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Focus

After a Merger, Bar Is Higher for Dissenters to Challenge It

By Thomas C. Klein

Minority shareholders objecting to the acquisition of their corporation may dissent from the acquisition and have their shares bought out for fair value. Every state has adopted some form of statutory appraisal procedure for determining the fair value of dissenting shareholders' shares. Historically, the consent of every shareholder was required to effect an acquisition of a corporation. This unanimity requirement often impeded many value-enhancing transactions because a determined, and sometimes unreasonable, minority of shareholders could thwart the will of the majority. Appraisal or dissenters' rights statutes were adopted to enable acquisitions approved by a majority of the corporation's shareholders while providing fair value to the minority shareholders opposed to the merger.

These statutes provide protection to minority shareholders who not only might disagree with the merger but also might believe that conflicts of interest or other breaches of fiduciary duty resulted in a lower than fair value price for shares in a merger. Consistent with the policy of enabling majority-approved acquisition transactions, these statutes also typically insulate the merger transaction from attacks on its validity by the minority shareholders. California's dissenters' rights statute, California Corporations Code, Sections 1300-1313, states that no shareholder who has dissenters' rights can attack the validity of the acquisition except to test whether the proper vote was obtained to approve the transaction.

The California dissenters' rights statute provides that within 10 days after the approval of a transaction changing the control of the corporation (and certain asset sale transactions) — called "reorganizations" — the corporation must mail to each potential dissenting shareholder: 1) a statement of the fair market value of dissenting shares determined by the corporation as of the day before the first announcement of the proposed reorganization, excluding any change in value in consequence of the proposed transaction itself; 2) a brief description of the procedure to be followed to exercise dissenters' rights; and 3) copies of certain portions of the dissenters' rights statute. The statement of fair market value sent to these shareholders constitutes an offer by the corporation to buy the dissenting shares at that price. If the dissenters disagree with the price offered, they can petition for an appraisal procedure overseen by the proper California Superior Court.

In the recent case of *Singhania v. Uttarwar,* 2006 DJDAR 1478 (Feb. 3, 2006), the California Court of Appeal addressed whether the appraisal remedy of the California dissenters' rights statute was the exclusive remedy after a reorganization for a shareholder who alleges misrepresentation by the corporation and corporate insiders regarding the dissenters' rights process and concealment of information that might be useful to a shareholder in deciding whether to dissent from an acquisition. The question before the Court of Appeal was whether the appraisal remedy acted as a bar to post-merger challenges to the acquisition, even if such challenges were asserted against individual corporation fiduciaries — directors, officers and majority shareholders.

In *Singhania*, the plaintiffs — a group of former minority shareholders and former employees of Soft Plus Inc., a California corporation that was merged into a subsidiary of then-publicly traded U.S. Interactive Inc. — alleged that the information soliciting approval of the merger transaction disseminated by Soft Plus to its shareholders failed to contain the information required by the California dissenters' rights statute. Principally, the plaintiffs asserted that the corporation failed to inform them of the corporation's responsibility to state a fair market value for dissenting shares and that such stated value would constitute an offer to purchase such dissenting shares at that price.

Furthermore, the plaintiffs alleged that the defendant fiduciaries breached their fiduciary duty by omitting the statement of fair value and by stating that dissenting shareholders had to make a demand on the corporation to purchase their shares without the corporation having provided any price to the shareholders. The plaintiffs also claimed that the defendants breached their fiduciary duty by concealing information and documents essential to plaintiffs' decision of whether to exercise their dissenters' rights.

The merged company and U.S. Interactive filed for bankruptcy protection from creditors sometime after the merger. Claims against Soft Plus and U.S. Interactive did not survive the bankruptcy. Accordingly, the plaintiffs sought a remedy from the former Soft Plus fiduciaries. The plaintiffs' complaint in the trial court was dismissed multiple times with leave to amend, and ultimately the fourth amended complaint was dismissed by the trial court on an order sustaining the defendant's demurrer.

On the plaintiffs' appeal, the Court of Appeal examined what it termed the "statutory bar" to post-acquisition claims in Section 1312(a) of the California Corporations Code, which prohibits post-reorganization attacks on the validity of a reorganization on the theory that dissenting shareholders have the appraisal remedy, and in any such proceeding a dissenting shareholder can prove that he or she is entitled to a higher price because of any number of factors, including breaches of fiduciary duty. The Court of Appeal cited

as authority the California Supreme Court decision of *Steinberg v. Amplica,* 42 Cal.3d 1198 (Dec. 31, 1986, as modified Feb. 11, 1987), which held that where a plaintiff is aware of all the facts underlying a claim for breach of fiduciary duty before the merger but refrained from filing the action for damages until after the merger was completed, Section 1312(a) acts as a bar to such suit. The *Steinberg* court reasoned that a plaintiff aware of the facts of a breach of fiduciary pre-acquisition should bring her claims in the appraisal process and if the price of the stock is artificially deflated because of the breach of fiduciary duty, then the plaintiff can seek full value and be cashed out in the appraisal process.

The plaintiffs in *Singhania* strove to distinguish the facts of their case from that of *Steinberg*, alleging that they were not aware of all of the facts of the breach of fiduciary duty because the corporation withheld documents and information that would have assisted the plaintiffs in deciding whether to exercise their appraisal remedy. The plaintiffs argued that they were damaged by a procedural infraction committed by Soft Plus for not including the statement of fair market value as well as a substantive breach of duty and fraud by the fiduciaries withholding information and thereby precluding the shareholders from making a timely or informed decision to participate in the merger. The plaintiffs asserted that *Steinberg* does not apply because they were not aware of all the facts that were withheld.

The Court of Appeal noted that all shareholders of Soft Plus received an information statement detailing the terms of the acquisition, the approval process for the acquisition, the merger consideration to be paid to the shareholders and, among other information, a statement of the procedure the shareholders needed to follow to exercise their dissenters' rights. In addition, Soft Plus included a copy of the relevant statutory dissenters' rights provisions of California law. The court determined that any procedural infraction by Soft Plus was negated by Soft Plus' providing the shareholders with a copy of the dissenters' rights statute setting out the applicable statutory provisions for exercising their dissenters' rights, notwithstanding the corporation's failure to state a fair market value price.

With regard to the claim of withholding information, the court found that Soft Plus was not obliged to provide any information requested by the plaintiffs beyond that to which they were entitled under the shareholder information provisions of Sections 1600 and 1601 of the California Corporations Code.

Therefore, the plaintiffs had a means to obtain the information they claim they lacked and they could have obtained such information within the time period for exercise of the dissenters' rights. Furthermore, the court noted that shareholders do not have an enhanced right to corporate records or information in a merger when deciding whether to exercise their dissenters' rights. Accordingly, the Court of Appeal concluded that Section 1312(a) acts as a bar to a post-acquisition claim that fiduciaries concealed certain information when the corporation had no statutory duty to provide such information.

The court nevertheless made clear that Section 1312(a) may not bar an action for a fraud or a breach of fiduciary duty that causes a shareholder to go along with a reorganization based upon misinformation or nondisclosures material to a decision about exercising dissenters' rights.

However, absent evidence that the plaintiffs lacked material information to which they were entitled, the court reasoned that Section 1312(a) should bar claims that are ultimately just about fair value, which can be best adjudicated in an appraisal process. The Section 1312(a) bar thus supports a policy articulated by Justice Stanley Mosk in *Steinberg,* namely to enable "the consummation of mergers benefiting the majority and the corporation as a whole ... [and limiting] the prospect of personal liability of those who arranged the merger, including liability for punitive damages, that would be a powerful disincentive to legitimate mergers."

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