, 50 B.U.L. REV. 57, 73 (1970).

25. *See* Pittston Co. v. O'Hara, 191 Va. 886, 63 S.E.2d 34 (1951); *In re* Plummer, Chancery Court of the City of Richmond, October 10, 1933, *appeal denied*, Tobacco Products Corp. v. Plummer, 161 Va. xvii (1934); Note, *Corporations—Rights of Dissenting Stockholders Pending Statutory Appraisal Proceedings*, 21 VA. L. REV. 825 (1935).

26. 205 Va. 84, 135 S.E.2d 147 (1964).

27. Chancery Court of the City of Richmond, March 28, 1973.

28. Chancery Court of the City of Richmond, October 10, 1933, *appeal denied*, Tobacco Products Corp. v. Plummer, 161 Va. xvii (1934). *See* Pittston Co. v. O'Hara, 191 Va. 886, 63 S.E.2d 34, 44-7 (1951) (Hudgins, C.J., dissenting).

29. ABA-ALI MODEL BUS. CORP. ACT § 81, p. 447 (1971); J. Vorenberg, *Exclusiveness of the Dissenting Stockholder's Appraisal Right*, 77 HARV. L. REV. 1189, 1201 (1964).

30. Adams v. United States Distrib. Corp., 182 Va. 134, 34 S.E.2d 244 (1945), *cert. denied*, 327 U.S. 788 (1946); Craddock-Terry Co. v. Powell, 180 Va. 242, 22 S.E.2d 30, 36 (1942), *modified*, 181 Va. 417, 25 S.E.2d 363 (1943) (case decided under wording of MICHIE CODE,

Despite the exclusivity of the appraisal remedy where the stockholder is dissatisfied with the corporation's offer there is New York precedent holding that it is not an absolute right but discretionary with the court, and should not be wielded as an offensive weapon nor employed to cause "unwarranted expense or embarrassment to the corporation and its majority shareholders."[31]

As a result of the rewording of both Code sections by the General Assembly in 1975 (especially the inclusion of the requirement that the dissenter notify the corporation in writing of his desire to exercise his right of dissent, the number of shares as to which he will be asserting such rights, which notice must be received by the corporation prior to the vote on the triggering transaction or mailed by the shareholder "not less than five days prior to the date on which the stockholders vote on" such transaction)[32] these sections are now weighted in favor of corporate management. One commentator has noted that:

> the net effect of the 1975 revisions (despite the new notice provisions) should be to make their exercise of such rights even more expensive and make disputes with the corporation over the fair value of dissenting shares somewhat more of a financial risk. From the point of view of management, on the other hand, the revisions are clearly desirable. Appraisal statutes have been a source of considerable difficulty for the corporation, especially where the dissenter is not required to give notice of his objection until after the merger or other action is completed. Management faces an uncertainty concerning the amount of cash needed to pay off the dissenters. In addition, such statutes carry the potential for abuse by the stockholder who finds himself in a position to make a side deal in return for not dissenting. A principal benefit to management from the 1975 revisions to the Virginia statute

1942, § 3820a which also gave dissenters rights under "the general law."); McGhee v. General Finance Corp. 84 F. Supp. 24 (W.D.Va. 1949); Sheridan v. American Motors Corp., 132 F. Supp. 121 (E.D.Va. 1955); Weiss v. Routh, 149 F.2d 193, 195 (2d Cir. 1945) (invoking "internal affairs" doctrine); Note, *Corporations—Appraisal Statutes*, 37 VA. L. REV. 901 (1951).

31. Corwin v. Shelter Island Light & Power Co., 199 N.Y.S.2d 866, 868 (Sup. Ct. Suffolk County 1960). *Cf. In re* Marcus, 273 App. Div. 725, 79 N.Y.S.2d 76 (1948), *modifying in part*, 191 Misc. 808, 77 N.Y.S.2d 529 (1948) (dissenting shareholder owning 50 shares of R. H. Macy & Co. preferred stock out of 1,650,000 shares of stock outstanding denied subpoena seeking production of multitudinous books and records of corporation and all of its subsidiaries).

32. VA. CODE ANN. §§ 13.1-75(c)(i)(A); 13.1-78(c)(i)(A) (Supp. 1977).

should be the opportunity to determine in advance the extent of stockholder opposition to a proposed [transaction].[33]

II. Exclusivity of Cash-Out Remedy

Following an affirmative vote of the required proportion of the stockholders of the corporate parties for a proposed plan of merger, consolidation, sale or exchange of all or substantially all the assets of a Virginia corporation, or for a qualifying exchange of shares, a stockholder of a Virginia corporation which is a party to the transaction who is dissatisfied with the consideration being offered for his stock under the plan adopted has, as his only legal remedy for this perceived wrong, a statutory right of valuation and cash-out of his investment under sections 13.1-75 and 13.1-78.[34] This was also the situation under prior versions of these Code sections with a stockholder having "an election either to dissent and secure in the prescribed manner the fair cash value of his stock, or if he fails to dissent, to be bound by the terms of the merger."[35] No independent suit in equity can be maintained for that purpose.[36] Prior to a radical change in 1922[37] in the section governing dissenting stockholders' rights where merger or consolidation had been involved, it has been held that cash-out was not the exclusive remedy open to dissenters

33. Note, *Twentieth Annual Survey of Developments in Virginia Law, 1974-1975: Business Associations,* 61 Va. L. Rev. 1650, 1665 (1975). *See* Note, *The Dissenting Shareholders' Appraisal Statute: Influence of Cost and Interest Provisions on the Efficacy of the Remedy,* 50 B.U.L. Rev. 57 & n.15 (1970); J. Vorenberg, *Exclusiveness of the Dissenting Stockholder's Appraisal Right,* 77 Harv. L. Rev. 1189, 1201 (1964). The prospective delays and attendant uncertainties, including the item of interest, which is discretionary with the court, can be expected to dampen any dissenter's appetite for an appraisal proceeding and incline him toward acceptance of the corporation's "good faith" offer. The judicial battles involving these appraisals have been known to be drawn out over years: 8 years, Pittston Co. v. O'Hara, 191 Va. 886, 63 S.E.2d 34 (1951) (a particularly bitter battle fought in federal courts and state courts in Virginia and New York); 5 years, Craddock-Terry Co. v. Powell, 181 Va. 417, 25 S.E.2d 363 (1943); and 3-½ years, Lucas v. Pembroke Water Co., 205 Va. 84, 135 S.E.2d 147 (1964).

34. Adams v. United States Distrib. Corp., 184 Va. 134, 34 S.E.2d 244, 249 (1945), *cert. denied,* 327 U.S. 780 (1946); Pittston Co. v. O'Hara, 191 Va. 886, 63 S.E.2d 34, 36 (1951); O'Hara v. Pittston Co., 186 Va. 324, 42 S.E.2d 269, 274 (1947); Weiss v. Routh, 149 F.2d 193, 196 (2d Cir. 1945); Note *Corporations—Rights of Dissenting Stockholders Pending Statutory Appraisal Proceedings,* 21 Va. L. Rev. 825, 827 (1935).

