

THE FORM AND SUBSTANCE OF A MERGER: A READING  
OF *FARRIS v. GLEN ALDEN CORP.*

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*Editor's Preface*

THE STYLE OF the following article, while not unusual for the author,<sup>a</sup> is likely to be quite unfamiliar to the reader. The article offers a multifaceted analysis of the subject under consideration and employs a method whereby the reader is continually exposed to slightly varied factual patterns which give insight into the reasoning of the decisionmaking bodies. The technique, in effect, forces the reader toward the conclusion while offering little in the way of customary concrete guidelines. Thus, the article's unorthodox approach and complexity require considerable effort from the reader. Accordingly, this brief preface and several editors' notes have been provided to assist the reader.

Successful judicial opinions serve at least two functions: they resolve a particular controversy before the court and, at the same time, contribute to the continuing development of a viable legal doctrine. In a few instances, moreover, an opinion may provide an impetus for academic comment upon the merits of the decision and the doctrine it represents.

The decision of the Supreme Court of Pennsylvania in *Farris v. Glen Alden Corp.*<sup>b</sup> is such an opinion. In this article, Professor Deutsch offers a functional basis for the de facto merger doctrine espoused by the *Farris* court, indicates how academicians have distorted that decision, and demonstrates the significance of the de facto merger doctrine for various professionals.

— *The Editors*

Lay incomprehensibility being necessary to professional status, the function of a profession is the practise of mysteries, and the profession will remain economically viable only so long as new members can continue to master the strange compound of empiricism and superstition whereby doctrines deemed crucial by the laity can simultaneously

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a. See Deutsch, Perlman v. Feldmann: *A Case Study in Contemporary Legal History*, 8 U. MICH. J.L. REF. 1 (1974); Deutsch, *Precedent and Adjudication*, 83 YALE L.J. 1553 (1973).

b. 393 Pa. 427, 143 A.2d 25 (1958).

be manipulated and remain mysterious. What follows is my reading of such a mystery: a doctrine created by a decision in which the Supreme Court of Pennsylvania held void a legal act done by lawyers in their professional capacities.

I.

A.

The holding of *Farris v. Glen Alden Corp.* was that:

[T]he combination contemplated by the reorganization agreement, although consummated by contract rather than in accordance with the statutory procedure, is a merger within the protective purview of sections . . . of the corporation law. The shareholders of Glen Alden should have been notified accordingly and advised of their statutory rights of dissent and appraisal. The failure of the corporate officers to take these steps renders the stockholder approval of the agreement at the 1958 shareholders' meeting invalid.<sup>1</sup>

On February 2, 1971, James L. Lopata, a Pennsylvania resident, was injured at his employer's plant in New Jersey while attempting to unjam an allegedly defective machine which had been manufactured by the Rock Wool Engineering and Equipment Company.<sup>2</sup> Pursuant to an agreement executed upon March 31, 1966, Rock Wool had sold the bulk of its assets to Bemis Company, Inc. (which continued to manufacture similar machines), had subsequently changed its corporate name to Overman & Shovlin, and had eventually dissolved in April, 1967.<sup>3</sup> In the proceedings brought by Lopata against Bemis, the federal district court held that there was no issue as to fact, and that the governing legal principle was that a sale of corporate property by one company to another does not render the purchaser liable for unassumed liabilities of the seller unless, *inter alia*, the transaction amounted to a merger.<sup>4</sup> Citing *Farris*, Lopata argued that the transaction between the two companies constituted a *de facto* merger and consequently fell within the exception to the general rule.<sup>5</sup>

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1. *Farris v. Glen Alden Corp.*, 393 Pa. 427, 438, 143 A.2d 25, 31 (1958).

2. *Lopata v. Bemis Co.*, 383 F. Supp. 342, 343 (E.D. Pa. 1974).

3. *Id.*

4. *Id.* at 344.

5. *Id.* at 344-45. See also *In re Penn Cent. Sec. Litigation*, 367 F. Supp. 1158 (E.D. Pa. 1973), where the court stated:

That the concept of a *de facto* merger has until now been applied mainly to lawsuits by dissenting shareholders seeking rights of appraisal does not mean that it may be used only in that situation. We can discern no reason either in the origin of the doctrine or in the cases applying it why it should be so limited. The *de facto* merger doctrine is a judge-made device for avoiding patent injustice which might befall a party simply because a merger has been called something

## B.

In *Farris v. Glen Alden Corp.*, the court began by defining the issue presented for decision:

We are required to determine on this appeal whether, as a result of a "Reorganization Agreement" executed by the officers of Glen Alden Corporation and List Industries Corporation, and approved by the shareholders of the former company, the rights and remedies of a dissenting shareholder accrue to the plaintiff.<sup>6</sup>

Later in its opinion, the *Farris* court noted that:

The gravamen of the complaint was that the notice of the annual shareholders' meeting did not conform to the requirements of the Business Corporation Law in three respects: (1) It did not give notice to the shareholders that the true intent and purpose of the meeting was to effect a merger or consolidation of Glen Alden and List; (2) It failed to give notice to the shareholders of their right to dissent to the plan of merger or consolidation and claim fair value for their shares, and (3) It did not contain copies of the text of certain sections of the Business Corporation Law as required.<sup>7</sup>

Analyzing the decision, Professor Folk noted that:

The *de facto* merger holding was based on a variety of factors which the court found in the transaction, including a complete change in the nature of the corporation's business, the doubling of the size of the successor corporation, a shift in control of the board of directors to the selling corporation, the purchaser's assumption of the seller's liabilities, a reduction of the proportionate interest of the purchasing corporation's shareholders in the successor corporation plus a sharp drop in the book value of their shares, and the fact that the selling corporation dissolved and distributed the shares it received to its shareholders. Evidently, in the court's view, no one of these factors alone can transform an assets sale into a merger, but the court did not disclose the precise combination of factors which would. Indeed, some of the factors are to be found in many assets sales of impeccable legitimacy.<sup>8</sup>

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else. The deprivation of a corporation's right to sue under § 10(b) and Rule 10b-5 because the equivalent of a merger has been achieved by a roundabout transaction is as much an injustice as the deprivation of a shareholder's right of appraisal, and makes it necessary for a court to look at the substance of the transaction rather than its form.

*Id.* at 1170.

6. 393 Pa. 427, 428, 143 A.2d 25, 26 (1958).

7. *Id.* at 430-31, 143 A.2d at 27 (footnote omitted).

8. Folk, *De Facto Mergers in Delaware: Hariton v. Arco Electronics, Inc.*, 49 VA. L. REV. 1261, 1266 (1963).

Comparing the actions of the *Farris* court with such Delaware decisions as *Heilbrunn v. Sun Chemical Corp.*,<sup>9</sup> *Hariton v. Arco Electronics, Inc.*,<sup>10</sup> and *Orzeck v. Englehart*,<sup>11</sup> Professor Folk concluded that the Pennsylvania decision was inadequate for three reasons: First, "these individual factors seem only marginally relevant, at best, to the question when a sale of assets becomes a *de facto* merger."<sup>12</sup> Second, "a *de facto* merger test based on some combination of factors is unsettling to the security of transactions when it is impossible or difficult to state the disqualifying factors, for no objective standard is available for measuring a proposed transaction in advance."<sup>13</sup> And third, "assuming that some of these factors are indicative of a 'real' merger, it is question-

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9. 38 Del. Ch. 321, 150 A.2d 755 (Sup. Ct. 1959), *aff'g* 37 Del. Ch. 552, 146 A.2d 757 (Ch. 1958).

[Editors' note] In *Heilbrunn*, two corporations had agreed to a plan under which one would purchase all the assets of the other with stock, the selling corporation to distribute the stock to its shareholders and then dissolve. A shareholder of the purchasing corporation attacked the plan as invalid upon the ground that it was a *de facto* merger which would deny him statutorily required appraisal rights. *Id.* at 323-24, 150 A.2d at 756-57. The Supreme Court of Delaware held the plan valid under the overlapping merger and sale of assets sections of the Delaware corporation law. *Id.* at 325, 150 A.2d at 757. The *de facto* merger doctrine was held inapplicable because there had been no injury to the purchaser's shareholder since: (1) the business of the purchaser would continue as before; (2) the shareholder had not been forced to accept stock in another corporation; and (3) the essential nature of the purchaser remained unchanged. *Id.* at 326, 150 A.2d at 758.

10. 41 Del. Ch. 74, 188 A.2d 123 (Sup. Ct. 1963), *aff'g* 40 Del. Ch. 326, 182 A.2d 22 (Ch. 1962).

[Editors' note] In *Hariton*, two corporations had entered into a "reorganization" plan whereby one agreed to sell its assets to the other in return for stock of the purchaser. Such stock was to be distributed to the stockholders of the seller, and the selling corporation was then to dissolve. A shareholder of the seller attacked the validity of the plan, claiming it was a *de facto* merger in which no appraisal rights were granted as required by the merger section of Delaware's corporation law. *Id.* at 75-76, 188 A.2d at 124. The Supreme Court of Delaware held that the validity of a corporate act under one section of Delaware's corporation law was not dependent upon its validity under another section. Therefore, while the results of the instant transaction were the same as a merger yet the plan did not comply with the merger section of the statute, it was nonetheless valid since it did meet the requirements of Delaware's sale of assets section. *Id.*, 188 A.2d at 125.

11. 41 Del. Ch. 223, 192 A.2d 36 (Ch. 1963).

[Editors' note] In *Orzeck*, a corporation's plan to purchase the stock of seven other corporations was attacked by a shareholder who claimed it would result in a *de facto* merger which would be unlawful for failure to comply with the merger section of Delaware's corporation law. *Id.* at 224-25, 192 A.2d at 36-37. The Delaware Court of Chancery upheld the plan upon the grounds that: (1) the plan complied with a separate section of the Delaware corporation law and hence was valid since the various sections of the corporation law were independent of each other; and (2) that the *de facto* merger doctrine was inapplicable because the relationship created by the stock sale was not the same as that created by a merger, and in the instant case there was to be no essential change in the nature of the purchasing corporation. *Id.* at 227-28, 192 A.2d at 38-39. The Delaware Supreme Court opinion, which had not yet issued when Professor Folk's article was written, affirmed, upon similar grounds. *Orzeck v. Englehart*, 41 Del. Ch. 361, 195 A.2d 375 (Sup. Ct. 1963).