35. Adams v. United States Distrib. Corp., 184 Va. 134, 34 S.E.2d 244, 249 (1945), *cert. denied,* 327 U.S. 788 (1946).

36. Pittston Co. v. O'Hara, 191 Va. 886, 63 S.E.2d 34, 36 (1951).

37. 1922 Va. Acts, ch. 380 at 625, 632-34.

and that they were "not bound to follow the statutory procedure."[38] However, in 1945 the Supreme Court of Appeals noted that the silence on the subject of the exclusivity of the cash-out remedy existing in the pre-1922 law had been cured, and that cash-out pursuant to the statutory provision was then the "exclusive remedy" for mergers and consolidations.[39]

Cash-out had been held not to be the exclusive remedy under the section governing the sale of all or substantially all of the corporate property because the statute entitled dissenting stockholders to the then standard of "fair cash value" to be determined in the same manner as afforded a dissenting stockholder in a merger of consolidation "and/or as now exists under the general law. . . ." The section went on to say, "but nothing herein contained shall deprive any stockholder of existing remedies at law or in equity in the event of fraud or inadequacy of consideration. . . ."[40] This language has been omitted since the revision of the Virginia Stock Corporation Act in 1956,[41] with the language of both sections and the rights provided thereunder being virtually identical. Therefore, under Virginia law, cash-out is now equally the exclusive remedy for dissenters to a sale or exchange of all the corporate assets as it is for those stockholders dissatisfied with an exchange, merger or consolidation.

The interpretation that cash-out was to be the exclusive remedy afforded under the 1956 general revision of the law is confirmed by Mr. George D. Gibson, who was Special Counsel for the Commission which drafted the Virginia Stock Corporation Act of 1956.[42] This intent has been carried through to the present version of these two sections as evidenced by the declaration in both that "the right to the fair value of shares under this section is contingent upon compliance with the requirements of this section."[43]

38. Winfree v. Riverside Cotton Mills, 113 Va. 717, 724, 75 S.E. 309, 312 (1912).

39. Adams v. United States Distrib. Corp., 184 Va. 134, 34 S.E.2d 244, 248-9 (1945), *cert. denied*, 327 U.S. 788 (1946).

40. MICHIE'S CODE § 3820a (1942); Craddock-Terry v. Powell, 181 Va. 417, 25 S.E.2d 363, 372-3 (1943).

41. 1956 Va. Acts, ch. 428 at 519-20, 522-24.

42. "The [appraisal remedy] is intended to be an exclusive remedy so that no cash award may be made in an equitable proceeding whether in Virginia or elsewhere. This will effectuate the ancient maxim that equality is equity." Gibson, *supra* note 18, at 470.

43. VA. CODE ANN. §§ 13.1-75(b); 13.1-78(b) (Supp. 1977).

If the cash-out remedy was not the exclusive remedial procedure, values determined by the different courts or even the same court might vary substantially depending upon the nature of the claim asserted by the dissenting stockholder. A plethora of possible remedies would invite a multiplicity of suits in state and federal courts, which tribunals of necessity would be inquiring into the basic fairness of transactions which should be subject to Virginia law as applied by Virginia courts.[44]

To follow a contrary course would be to displace the "practical market test" of the adequacy or "fairness" of such a transaction with the judicial process, which, with the benefit of hindsight, would be second-guessing in the light of later-discovered evidence. Accordingly, Virginia

> [f]ollowing the Model [Business Corporation] Act, . . . rejects the view that any administrative tribunal should be authorized to review a plan for fairness and permit only approved plans to be carried out. Like most other states, Virginia has never had such a practice. By the same token the new Act rejects the view that any judicial tribunal should be authorized to review a plan for fairness and reverse and set aside any plan it may deem unfair.[45]

Instead, evaluation of the elements of "fairness" is left to the individual stockholder, who is given ample opportunity for reflection on this question through notice and required disclosures under various Code sections.[46] Failure to comply with these statutory requirements is sufficient grounds for the State Corporation Commission to re-

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44. *See* Santa Fe Indus., Inc. v. Green, 430 U.S. 462 (1977) (holding that a majority stockholder's alleged breach of the fiduciary duty of loyalty in effecting a short-form cash-for-stock merger under Delaware law for the purpose of eliminating minority interests without any valid business reason was not a violation of the Securities Exchange Act and Rule 10b-5 thereunder, because such conduct was not manipulation or deception, but corporate mismanagement, which as an "internal affair" of the corporation is left to state regulation). The Supreme Court stated: "minority shareholders could either accept the price offered or reject it and seek an appraisal in the Delaware Court of Chancery. The choice was fairly presented and they were furnished with all relevant information on which to base their decision." *Id.* at 1303. *But see* Singer v. Magnavox Co., SEC. REG. & L. REP. (B.N.A.) October 5, 1977, E-1 (Del. Sup. Ct.).

45. Gibson, *supra* note 18, at 618.

46. *E.g.*, VA. CODE ANN. §§ 13.1-26; 13.1-68; 13.1-69.1; 13.1-70; 13.1-75(d); 13.1-78(d) (Supp. 1977).

voke any order issuing a certificate of merger.[47] On this subject, Mr. Gibson states:

> While a change is not to be rejected by a court because it may disapprove on grounds of fairness, this result depends upon compliance with the statutory requirements. If in any case there be circumstances to invalidate the vote as an authentic expression of the owners' preference, the policy of the [Virginia Stock Corporation] Act is not being met and the court should be alert for fraud.[48]

While the general view is that courts will not undertake to review the action of a specified stockholder majority on grounds of fairness, they will entertain review of an action challenged on grounds of fraud[49] or illegality, and there is language in one Virginia case to suggest that the same would be true in Virginia.[50] The Code Com-

47. *Id.* § 13.1-125.

48. Gibson, *supra* note 18, at 621.

49. *Id.* at 618.

50. "Suffice it to say, that the weight of authority is to the effect that unless the corporate merger be tainted with *fraud or illegality* . . . the dissenting stockholder may pursue the remedy prescribed by the appraisal statute." Adams v. United States Distrib. Corp., 184 Va. 134, 34 S.E.2d 244, 250 (1945), *cert. denied*, 327 U.S. 788, (1946).

The situation is different in Delaware:

> The chief issue considered by the Delaware courts is the standard of "fairness" applicable when stockholders seek to enjoin a merger as "unfair." Here the courts draw a fundamental distinction between, on the one hand, mergers in which common stock interests, common directors or both are significant factors in shaping the merger and, on the other hand, mergers between corporations where "the same parties or persons [are] not on both sides of [the] transaction." In the first situation where common interests are important, the judicial standard is "fairness"; in the second situation, where the corporation merges with "a third party" in an apparently arm's-length transaction, the test is "fraud, or the equivalent thereof."