12. Folk, *supra* note 8, at 1275.

13. *Id.* at 1276.

able whether a court on its own should declare standards supplementary to whatever standards the statute provides."<sup>14</sup>

That the Delaware cases surveyed by Professor Folk were rooted in the particular view of legislative power underlying his third criticism of *Farris* is illustrated by the statement of the Delaware Court of Chancery in *Hariton* that, "While plaintiff's contention that the doctrine of de factor merger should be applied in the present circumstances is not without appeal, the subject is one which, in my opinion, is within the legislative domain."<sup>15</sup> It should be noted, however, that the rationale offered by the *Hariton* court to justify its opinion is based not upon legislative authority, but upon the fact that

[T]here is authority in decisions of courts of this state for the proposition that the various sections of the Delaware Corporation Law conferring authority for corporate action are independent of each other and that a given result may be accomplished by proceeding under one section which is not possible, or is even forbidden under another.<sup>16</sup>

and that "[a] holding in the stockholder's favor would be directly contrary to the theory of the cited cases."<sup>17</sup> Moreover, the Supreme Court of Delaware strikingly confined its conflict with the Pennsylvania decision to this precise formulation:

We do not intend to be understood as holding that the doctrine of *de facto* merger is not recognized in Delaware . . . .

. . . .

We note that the Supreme Court of Pennsylvania has rejected the theory, firmly embodied in the Delaware Corporation Law, of the independent legal significance of action taken under one section of that law, as opposed to other sections. If that is the holding in the *Farris* case, as we think it is, we decline to accept it as persuasive.<sup>18</sup>

14. *Id.* at 1277.

15. 40 Del. Ch. at 331-32, 182 A.2d at 25.

16. *Id.* at 333, 182 A.2d at 26.

17. *Id.* at 334, 182 A.2d at 27.

[Editors' note] The cases cited by the *Hariton* court were: *Hotzemstein v. York Ice Mach. Corp.*, 45 F. Supp. 436 (D. Del. 1942), *aff'd*, 136 F.2d 944 (3d Cir. 1943); and *Federal United Corp. v. Havender*, 24 Del. Ch. 318, 11 A.2d 331 (Sup. Ct. 1940), *motion for leave to file bill of review denied*, 146 F.2d 835 (3d Cir. 1944), *cert. denied*, 325 U.S. 886 (1945). These cases stand for the proposition that while the elimination of accrued dividends upon preferred stock through amendment of the corporate charter is prohibited by one section of the corporation law, the prohibited elimination can be accomplished through compliance with the merger statute.

18. *Orzeck v. Englehart*, 41 Del. Ch. 361, 367, 195 A.2d 375, 378 (Sup. Ct. 1963).

The *Farris* opinion clearly indicates that its holding was rooted in judicial rather than legislative law-making authority:

[I]t is no longer helpful to consider an individual transaction in the abstract and solely by reference to the various elements therein determine whether it is a "merger" or a "sale." Instead, to determine properly the nature of a corporate transaction, we must refer not only to all the provisions of the agreement, but also to the consequences of the transaction and to the purposes of the provisions of the corporation law said to be applicable . . . .<sup>19</sup>

....

[The] provision [held to be applicable] had its origin in the early decision of this Court [in which] a shareholder who objected to the consolidation of his company with another was held to have a right in the absence of statute to treat the consolidation as a dissolution of his company and to receive the value of his shares upon their surrender.<sup>20</sup>

....

[D]efendants contend that the 1957 amendments to . . . the corporation law preclude us from reaching [our] result and require the entry of judgment in their favor . . . .<sup>21</sup>

....

Defendants view these amendments as abridging the right of shareholders to dissent to a transaction between two corporations which involves a transfer of assets for a consideration even though the transfer has all the legal incidents of a merger. They claim that only if the merger is accomplished in accordance with the prescribed statutory procedure does the right of dissent accrue. In support of this position they cite to us the comment on the amendments by the Committee on Corporation Law of the Pennsylvania Bar Association, the committee which originally drafted these provisions. The comment states that the provisions were intended to overrule cases which granted shareholders the right to dissent to a sale of assets when accompanied by the legal incidents of a merger . . . . Whatever may have been the intent of the *committee*, there is no evidence to indicate that the *legislature* intended the 1957 amendments to have the effect contended for . . . . To divest shareholders of [the]

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19. 393 Pa. at 432, 143 A.2d at 28.

20. *Id.* at 433, 143 A.2d at 29. The court referred to *Lauman v. Lebanon Valley R.R.*, 30 Pa. 42 (1858), where the court had stated:

By [the transaction before the court] the Lebanon company loses its actual identity, abandons its name, and therefore its legal identity and its corporate existence, and can no longer claim any legal recognition. This is called a merger of the Lebanon corporation into the other; but such a merger is a dissolution, destroying the actual identity of both, while the legal identity of one of them is preserved.

*Id.* at 45.

21. 393 Pa. at 435, 143 A.2d at 30. The amendments referred to by the *Farris* Court were: Act of July 11, 1957, §§ 311(F), 908(C), [1957] Pa. Laws 725, 759 (amended 1959).

right of dissent under [the] circumstances [before us] would require express language which is absent from the 1957 amendments.<sup>22</sup>

That legislative behavior did not invalidate the premises upon which was based the defendants' argument concerning the relevance of Bar Association comments to the question of statutory intent, was demonstrated by the Pennsylvania legislature's adoption in 1959<sup>23</sup> of further amendments, described in the following terms by the Bar Association committee that drafted them :

In order to overcome [the *Farris*] decision the proposed amendment will change slightly the language of [the merger and sale of assets provisions] to clarify questions raised by the courts in the *Farris* case. The bill also contains in its title a statement that one of its features is to abolish the doctrine of *de facto* merger or consolidation . . . . This may seem an extreme measure to demonstrate the intention of the legislature but under legislative practice in Pennsylvania and the decision of the Supreme Court in the *Farris* case no other method of demonstrating such an intention (which the courts would consider) has occurred to the Committee.<sup>24</sup>

Possibly aware that the statutory provision according appraisal rights to a shareholder who objected to a "plan of merger or consolidation" was not in itself determinative of the case before it, the *Farris* court concluded its opinion with the argument that :

Even were we to assume that the combination provided for in the reorganization agreement is a "sale of assets" . . . it would avail the defendants nothing; we will not blind our eyes to the realities of the transaction. Despite the designation of the parties and the form employed, Glen Alden does not in fact acquire List; rather, List acquires Glen Alden . . . and . . . the right of dissent would remain with the shareholders of Glen Alden.<sup>25</sup>

However, this argument is subject to criticism. The reorganization agreement provided that Glen Alden Corporation, after acquiring all the assets of List, would change its name to List Alden Corporation; that List would then dissolve; and that List Alden would carry on the operations of both former corporations.<sup>26</sup> Given these provisions, and assuming that the court's finding that "Despite the designation of the

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22. 393 Pa. at 436-38, 143 A.2d at 30-31.

23. Act of Nov. 10, 1959, §§ 311(F), 908(C), [1959] Pa. Laws 1410, 1431 (now PA. STAT. ANN. tit. 15, §§ 1311(F), 1908(C) (1974).

24. 64 PA. B. ASS'N ANNUAL REP. 151-52 (1959).

25. 393 Pa. at 438, 143 A.2d at 31.

26. *Id.* at 429-30, 143 A.2d at 27.

parties and the form employed . . . List acquires Glen Alden" implied that it was Glen Alden rather than List that was to be dissolved, then the specific terms of the very statutory provision upon which the court relied<sup>27</sup> prohibited the transaction being scrutinized.<sup>28</sup>

Given this reading of the opinion, the question about the justification for the result reached must be answered: what in fact was the basis for the decision rendered by the Supreme Court of Pennsylvania?

### C.

Professor Folk summarized the basis of his preference for the Delaware decisions as follows:

The basic premise implicitly adopted in *Hariton* may perhaps be stated more affirmatively. One does not invest in a unique corporate entity or even a particular business operation, but rather in a continuous course of business which changes over a long period of time. Certainly the best investments are growth investments — investments in enterprises which change with time, technology, business opportunities, and altered demand; and the worst investments are those which diminish in value because the type of business has lost importance and the corporation has been unable to adapt to the changed conditions. Although a shareholder's enthusiasm dwindles when an enterprise changes internally for the worst, no one suggests that he should have an option to compel the return of his investment. Viewed this way, the fact that the change — for better or for worse — comes through marriage, whether by merger or assets sale, seems purely incidental. The fact that the corporate entity in which one invested disappears as a result of a merger or of a sale of assets coupled with dissolution

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27. The *Farris* Court relied on the following statute:

If any shareholder of a business corporation which sells . . . all or substantially all of its property *otherwise than . . . (3) in connection with its dissolution . . .* shall object to such sale . . . such shareholder shall be entitled to the rights and remedies of dissenting shareholders . . . .

*Id.* at 438 n.8, 143 A.2d at 31 n.8, quoting Act of July 11, 1957, § 311(D), [1957] Pa. Laws 725, (amended 1959) (emphasis added).

28. *See*, in this connection, the discussion of the *Lauman* case, note 20 *supra*. *See also* PA. STAT. ANN. tit. 15, § 1311(A) (1967), containing the 1957 amendment to the Pennsylvania Business Corporation Law which provides that a sale of assets in connection with dissolution is governed by statutory provisions which fail to grant appraisal rights. *Cf. Orzeck v. Englehart*, 41 Del. Ch. 361, 195 A.2d 375 (Sup. Ct. 1963), where the court stated:

It is true that the Vice Chancellor in the *Fidanque* case laid stress on the absence of any agreement for the liquidation or dissolution of the selling corporation, but we think the point not decisive of the question. The plan in the *Heilbrunn* case to effect a reorganization by the sale of assets in fact required the dissolution of the selling corporation but we held that fact did not make the transaction a merger.