FOLK, *supra* note 1, at 333. *See also* Cole v. National Cash Credit Ass'n, 18 Del. Ch. 47, 156 A. 183, 187-90 (Del. Ch. 1931). The court in *Cole* said:

> mere inadequacy of price will not reveal fraud. The inadequacy must be so gross as to lead the court to conclude that it was not due to an honest error of judgment but rather to bad faith, or to a reckless indifference to the rights of others interested. There is a presumption that the judgment of the governing body of the corporation, whether at the time it consists of directors or majority stockholders, is formed in good faith and inspired by bona fides of purpose."

Id. at 1887.

Stricter standards of scrutiny are applied when the merger is between a parent and subsidiary. *See* David J. Green & Co. v. Schenley Indus., Inc., 281 A.2d 30 (Del. Ch. 1971); David J. Green and Co. v. Dunhill Int'l, Inc., 249 A.2d 427 (Del. Ch. 1968); Tanzer v. International Gen. Indus., Inc., CORP. GUIDE (P-H) ¶ 82,247 (Del. S. Ct. 1977) [applying test of "entire fairness"].

mission in drafting the Virginia Act has stressed that should such a case of fraud arise in Virginia, "the courts are given jurisdiction before the Commission acts to determine it and grant all appropriate relief."[51] Mr. Gibson interprets that provision as meaning "that any court of competent jurisdiction may consider and determine such an issue when suitably raised."[52]

The question as to the meaning of the concept of fraud is still open:

> The General Assembly and the Code Commission deliberately abstained from definition. The concept of fraud has proved flexible and evolving. It will suffice to redress the shocking case, no matter how it should come up. But though there is no definition, the use of the term in the context of the [Virginia Stock Corporation] Act permits certain conclusions to be drawn.[53]

Mr. Gibson then proceeds to analyze the meaning of "fraud" from clues to be gleaned from the Virginia Stock Corporation Act. Beyond these indications as to the design of the legislature, the courts, within the parameters granted by the Virginia Act, will have to construct any expanded definition of "fraud" on the basis of an "appraisal of actual experience."

At the outset, he states that none of the changes of rights of the type specified in Title 13.1, such as mergers, consolidations or acquisition of all or substantially all of the assets, "can possibly be fraudulent in and of itself."[54] The implication is that the same would be true of a plan of exchange under section 13.1-69.1. In addition, it is believed that the Virginia courts will strictly adhere to the standard of actual fraud and not reach out to encompass any

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51. Gibson, *supra* note 18, at 619. *See* VA. CODE ANN. § 13.1-125 (Supp. 1977) which states in pertinent part:

> No court within or without Virginia shall have jurisdiction to enjoin or delay the holding of any meeting of directors or stockholders for the purpose of authorizing or consummating any such amendment, merger, consolidation, or exchange, or the execution or delivery to the Commission of any papers for such purpose, except for fraud. . . .

Id.

52. Gibson, *supra* note 18, at 620.

53. *Id.*

54. *Id.*

concept of "constructive fraud," *e.g.*, where the action taken is so palpably unfair as to amount to such a fraud.[55] If the courts were to reach out and grasp the standard of "constructive fraud," it would essentially involve assumption of a power to reexamine degrees of fairness, which has heretofore been asserted to be contrary to the legislative purpose.

While to be free from fraud and illegality a transaction must as a prerequisite be in compliance with the statutory requirements applicable to it, there are situations in which it is conceivable that despite such strict technical compliance a transaction resulting in the "freeze-out" or explusion of minority stockholders may be subject to scrutiny for breach of fiduciary duty to those minority stockholders where there is either a questionable business purpose therefor or none whatsoever.[56] Although stockholders are normally permitted to act on the basis of their own interest, if it can be

> shown that controlling stockholders act together as a group and have a conflicting interest of such substantiality as to control their vote, then they may well be required to show that the plan approved is fair to the class for which they cast the controlling vote. This could be done by showing a corporate need for the change or a compensatory benefit for those adversely affected or other justifying circumstances.[57]

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55. *See* Porges v. Vadsco Sales Corp., 27 Del. Ch. 127, 133, 32 A.2d 148, 151 (Ch. 1943); Cole v. National Cash Credit Ass'n., 18 Del. Ch. 47, 57, 156 A. 183, 187 (Ch. 1931); MacFarlane v. North American Cement Corp., 16 Del. Ch. 172, 178, 157 A. 396, 398 (Ch. 1928); MacCrone v. American Capital Corp., 51 F. Supp. 462, 466 (D. Del. 1943); Barrett v. Denver Tramway Corporation, 53 F. Supp. 198, 201 (D. Del.), *aff'd.*, 146 F.2d 701 (3rd Cir. 1944); FOLK, *supra* note 1, at 339-40 Vorenberg, *Exclusiveness of the Dissenting Stockholder's Appraisal Right*, 77 HARV. L. REV. 1189, 1210-11 (1964).

56. Singer v. Magnavox Co., SEC. REG. & L. REP. (B.N.A.) October 5, 1977, E-1 (Del. Sup. Ct.). *See also* Berkowitz v. Power/Mate Corp., 137 N.J. Super. 36, 342 A.2d 566, 574 (Supp. Ct. Ch. Div. 1975); Bryan v. Brock & Blevins Co., Inc., 490 F.2d 563 (5th Cir.), *rehearing denied*, 493 F.2d 664 (5th Cir.), *cert. denied*, 419 U.S. 844, 77 (1974); Grimes v. Donaldson, Lufkin & Jennette, 392 F. Supp. 1393 (N.D. Fla. 1974), *aff'd without opinion* 521 F.2d 812 (5th Cir. 1975).

57. Gibson, *supra* note 18, at 621.

In the recent case of Singer v. Magnavox Co., SEC. REG. & L. REP. (B.N.A.) October 5, 1977, E-1 (Del. Sup. Ct.), the court was presented with the case of a short-form merger accomplished by a majority stockholder for the purpose of eliminating minority interests on a cash-for-stock basis. The Delaware Supreme Court, stating that it was the duty "of an equity court to scrutinize a corporate act when it is alleged that its purpose violates the fiduciary duty owed to minority stockholder," held that the majority stockholder owes a fiduciary duty to

Finally, it is necessary that the applicable notice requirements be met. This is because adequate notice and full and fair disclosure in such notice is essential so that the stockholders will be informed on the question of the fairness of the transaction.

III. ELEMENTS OF VALUATION

Like most state dissenters' rights statutes, the Virginia provision merely employs the term "fair value" without adequately defining the term. The statute more fully describes what the term does not include. Thus, the "fair value" of a dissenter's stock is not to include any appreciation or depreciation attributable to fluctuations resulting from anticipation of the corporate action,[58] however that is to be determined. While a vast majority of the states have similar provisos,[59] there appears to be no reported case discussing the method of

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the minority stockholders similar to the duty of unselfish loyalty owed to a corporaton by its officers and directors, in the exercise of control over corporate powers and property, and that "use of such power to perpetuate control is a violation of that duty." Moreover,

> a Delaware court will not be indifferent to the purpose of a merger when a freeze-out of minority stockholders on a cash-out basis is alleged to be its sole purpose. In such a situation, if it is alleged that the purpose is improper because of the fiduciary duty owed to the minority, the Court is duty bound to closely examine that allegation even when all of the relevant statutory formalities have been satisfied.

Id. at E-6. The exercise of this duty was not vitiated in any way because of the availability of appraisal rights to the minority. *Id.* at E-5.

However, the court implies that the result in this case may have been different if the merger had not been cast, as alleged, as an attempt to completely terminate the minority's equity interest by cashing them out, but as a stock-for-stock conversion. *Id.*

See Cary, *Federalism and Corporate Law: Reflections upon Delaware,* 83 YALE L. J. 633, 700 (1974) (arguing for establishment of standards of discharge of fiduciary duty at the federal level), cited in the minority opinion in Santa Fe Indus. v. Green, 430 U.S. 462 (1977). *See also Minority Stockholder Freezeouts and Going Private Transactions—A Panel,* 32 BUS. LAW 1489 (1977).

58. VA. CODE ANN. §§ 13.1-75(a); 13.1-78(a) (Supp. 1977).

59. ARIZ. REV. STAT. ANN. § 10-081(k); CAL. CORP. CODE ANN. § 1300(a) (West, 1977); CONN. GEN. STAT. ANN. § 33-374(d); DEL. CODE ANN. tit. 8, § 262(f); FLA. STAT. ANN. § 607.247(3); GA. CODE ANN. § 22-1202(g)(4); ME. REV. STAT. ANN. tit. 13-A, § 909(1); MD. CODE ANN. § 3-202; MASS. GEN. LAWS ANN. ch. 156B, § 90; MICH. COMP. LAWS ANN. § 450, 1768; MISS. CODE ANN. § 79-3-161; MONT. REV. CODES ANN. § 15-2274(1); NEB. REV. STAT. § 21-2080; NEV. REV. STAT. § 78-505; N.J. STAT. ANN. § 14A:11-3; N. M. STAT. ANN. § 51-21-4(A); OHIO REV. CODE ANN. § 1701.85(c); OKL. STAT. ANN. tit. 18, § 1.159(2); ORE. REV. STAT. § 57.437(2); PA. STAT. ANN. tit. 15, § 515(B); R. I. GEN. LAWS ANN. § 7-1.1-74; S. D. BUS. CORP. ACT § 47-6-25; TENN. GEN. CORP. ACT. § 48.909(5); TEXAS BUS. CORP. ACT art. 15.16(E)(1); UTAH CODE ANN. § 16-10-76; VT. STAT. ANN. tit. 11, § 2004(a); WASH. REV. CODE ANN. § 23A-24-030; W. VA. CODE §

computing this required adjustment,[60] probably due to the relatively recent addition of such provisions.[61] In addition, the computation of "fair value" should not include any allowance for a claim for the value of stock options that may be lost as a consequence of the merger or consolidation of the issuing corporation.[62]

The lack of an adequate statutory definition and method of computation creates considerable uncertainty with which the corporations, dissenters and, ultimately, the courts have to wrestle. In Virginia, although there are numerous reported cases involving the predecessors of both Code sections, there is no Virginia Supreme Court case discussing in detail the methodology by which shares are to be valued by the corporation or in an appraisal proceeding. The main guidepost is *Lucas* v. *Pembroke Water Company,*[63] an action by the corporation to fix the value of the dissenters' stock in a sale

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31-1-123(a); WIS. STAT. ANN. § 180.72(2); WYO. STAT. § 17-36.72. *See* ABA-ALI MODEL BUS. CORP. ACT § 81 (1971).

60. Such an adjustment would require the sifting and disregard of many complex psychological factors. *See* note 88 *infra*. Inasmuch as there is a relationship between concepts of "fair value" of stock in an appraisal proceeding and the fairness of merger terms, J. Vorenberg, *Exclusiveness of the Dissenting Stockholder's Appraisal Right*, 77 HARV. L. REV. 1189 (1964); Brudney & Chirelstein, *Fair Shares in Corporate Mergers and Takeovers*, 88 HARV. L. REV. 297 (1974), cases discussing the fairness of such terms may be looked to for some hint as to the computation of such intrinsic "fair value." Such a case is Mills v. Electric Auto-Lite Co., 552 F.2d 1239 (7th Cir.), *cert. denied*, 98 S. Ct. 398, *rehearing denied*, 98 S. Ct. 649 (1977), where the court sought to establish the pre-merger value of the disappearing company in a merger. The circuit court, placing great emphasis on the pre-merger market value and the value of the synergism generated by the combination, reversed a district court determination that the merger terms were unfair which was based primarily on comparative earnings and book value. The court, in computing pre-merger value said:

> We must now decide what period of time should be used in calculating [the relative value] between each corporation's stock. Since prices from the period immediately preceding the merger are the most likely to reflect the *actual value* of the corporation at the time the merger was consummated, we begin with a presumption that a short period is appropriate. Accordingly, we hold that the average market value for approximately the six month period preceding the merger should be used unless there are special factors indicating that this period is unreliable. Six months is long enough so that very short-term price fluctuations will not play an unfairly important role and short enough so that the calculated [exchange] ratio does not reflect business conditions that have substantially changed as of the time of the merger.

552 F.2d at 1246-47 (emphasis added).

61. This change in the valuation of dissenter's stock under Virginia law was incorporated in these sections when they were rewritten in 1975. 1975 Va. Acts ch. 500, at 921.

62. Lichtman v. Recognition Equip., Inc., 295 A.2d 771, 772 (Del. Ch. 1972).

63. 205 Va. 84, 135 S.E.2d 147 (1964). *See* Gibson & Freeman, *The Annual Survey of Virginia Law: Business Associations*, 50 VA. L. REV. 1265, 1278 (1964).

of all that company's assets. The court, deferring to the trial court's methodology of valuation, sustained its finding of a value considerably less than the ascertained book value, and said that among the elements to be weighed are market value, net asset value, investment value and earnings capacity.[64] None of these elements is to be controlling in and of itself, but where there was "ample evidence" to support its finding, the court held "that the determination of the fair value of the dissenters' stock upon . . . conflicting evidence was for the trial court. . . ."[65] Mere book value was held not to be determinative on the grounds that "had the legislature so intended, the statute would have so provided."[66] Moreover, the court held that "fair cash value," which was the requirement under prior law, was equivalent in meaning to the requirement for "fair value" as used in the present law, thus rendering relevant those cases decided under the prior standard.