*Id.* at 366-67, 195 A.2d at 378.

is also beside the point. One's investment may gain immortality when it takes a new form, *i.e.*, a share in a successor enterprise.<sup>29</sup>

The *Farris* opinion clearly indicated the extent to which its holding was premised upon a denial of Professor Folk's argument:

The rationale of the *Lauman* case, and of the present section of the Business Corporation Law based thereon, is that when a corporation combines with another so as to lose its essential nature and alter the original fundamental relationships of the shareholders among themselves and to the corporation, a shareholder who does not wish to continue his membership therein may treat his membership in the original corporation as terminated and have the value of his shares paid to him.<sup>30</sup>

Given this fact, it is important that in both the *Heilbrunn*<sup>31</sup> and *Orzeck*<sup>32</sup> decisions the Delaware courts explicitly stated the basis for their beliefs that the records before them permitted a judicial finding of substantial equivalence in the shareholder's interest before and after the corporate transaction. It should also be noted, in this connection, that the applicability of the *Farris* decision was rejected in *Lopata v. Bemis Co.*,<sup>33</sup> upon the basis that

[i]n the instant case, no basic fundamental change in the relationship of the stockholders to their respective corporations occurred and without this essential element, the *de facto* merger argument must fail. *A fortiori*, without any legal change in the ownership

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29. Folk, *supra* note 8, at 1280-81 (footnotes omitted).

30. 393 Pa. at 433, 143 A.2d at 29.

31. In *Heilbrunn v. Sun Chem. Corp.*, 38 Del. Ch. 321, 150 A.2d 755 (Sup. Ct. 1959), the court stated:

[W]e fail to see how any injury has been inflicted upon the Sun stockholders. Their corporation has simply acquired property and paid for it in shares of stock. The business of Sun will go on as before, with additional assets. The Sun stockholder is not forced to accept stock in another corporation. Nor has the reorganization changed the essential nature of the enterprise of the purchasing corporation, as in *Farris* . . . .

*Id.* at 326, 150 A.2d at 758.

32. In *Orzeck v. Englehart*, 41 Del. Ch. 223, 192 A.2d 36 (Ch. 1963), the court stated:

Plaintiff contends that the purchase by the corporation of the Olson companies' stock has resulted in a change in the essential nature of the enterprise of the corporation. The fallacy of this contention is readily apparent. By virtue of the transaction complained of the corporation became merely a holding company. It did not thereby become engaged in the egg business. So far as business enterprise was concerned it remained that "empty shell" as characterized by plaintiff.

*Id.* at 228, 192 A.2d at 38-39.

33. 383 F. Supp. 342 (E.D. Pa. 1974).

configuration of the two corporations, the contention that a merger or consolidation has occurred also fails.<sup>34</sup>

It remains, however, for one to formulate in reasonably precise terms why the Supreme Court of Pennsylvania reached its result in *Farris*.

D.

The starting point for any such formulation must be the insight that:

[O]ne's history is a part of his present. Monuments often outlive the philosophies they were built to glorify. The pyramids are one example. The appraisal statutes are another. To the nineteenth century mind contemplating such matters, a corporate merger was a major and significant event. In the first place it involved a species of corporate assassination. A "corporation" died. A three-dimensional thing, created by the sovereign legislature, had passed away. These things were not matters to be taken casually. But something else happened, too. The shareholders of corporation A somehow became shareholders of corporation B and no longer shareholders of corporation A. The mere statement of such a preposterous proposition did violence to fundamental principles. How *could* a man who owned a horse suddenly find that he owned a cow? Furthermore — or perhaps this is but another statement of the same point — even if this transmutation could somehow be brought off, surely it could not constitutionally be done without the owner's consent. You might try to persuade him to sell his horse or to exchange it for a cow, but surely you could not whisk it away from him. Freedom of contract, rights of property, Constitution, law, and morals would forbid it, even if the *leger demain* for the conversion had been mastered. Given a nineteenth century view of freedom of contract this line of reasoning required only one premise: A "corporation"

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34. *Id.* at 345. *But see* *Knapp v. North American Rockwell Corp.*, 506 F.2d 361 (3d Cir. 1974).

[Editors' note] In *Knapp*, an employee was injured by a defective machine which previously had been purchased from the manufacturer. Prior to the accident, the manufacturer had contracted to sell all its assets to another corporation in exchange for stock of the purchaser, to distribute the stock to its shareholders, and then to dissolve as soon as practicable. The employee sued the purchaser corporation for damages claiming it was the manufacturer's successor and liable for his injuries. *Id.* at 362-63. The United States Court of Appeals for the Third Circuit held that under Pennsylvania law, the purchasing corporation was liable since the transaction had been a merger — the finding of a merger based, not upon the fulfillment of formalities, but upon the public policy consideration that the purchasing corporation was more financially able to spread the loss involved. *Id.* at 369-70.