In considering the case law, the understanding of "fair value" is enhanced by the knowledge that the "design of the Virginia statute is to assure to the dissenting stockholder that he will be fully compensated for the value of that which he has been deprived by the merger, and no more,"[67] and therefore the statute should be liberally construed in the dissenters' favor.[68] "Fair value" therefore means the "actual" or "intrinsic worth" of the stock "after an appraisal of all of the elements of value."[69] However, further meaning is shrouded because there is no reported Virginia case indicating how the elements are to be valued or how they are to fit together.

Because of this void in the case law which presents itself in any determination of "fair value" under the Virginia section, further clarification must be had by reference to general principles of law,

64. 135 S.E.2d at 150.

65. *Id.* at 152.

66. *Id.* at 151.

67. Adams v. United States Distrib. Corp., 184 Va. 134, 34 S.E.2d 244, 249-50 (1945), *cert. denied*, 327 U.S. 788 (1946). *See also* Craddock-Terry v. Powell, 181 Va. 417, 25 S.E.2d 363, 374 (1943); Winfree v. Riverside Cotton Mills, 113 Va. 717, 75 S.E. 309 (1912).

68. *See* Note, *Corporations - Rights of Dissenting Stockholders Pending Statutory Appraisal Proceedings*, 21 VA. L. REV. 825 (1935).

69. Pittston Co. v. O'Hara, 191 Va. 886, 63 S.E.2d 34, 36 (1951); Adams v. United States Distrib. Corp., 184 Va. 134, 34 S.E.2d 244, 249-50 (1945), *cert. denied*, 327 U.S. 788, (1946); Craddock-Terry v. Powell, 181 Va. 417, 25 S.E.2d 363, 374 (1943); Winfree v. Riverside Cotton Mills Co., 113 Va. 717, 75 S.E. 309 (1912).

even though established by decisions in other jurisdictions.[70] Special significance should be attached to the decisions of jurisdictions whose standard of valuation, when reduced to its essence, is the same as adopted by the Supreme Court of Virginia; that is, "actual" or "intrinsic value."[71] Two such jurisdictions are the leading states of Delaware[72] and New York.[73] What these cases produce in general is the inescapable conclusion that there is no definite rule for determining "fair value," but that the proper result in each case will depend on the particular circumstances of the corporation and the type of stock involved.[74] Even the amount of stock or other consideration issued under the terms of the transaction cannot be conclusive evidence of the value of the shares of the subject corporation,[75] although much probative weight should be attached to this indicator where the terms were arrived at through arm's length negotiations between the corporate parties thereto.[76]

Of some comfort is the generalization that deference to the expertise of the corporation and appraisers is inevitable. Courts have been reluctant to disturb appraisers' findings unless the figures are arbitrary or based on unreasonable premises, and likewise, unless the corporation is unable to justify it under some reasonable method of valuation,[77] courts will presume the fairness of the proposed offer.

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70. The Virginia Supreme Court has shown a willingness in the area of dissenters' rights to refer to cases decided in other jurisdictions both directly, and indirectly through syntheses of these decisions in such treatises as FLETCHERS CYCLOPEDIA CORPORATION, and in such encyclopedias as AMERICAN JURISPRUDENCE and CORPUS JURIS SECONDUM. *See, e.g.*, Lucas v. Pembroke Water Co., 205 Va. 84, 135 S.E.2d 147; Adams v. United States Distrib. Corp., 184 Va. 134, 34 S.E.2d 244 (1945), *cert. denied*, 327 U.S. 788 (1946).

71. *See* note 69 *supra*.

72. Tri-Continental Corp. v. Battye, 31 Del. Ch. 523, 74 A.2d 71, 72 (Sup. Ct. 1950).

73. *See* 11 N.Y. JUR. REV. *Corporations* § 584 (and cases cited therein).

74. ABA-ALI MODEL BUS. CORP. ACT ANN. § 81, at 447 (1971); 55 MICH. L. REV. 689, 696 (1957).

75. Adams v. R. C. Williams & Co., 39 Del. Ch. 61, 158 A.2d 797, 799 (1960).

76. Brudney & Chirelstein, *Fair Shares in Corporate Mergers and Takeovers*, 88 HARV. L. REV. 297 (1974) [discussion of mergers between parent corporations and their subsidiaries with minority stockholders].

77. Lucas v. Pembroke Water Co., 205 Va. 84, 135 S.E.2d 147, 151 (1964) (importance of appraisers' report); American General Corp. v. Camp, 171 Md. 629, 190 A. 225, 230 (1937); Allaun v. Consolidated Oil Co., 16 Del. Ch. 318, 147 A. 257 (1929); Note, *Valuation of Dissenters' Stock Under Appraisal Statutes*, 79 HARV. L. REV. 1453, 1454 (1966); 55 MICH. L. REV. 689, 696 (1957).

A. *Market Value*

The market value of the stock involved in the appraisal, if it can be ascertained, is undoubtedly the most important factor in determining "fair value," and one commentator has equated Virginia's "fair value" standard with "fair market value."[78] This position finds support in the *Home Beneficial Life Insurance Co.*[79] case, in which the Richmond Chancery Court adopted the value placed upon the stock by the court-appointed appraiser, who had adopted the consensus price of the "market makers" in the unlisted stock of that corporation. Although the court considered the appraiser's evaluation, the market value, the net asset value, and earnings capacity of the stock, the reference to these other elements was in the opinion letter of the appraiser. Noting no "unusual fluctuations" in price or volume of orders in the months prior to and subsequent to the shareholder vote, the letter stated that insomuch as there was an active market in the stock allowing the "investing public" to appraise all of the elements of value including "earnings, dividends, future growth and potential and projected market environment," on a continuing basis, their informed collective opinion as to price represented the "fair value" of the stock.

The theory that market value may be determinative and thus the sole factor to be considered where "it fairly reflects the opinion of informed buyers and sellers" within the apparent meaning of the *Home Beneficial* case is buttressed by cases in other jurisdictions, especially New York.[80] In addition, corporations have sought to establish market value as the sole criterion for the valuation of dissenting shares. "Certainly, this is the simplest, if not the fairest test since the stock market quotations on the date prior to the date the vote is taken will determine the value of the shares."[81]

78. Note, *Seventeenth Annual Survey of Developments In Virginia Law: Business Associations*, 58 VA. L. REV. 1172, 1179 (1972).

79. Chancery Court of the City of Richmond, March 28, 1973.

80. *See* Jones v. Healy, 184 Misc. 923, 936, 55 N.Y.S.2d 349, 359-60 (Sup. Ct. 1945), *aff'd mem.*, 270 App. Div. 895, 62 N.Y.S.2d 605, *appeal denied*, 270 App. Div. 998 (1946); *In re* Marcus, 273 App. Div. 725, 727, 79 N.Y.S.2d 76, 78 (1948), *modifying in part*, 191 Misc. 808, 77 N.Y.S.2d 529 (1948); Jeffrey v. American Screw Co., 98 R.I. 286, 201 A.2d 146, 150 (1964); *In re* Deutshman, 281 App. Div. 14, 19, 116 N.Y.S.2d 578, 581 (Sup. Ct. 1952); *In re* Behrens, 61 N.Y.S.2d 179, 182, 183 (Sup. Ct. 1946), *aff'd*, 271 App. Div. 1007, 69 N.Y.S.2d 910 (1947).

81. Note, *Appraisal Statutes—An Analysis of Modern Trends*, 38 VA. L. REV. 915, 932 (1952).

Where the stock in question was not listed on a national securities market and there was no otherwise reliable market for it, establishment of a market value by resort to the trading price of the last sale of the stock, which had been several years earlier, has been approved by the Virginia Supreme Court.[82]

However, in light of the cases in Virginia, while major weight should be given to the market value of listed stock having an active market and regularly published quotations, market value on the day prior to the vote on the proposed transaction is susceptible to "extraneous pressures," such as fluctuations in anticipation of the corporate action, and therefore "not too dependable as a guide to intrinsic worth."[83] For that reason, in Virginia, market value has traditionally not been the sole criterion used in ascertaining "fair value."

With the addition to these statutes of the "Wall Street Rule"[84] in 1975, market value has assumed a new, but somewhat anomalous position. Virginia has by legislation adopted the rule that where there is a large reliable public market both for the class of stock to be given up and (in the case of mergers, consolidations and exhanges) for the stock of a corporation other than the "surviving, new or acquiring" corporation, if any, being received, obtaining prevailing market value by selling the stock is an adequate and exclusive remedy for stockholders dissatisfied with an extraordinary corporate transaction. Thus, the General Assembly, by eliminating appraisal in such circumstances, has effectively made market value "the conclusive test of value."[85] The right to dissent and demand "fair value" then remains a possibility in Virginia only for: (1) the corporation with no reliable public market for its stock; (2) holders of those classes of stock of an otherwise widely-held corporation which class is not listed on a national securities exchange or held of record by more than 2,000 persons; and (3) for those stockholders being required to accept in a section 13.1-75 transaction a form of consideration not qualifying under section 13.1-75(i)(2).

82. Lucas v. Pembroke Water Company, 205 Va. 84, 135 S.E.2d 147, 151 (1964).

83. Woodward v. Quigley, 257 Iowa 1077, 133 N.W.2d 38, 40, *modified on rehearing*, 257 Iowa 1160, 136 N.W.2d 281 (1965). *See also* note 88 *infra*.

84. *See* discussion of the "Wall Street Rule," Section I *supra*.

85. Brudney & Chirelstein, *Fair Shares In Corporate Mergers And Takeovers*, 88 HARV. L. REV. 297, 305 & n.20 (1974).

As they now read, the sections set a double standard of treatment. Qualified dissenting stockholders are entitled to receive "fair value" for their stock, which value is to be exclusive of price fluctuations occurring in anticipation of the proposed corporate transaction, while those stockholders whose remedy lies under the "Wall Street Rule" are left to a market value which will naturally reflect the psychological factors generated by anticipation of the proposed corporate transactions, which are often exacerbated by the presence of imbalancing factors in the market for the stock, such as arbitrageurs.[86] The problem arises that this double standard may be applied to stockholders who, while in the same corporation, hold different classes of its stock (because one class is widely traded and the other not, or because one class is required to take stock not qualifying under the "Wall Street Rule").[87] Thus, it is possible in many transactions involving large publicly-held corporations to structure transactions so as to avoid the necessity of granting to dissenting stockholders any rights under the Virginia sections.

Whether or not this double standard was intended by the General Assembly, the fact remains that it does exist.[88] Inasmuch as Virginia

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86. This phenomenom has been defined as follows:

> Arbitrage may be broadly defined as the purchase of property in one market and the simultaneous or near-simultaneous sale of the same property, or its equivalent, in either the same or a different market for the purpose of generating a profit resulting from the differential in price for such property or its equivalent. An arbitrageur in securities is therefore not an investor in the ordinary sense of the word in that he engages in such transactions in an effort to take advantage of price differentials rather than purchasing or selling securities on the basis of fundamental investment values.

E. A. Aranow & H. A. Einhorn, Tender Offers For Corporate Control 174 (1973).

87. The requirement for equality of treatment with respect to giving "fair value" for dissenters' stock extends to stockholders of the same class, so that all similarly situated receive equal value. Va. Code Ann. §§ 13.1-75(d); 13.1-78(d) (Supp. 1977). *See also* Fein v. Lanston Monotype Machine Co., 196 Va. 753, 85 S.E.2d 353, 360 (1955).

88. At this writing the Committee on Corporate Laws of the American Bar Association has proposed for comment changes in the Sections of the Model Business Corporation Act affecting dissenters' rights, including a proposal for the deletion of the "Wall Street Rule" which is included in its section 80. Although Virginia's version of the rule is more nearly like Delaware's, the reasons for the deletion advanced by the Committee merit attention because of their applicability to the general concept. The Committee puts forth four reasons for the deletion: (1) the marketplace of the 1970's has been characterized by "depressed prices" which it feels negates the possibility of obtaining "fair value;" (2) the unavailability of the Rule to those stockholders disqualified from selling shares under Federal or State securities laws because they occupy the status of an "insider" who has acquired shares within the prescribed period, or because they possess inside information; (3) a stockholder may possess

law recognizes that a reliable public market price is to be the conclusive test of value under certain prescribed circumstances, it creates a further basis for asserting that any market value which can be ascertained as being "reliable" should be the preeminent, if not the controlling, factor in the determination of the "fair value" of those dissenters entitled to demand "fair value."[89]

B. *Net Asset Value*

Net asset value has been defined as the "share which the stock represents in the value of the net assets of the corporation."[90] The net asset value should be determined by the "going concern" value, rather than the liquidation value of the assets.[91] However, there are cases in which the going concern value has been given no value, as where the market place as of the date of the consummation of the extraordinary transaction was less than the dissolution value of the company.[92]

In order to find the current value of the assets, the present replacement cost of those same assets should be determined.[93] "[T]his amount should then be depreciated to reflect age and may be discounted further to take account of obsolescence."[94] In addi-

a disproportionately large holding of stock in a "thin market;" and (4) the recognition that psychological factors in the marketplace will inevitably influence market price. *Changes in the Model Business Corporation Act Affecting Dissenters' Rights, A Report of the Committee on Corporate Laws,* 32 BUS. LAW. 1855, 1862 (1977). The Committee, taking the view that "corporate acquisitions are part of the normal life of corporations [and] when they do not involve a major change in the corporation's business, they should not entitle a shareholder to withdraw his investment," *id.*, has proposed changes to the Model Business Corporation Act, which in addition to its present text would have the effect of limiting the availability of dissenters' rights substantially so as to effectuate this policy.