A comparison of the *Knapp* case with the *Lopata* decision leads one to the conclusion that had the *Knapp* holding existed at the time *Lopata* was decided, the result in *Lopata* would have been different.

is just like a horse. The law of the last century had no doubt that it was.<sup>35</sup>

Applying this historical assessment of the function served by appraisal rights, the then-Professor Manning noted that:

[T]o the nineteenth century mind, mergers were deeply suspect. When commercial pressures forced the enactment of the general merger statutes, the function of the appraisal statutes was clear. They met a conceptual and ideological problem — how to preserve the constitutionality of the merger statutes.<sup>36</sup>

The historical focus of the *Farris* opinion, however, was upon the fact that

[W]hen use of the corporate form of business organization first became widespread, it was relatively easy for courts to define a “merger” or a “sale of assets” and to label a particular transaction as one or the other . . . . But prompted by the desire to avoid the impact of adverse, and to obtain the benefits of favorable, government regulations, particularly federal tax laws, new accounting and legal techniques were developed by lawyers and accountants which interwove the elements characteristic of each, thereby creating hybrid forms of corporate amalgamation. Thus, it is no longer helpful to consider an individual transaction in the abstract and solely by reference to the various elements therein determine whether it is a “merger” or a “sale.” Instead, to determine properly the nature of a corporate transaction, we must refer not only to all the provisions of the agreement, but also to the consequences of the transaction and to the purposes of the provisions of the corporation law said to be applicable.<sup>37</sup>

More recently, in response to Professor Manning’s argument that the assertion of appraisal rights may destroy the enterprise, one commentator has stated:

The gravity of the “threat to the corporate enterprise” seems highly exaggerated. No evidence is adduced that corporations involved in mergers are “in need of a blood transfusion,” and my own observation has been that most mergers involve two perfectly healthy enterprises.<sup>38</sup>

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35. Manning, *The Shareholder’s Appraisal Remedy: An Essay For Frank Coker*, 72 *YALE L.J.* 223, 246 (1962).

36. *Id.* (footnote omitted).

37. 393 Pa. at 432, 143 A.2d at 28. See also note 18 and accompanying text *supra*.

38. Eisenberg, *The Legal Roles of Shareholders and Management in Modern Corporate Decisionmaking*, 57 *CALIF. L. REV.* 1, 73 (1969).

In terms of the de facto merger doctrine, however, what seems important is that the *Farris* opinion explicitly noted that "if the corporation is required to pay the dissenting shareholders the appraised fair value of their shares, the resultant drain of cash would prevent Glen Alden from carrying out the agreement."<sup>39</sup>

In short, whether constitutionally mandated or not,<sup>40</sup> the crucial fact concerning dissenters' rights such as those created by the *Farris* opinion is that they perform, in connection with a proposed corporate transaction, the function that has historically been performed by constitutional decisions rendered by the Supreme Court of the United States: the provision, for those affected by the legal acts under scrutiny, of the opportunity for a "sober second thought."

The case study that follows is presented in the hope that it will to some extent illumine the value of that function and, in so doing, demonstrate the significance of the legal doctrine of de facto merger.

## II.

### A.

Accompanying a proxy statement, a letter dated March 20, 1959, from the Board of Directors to the shareholders of Glen Alden Corporation reported:

After extended consideration, your Directors have now approved the combination of the business and assets of your Corporation and List Industries Corporation, pursuant to a Merger Agreement entered into March 6, 1959. Glen Alden Corporation would be the continuing corporation without change of name.<sup>41</sup>

The described merger was accomplished upon April 21, 1959.

In *Gilbert v. Burnside*,<sup>42</sup> an opinion dated December 31, 1959, the New York Supreme Court, Special Term, Kings County, Part III, wrote that

[i]t is generally held that where directors seek legal advice and honestly act under it they are protected from personal liability

. . . .

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39. 393 Pa. at 431 n.5, 143 A.2d at 28 n.5.

40. See Eisenberg, *supra* note 38, where the author states:

Manning's argument that appraisal rights have a constitutional genesis is at best a minority view. Most commentators hold the opinion that the legislatures conferred appraisal rights on dissenting shareholders as a matter of fairness, not as a matter of constitutional compulsion.

*Id.* at 78 (footnote omitted).

41. Letter from Board of Directors of Glen Alden Corporation to shareholders, March 20, 1959 (copy on file at the *Villanova Law Review*).

42. 197 N.Y.S.2d 623 (Sup. Ct. 1959), *rev'd*, 13 App. Div. 2d 982, 216 N.Y.S.2d 430 (1961), *aff'd*, 11 N.Y.2d 960, 183 N.E.2d 325, 229 N.Y.S.2d 10 (1962).

However, I do not believe that any immunity under these rules can be granted to the directors herein. I find that the directors did not rely on counsel's advice but utilized the method of implementing the agreement as a device solely for the purpose of evading the impact of the merger laws of Pennsylvania . . . . The original Glen Alden directors were not primarily concerned with the form in which the transaction was to be concluded. However, despite their knowledge that a palpable and patent device of a simulated sale to Glen Alden of these assets was to be employed to avoid the requirements of the merger law for appraisal rights they permitted the agreement to be projected in the illegal fashion.<sup>43</sup>

B.