The Committee's points are well taken, and they should be balanced off against the convenience and certainty the "Wall Street Rule" provides to the parties in an extraordinary transaction where it is applicable. It might also provide for the Virginia General Assembly an opportunity to review the present double standard existing in the areas of dissenters' rights in light of constructive proposals for change.

89. *See* Mills v. Electric Auto-Lite Company, 552 F.2d 1239 (7th Cir.), *cert. denied*, 98 S. Ct. 398, *rehearing denied*, 98 S. Ct. 649 (1977).

90. 13 FLETCHER CYC. CORP. (Rev. Vol. 1970) § 5906.14, at 271.

91. American Gen. Corp. v. Camp, 171 Md. 629, 190 A. 225, 229-30 (1937).

92. Sporborg v. City Specialty Stores, Inc., 35 Del. Ch. 560, 123 A.2d 121 (1956); Note, 79 HARV. L. REV. 1453, 1457 (1966).

93. Note, 79 HARV. L. REV. 1453, 1457 (1966).

94. *Id.*

tion, in computing this valuation, Virginia apparently permits the inclusion as assets of sums withdrawn from the corporation's treasury that might be classified as an improper corporate expense, such as excessive salaries paid to officers.[95]

It has been argued that the expense involved in the appraisal of individual assets often justifies dispensing with the asset in valuation, especially where the dissenters' holdings are relatively small.[96] Earnings and market data and even estimations of the replacement costs of capital assets are available from corporate records, proxy material, securities markets and financial reporting services. Asset value has also been criticized as a "liquidation yardstick, inappropriate because minority stockholders typically have invested for dividend income or stock appreciation and rarely expect to share in the physicial assets."[97] Regardless, the significance of assets cannot be completely disregarded and, indeed, is one of the four elements which has been specifically required to be considered in Virginia.

C. *Investment Value*

Although it has been held that investment value is not an independent element because it duplicates earnings value,[98] it is, nonetheless, one of the elements that should be weighed in Virginia. Investment value has been defined as taking

> account of such factors as the capitalization of the company, earnings, and dividend record, position in the industry, prospects of the business and the industry, and the overall value of its securities in relation to general market conditions and the market values of comparable securities. There should be considered the rate of dividends, the regularity with which they have been paid, the management and reputation of the company, its prospects for the future, and all other circumstances helpful in estimating the future course of the stock in

95. Lucas v. Pembroke Water Co., 205 Va. 84, 135 S.E.2d 147, 152 (1964); Note, 79 HARV. L. REV. 1453, 1460 (1960). *See In re* Marcus, 273 App. Div. 727, 79 N.Y.S.2d 76, 81-2 (1948), *modifying in part,* 191 Misc. 808, 77 N.Y.S.2d 529 (1948).

96. Note, 79 HARV. L. REV. 1453, 1460 (1966). *See In re* Marcus, 273 App. Div. 727, 79 N.Y.S.2d 76, 81-2, *modifying in part,* 191 Misc. 808, 77 N.Y.S. 529 (1948).

97. Note, 79 HARV. L. REV. 1453, 1460 (1966).

98. Sporborg v. City Specialty Stores, Inc., 35 Del. Ch. 560, 123 A.2d 121, 125-6 (1956).

the market. Good will is to be considered, and earning capacity is always an important item.[99]

The earnings should be averaged over several years, probably at least five years, so as to avoid any "undue emphasis on either an exceptionally good or bad year." In addition, the period selected should be tailored so as to exclude factors and events that are no longer relevant to an evaluation of earnings. An attempt also should be made to eliminate any abnormalities in the earnings average that really are not reflective of the earnings trend.[100] At a minimum the [abnormal] event should be so exceptional that recurrence is unforeseeable; even then, perhaps it should be excluded only when the industry is so stable that earnings would have shown a detectable pattern but for the event in question.[101]

Delaware courts have disapproved of long-range predictions of earnings as being too speculative in nature, although the Virginia Supreme Court in *Lucas* v. *Pembroke Water Co.*[102] approved consideration of a projected future improvement in earnings. This view should be considered in the light of recent trends by the Securities and Exchange Commission encouraging the use of future economic projections in annual reports and through the media.[103]

It has been suggested that the valuation of the so-called "intangible assets," such as good will, may be dispensed with owing to the fact that this value is subsumed in the market value figure, which may already be expected to reflect the investment community's opinion as to the value of intangibles.[104]

On the subject of a capitalization ratio, or multiplier, deference to the calculations of the appraisers can be expected when the result appears to be "within the range of reason."[105] A similar deference would seem to be in order for the reasonable calculations of the

99. 13 FLETCHER CYC. CORP. (Rev. Vol. 1970) § 5906.15, at 274-5. *See also* Note, 79 HARV. L. REV. 1453, 1464 (1966); 55 MICH. L. REV. 689, 693 (1957).

100. Note, 79 HARV. L. REV. 1453, 1465 (1964).

101. *Id.*

102. 205 Va. 84, 135 S.E.2d 147, 151 (1964).

103. S.E.C. Release No. 34-9984 and Release No. 33-5362 (February 2, 1973), 38 F.R. 7220, 2 FED. SEC. L. RPTR. (C.C.H.) ¶ 23,508.

104. Note, 79 HARV. L. REV. 1453, 1466 (1964).

105. *Id.* at 1467.

corporation, exchange ratios which are the results of arm's-length negotiations among the parties and certainly for the informed opinions of independent investment bankers, if any.

D. *Earnings Capacity*

Although the Virginia Supreme Court lists earnings capacity as one of the elements constituting "fair value," there is little evidence of how this figure is intended to affect the valuation.[106] Indeed, it is not often considered as a separate element, but rather an element in determining investment value.[107] Because of its inclusion within investment value, even when considered as a separate element of valuation, earnings capacity has been assigned a weight of zero.[108] While this approach is certainly correct in a situation where there is no reasonable probability of dividends in the foreseeable future, or possibly where there is a pattern of non-payment of dividends, if earnings capacity is truly to have an input as a separate element in the appraisal process, this should not be the case where the corporate parties to the transaction are healthy, profitable businesses.

Perhaps the real importance of dividends comes in the computation of the interest rate in an appraisal which is discretionary with the trial court.[109] As Mr. Gibson has stated:

> The final judgment must allow [the dissenting shareholder] interest, though the rate remains to be found by the judge in accordance with what may be fair and equitable in all the circumstances of the case. An important circumstance is, of course, the earnings experience during the appraisal proceedings. If the stock is not earning anything, no award of more than purely nominal rate would seem to be equitable, unless dividends were being paid, though unearned on outstanding shares. If, on the other hand, the per share earnings are large, even

106. Lucas v. Pembroke Water Co., 205 Va. 84, 135 S.E.2d 147, 151 (1964).

107. 55 MICH. L. REV. 689, 690-1 (1957); 13 FLETCHER CYC. CORP. (Rev. Vol. 1970) § 5906.15, at 274.