In response to the criticism of two reports upon Episcopal theological education that "small seminaries operating in physical and sectarian isolation from each other . . . simply cannot effectively respond to [the] educational challenge,"<sup>44</sup> a 1969 feasibility study dealing with one such seminary — Berkeley Divinity School — assessed a method of meeting such a charge:

Berkeley could become an Episcopal Center for [Yale Divinity School], offering Anglican studies and scholarships to Episcopal students. This would make a strong school stronger and thereby promote theological education in general, while still using its endowment in service to the Episcopal Church . . . .

The trouble with this idea is that Berkeley would lose its identity or at least its independence . . . . If it specialized in Anglican studies, this would be a new venture. It does not do that now. And the value of preserving denominational purity in our day is limited.<sup>45</sup>

On June 30, 1971, an Affiliation Agreement was entered into between Berkeley Divinity School and Yale University. The Agreement contained the recital that

Berkeley desires to improve the training and instruction of its students for the sacred ministry in the Protestant Episcopal Church by providing for them a strengthened academic preparation in a strong ecumenical background available through closer association with the larger faculty, student body and resources of the Yale Divinity School . . . . Berkeley has further determined that by means of a closer affiliation with Yale Divinity School the material resources of Berkeley can be made to produce a larger effectiveness

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43. *Id.* at 633-34.

44. McCollough, Feasibility Study: Berkeley Divinity School (December 31, 1969) at 13 (copy on file at *Villanova Law Review*).

45. *Id.* at 44.

in the training and instruction of students for the sacred ministry of the Protestant Episcopal Church by being devoted less to the maintenance of separate establishments in administration, libraries, land, buildings and other facilities, and more to such training and instruction.<sup>46</sup>

The specific agreements entered into included the following provisions:

Except as expressly herein provided each of Yale and Berkeley shall retain unencumbered title and possession of its property and assets, and each shall separately control all of its property and affairs.<sup>47</sup>

During the term of this Agreement Yale and Berkeley shall each have the option of terminating this Agreement as of the last day of June in any year, which option shall be exercisable by either in its sole discretion.<sup>48</sup>

By a separate written agreement (Real Estate Agreement) of even date herewith Berkeley and Yale have provided for the sale by Berkeley to Yale of the real estate of Berkeley. The Real Estate Agreement and this Affiliation Agreement are independent. No amendment or termination of any provision of either shall affect the other, and no failure to perform any provision of one of them shall be a defense to an action based on a failure to perform the other. The invalidity of one in whole or in part shall not affect any of the legal relations created by the other.<sup>49</sup>

The Affiliation Agreement further provided that "within a reasonable time after July 1, 1975 [the parties] will arrange mutually for an outside evaluation . . . such outside evaluation to be completed on or about January 1, 1976 . . ." <sup>50</sup> The two parties to the agreement agreed, after studying the evaluation report, "to negotiate in good faith . . . concerning the questions of whether to extend this Agreement, and if to extend it, concerning the question of the revised terms and conditions, if any, for such an extension."<sup>51</sup>

During the spring semester of the 1973-74 academic year, an interim evaluation was conducted "in order that the timetable for negotiation of extension and changes in the agreement between the two institutions could be moved up so that it could be concluded during the

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46. Affiliation Agreement between Berkeley Divinity School and Yale University (June 30, 1971) at 2 [hereinafter cited as Agreement] (copy on file at the *Villanova Law Review*).

47. *Id.* at 6.

48. *Id.* at 12.

49. *Id.* at 13-14.

50. *Id.* at 12.

51. *Id.*

1974-75 academic year and permit the 1975-76 academic year to be a time of transition for any action that might be indicated . . . ."<sup>52</sup>

The report of that evaluation began by noting that what was being assessed

has been established at Yale Divinity School as the result of an affiliation between Berkeley Divinity School and Yale Divinity School, not a merger between the two institutions. Although this is plainly spelled out in the Affiliation Agreement, executed by legal representatives of Berkeley Divinity and Yale University on June 30, 1971 . . . many faculty members continue to refer to "the merger" or profess to be surprised by the specific terms of the Agreement. Most persons have not seen the legal documents of the Agreement, but the terms are those which were set out in the document . . . .<sup>53</sup>

This interim evaluation further noted :

At the time of negotiating the original agreement, the principal issues were legal (how to guarantee the separate existence of the two schools, and how to assure the use of Berkeley Divinity School's resources for the program of the Berkeley Center) and academic (how to set up core groups in the Center). These issues were first scouted by the President-Dean of Berkeley Divinity School and the Dean of Yale Divinity School. Then, the legal issues were put into final form by the secretary of the Berkeley Board of Trustees and the treasurer of Yale University, both of them lawyers; and the academic issues were considered by the joint faculty-student Berkeley Center Planning Committee, and approved by the Yale Divinity School Faculty.<sup>54</sup>

At the heart of both the original agreement and the operation of the Berkeley Center in its first three years has been a working relationship between the Dean of Yale Divinity School . . . and the

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52. Interim Evaluation of the Berkeley Center under Terms of the Affiliation Agreement between Berkeley Divinity School and Yale University (September, 1974) at 1 [hereinafter cited as Evaluation] (copy on file at the *Villanova Law Review*).