108. For a table illustrating how the courts in Delaware have allocated the weights to the valuation elements and a "typical" allocation situation synthesized therefrom, see Note, 79 HARV. L. REV. 1453, 1469-70 (1966).

109. VA. CODE ANN. §§ 13.1-75(f); 13.1-78(f) (Supp. 1977). *See* Lucas v. Pembroke Water Co., 205 Va. 84, 135 S.E.2d 147, 151 (1964); Pittston Co. v. O'Hara, 191 Va. 886, 63 S.E.2d 34 (1951) (decided under prior law).

though no dividends are paid, a reasonable rate of interest would seem right.[110]

E. *Weighing the Elements*

As has already been stated, there is no legal formula which can be enunciated and applied in valuation, and the determination remains a matter of judgment on the facts in each case with the weight to be attached to each factor naturally varying in accordance with the particular facts of each case.[111] The method employed in any one given case should therefore depend upon the circumstances requiring valuation.

Once the various elements have been computed, they must be balanced in order to arrive at a figure that will represent fair consideration for the dissenters' stock. The relative weights will necessarily vary according to the type of business involved, the type of stock and any special circumstances surrounding the industry. Less weight should be given a particular element when the estimate of its value is unreliable. In the Delaware case of *Heller* v. *Munsingwear, Inc.*,[112] less weight was assigned to a valuation element where it was substantially out of line with the other elements causing the court to lose confidence in its accuracy.

In this balancing act, courts are apt to rely on the appraiser's judgment unless it appears to be unreasonable. Thus, an

> appraiser's determination will not usually be upset unless it is arbitrary and unreasonable or unless it appears . . . that the award was, by reason of some material and prejudicial error of law . . . not the fair value of the stock . . . . In short, the appraiser has a wide discretionary power.[113]

Similarly, the Virginia Supreme Court has shown a willingness to defer to the opinion of the trial court in valuation, which opinion

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110. Gibson, *supra* note 18, at 471.

111. *In re* Behrens, 61 N.Y.S.2d 179, 182 (Sup. Ct. 1946), *aff'd*, 271 App. Div. 1007, 69 N.Y.S.2d 910 (1947).

112. 33 Del. Ch. 593, 98 A.2d 774, 777 (Del. Ch. 1953). *See also* American Gen. Corp. v. Camp, 171 Md. 629, 190 A. 225, 229 (1937).

113. Note, *Appraisal Statutes—An Analysis of Modern Trends*, 38 VA. L. REV. 915 (1952).

shall not be upset except where there is insufficient evidence to support its findings.[114]

Deference to the opinion of the corporation should also be expected since "courts will usually presume that the proposed price is fair unless the corporation is unable to justify it under any reasonable technique of valuation."[115] In Virginia, the corporation is under a legal duty to make a "good faith" offer, and in order to comply it would seem that the corporation would have to internally go through the appraisal process. Therefore, such offer should, in order to comply with the requirement of "good faith," be in and of itself the result of the application of some reasonable valuation technique.

In determining the "fair value" of stock, it may be wise to assign to each element of valuation an independent weight so as to avoid any allegation that one or more elements were not considered.[116] In light of the "Wall Street Rule," however, it may now be possible to assert that the independent element of market value includes consideration of the other required elements of valuation.

F. *Different Classes of Stock*

Even though management may have negotiated the best deal possible in the inter-corporate transaction, holders of preferred or preference stock may believe that the value of their preferred rights and interests have been eroded or removed, with little or no protection or participation afforded in the continuing or surviving corporate entity. "Clearly the market values of different classes will differ, as should the capitalization ratios for earnings."[117]

However, the dissenting stockholders holding preferred stock are not entitled to anything more than the "fair value" of their stock. They have no right to claim anything else, and where one such group claimed entitlement to a "contractual value" of their preferred stock based upon its par value plus dividends accrued but unpaid,

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114. Lucas v. Pembroke Water Co., 205 Va. 84, 135 S.E.2d 147, 152 (1964).

115. Note, 79 HARV. L. REV. 1452, 1454 (1966).

116. Home Beneficial Life Ins. Co. v. Lawrence, Chancery Court of the City of Richmond, March 28, 1973.

117. Note, 79 HARV. L. REV. 1452, 1472-3 (1966).

the Virginia Supreme Court denied the claim.[118] Although it was possible under the pre-1956 version of the section regarding sale of the assets to successfully maintain such a suit in equity, the right was found to be contained in the old wording which permitted resort to remedies found under the "general law," and allowing the maintenance of a separate suit in equity for "inadequacy of consideration. . . ." With the virtual identity of the wording of the two sections today, eliminating resort to the "general law," such claims can no longer be recognized.

IV. Conclusion

Where the stockholder in a Virginia corporation which is a party to an extraordinary transaction objects to the adequacy of the consideration being offered for his stock or the "fairness" of the transaction, he is given a choice between his statutory dissenter's rights, acceptance of the terms or being "cashed-out" by marketing his shares. In the absence of illegality, fraud or possibly a breach of fiduciary duty owed to minority stockholders by the majority stockholder in accomplishing a "freeze-out" of the former, the appraisal remedy constitutes the dissenting stockholders' exclusive alternative to being bound by the terms of the transaction (assuming compliance with all the statutory requirements for completion of an extra-ordinary transaction both procedural and substantive).

If any generalized conclusions may be safely reached regarding valuation of a dissenter's shares, they must fall in three categories. First, any determination of "fair value" is a matter of judgment to be made upon the specific facts of the case in question, including the reason for the valuation, the type of business involved, the type of stock involved, any special circumstances applicable to the company and, perhaps, any circumstances that are applicable to the industry. With the addition to the Virginia dissenters' rights statutes of the "Wall Street Rule," market value, which had been an important factor prior thereto, was raised to a pre-eminent position and may indicate a legislative intent to render reliable market value the "conclusive test" of "fair value."

118. Adams v. United States Distrib. Corp., 184 Va. 134, 34 S.E.2d 244 (1945), *cert. denied*, 327 U.S. 788 (1946).

Secondly, as to appraisal rights, courts (including Virginia courts) are reluctant to get too involved with the actual mathematics of a stock appraisal. If the corporation's price offer is reasonable and is the result of a rational method of valuation, courts show great deference to appraisers' opinions in adopting them as the "fair value" of dissenters' stock. It appears that the Virginia Supreme Court will confirm the valuation made by the trial court except where there is insufficient evidence to support it.

Finally, the appraisal process in Virginia presents a potentially expensive and drawn-out method to dissenters. In weighing the wisdom of pursuing this statutory remedy, most potential dissenters may be dissuaded from availing themselves of it. Thus, it would seem that only the truly large holder of stock desiring to exercise his appraisal rights would have anything to gain by rejecting the corporation's "good faith" offer and electing to go through the judicial appraisal procedures.