53. *Id.* at 2.

54. *Id.* at 3-4. The Evaluation later stated:

The questions of purpose and curriculum will be complex enough in themselves, but they will become hopelessly complicated if it is not clear where the planning for the School is done. We have already seen that the Berkeley Center Planning Committee gave its principal attention to setting up the core groups. Interviews with administration and faculty show that the School has had a variety of ways by which educational planning has been done in the past, and that it is less than clear where the responsibility lies at present . . . .

No evaluation will be possible at Yale Divinity School, whether of the Berkeley Center or any other part of the program, unless it is clear who in the School has responsibility for planning. In the meantime, everything is succeeding and everything is failing, because it is impossible to tell what would constitute an adequate accomplishment in the task of training for ministry that the School has set for itself.

*Id.* at 6.

Director of the Berkeley Center . . . who is also an Associate Dean of Yale Divinity School and President-Dean of Berkeley Divinity School. Neither at the beginning during the planning year nor in the three subsequent years has this been strictly a legal contract or an administrative relationship. Each party has been able to bring the strength of his institution to the partnership and been able to rely on various kinds of political power for carrying out his share of the relationship. In short, the working relationship has been far more political than it has been legal and contractual or administrative and organizational.<sup>55</sup>

Finally, the report evaluated the extent to which Episcopal expectations had been fulfilled :

The other aspect of the affiliation to which this evaluation has been sensitive is the extent to which the new relationship between the two schools has been able to fulfill Episcopal expectations that Yale Divinity School would continue to offer theological education which was comparable, if not equivalent to that of other Episcopal theological schools. Edward Sims and Richard Rising, who visited the program on January 29–30, 1973 for the Board for Theological Education of the Episcopal Church [BTE], questioned in their report whether this was the right question to ask, but they knew that it was a question being raised in the Episcopal constituency. Their own answers to the question were clearly positive :

On the narrowest interpretation of Episcopal Church responsibility, BDS qualifies . . . If the question we ask were to relate not so much to structure and its domination by Episcopalians as to the capacity of the merger-produced institution to present the content of Anglican history, tradition and ethos with respect and integrity, the answer in the case of BDS would be yes. The cultivation of Anglican hubris is doubtless more difficult in the kind of institution BDS now is : I regard that as a significant plus . . . It is my opinion that if the BTE were to back away from support of BDS-Yale because of this merger, we would be letting our policy or our timidity interfere with our goal of providing superior theological education for our postulants and candidates.

Although this evaluation understands the agreement to be an affiliation, not a "merger," the conclusions from observation, interviews and administration of a student questionnaire in the Spring of 1974 must be the same as those reached by the BTE visitors in January, 1973.<sup>56</sup>

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55. *Id.* at 4.

56. *Id.* at 11–12.

## C.

On June 12, 1961, in *Gilbert v. Burnside*,<sup>57</sup> three members<sup>58</sup> of a five judge panel in the Appellate Division of the Supreme Court of New York, Second Department, concluded that :

The judgment below determines, in effect, that these financiers (the Glen Alden directors) knew, or should have known, more Pennsylvania law than eminent Pennsylvania counsel. There is no evidence to support the Special Term's findings that the Glen Alden directors knew that the plan was illegal, or that they did not justifiably and in good faith rely on the advice of counsel to the effect that the plan was legal even though it did not accord the right of appraisal to dissenting shareholders.<sup>59</sup>

On May 10, 1962, the New York Court of Appeals, in a memorandum opinion, unanimously upheld what it characterized as the Appellate Division's "revers[al], on the law and on the facts . . . [of] a judgment of the Supreme Court,"<sup>60</sup> thus ending

[t]his derivative action [which] was originally commenced by the stockholders of the Glen Alden Corporation, a corporation incorporated under the laws of Pennsylvania, to restrain the consummation of a reorganization agreement, dated March 20, 1958 . . . [and in which, after *Farris v. Glen Alden Corp.*, 393 Pa. 427] [t]he complaint . . . was . . . amended to charge defendants-respondents, directors of the Glen Alden Corporation, with waste in promulgating the invalid agreement and to demand recovery of the expenses incurred by said corporation in negotiating, proposing and defending it.<sup>61</sup>

As the Court of Appeals noted: "No appearance for corporate respondent."<sup>62</sup>

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57. 13 App. Div. 2d 982, 216 N.Y.S.2d 430 (1961), *aff'd*, 11 N.Y.2d 960, 183 N.E.2d 325, 229 N.Y.S.2d 10 (1962).

58. The other two judges "dissent[ed] and vote[d] to affirm the judgment and order upon the opinion of the learned Justice at Special Term." *Id.* at 983, 216 N.Y.S.2d at 433.

59. *Id.*

60. *Gilbert v. Burnside*, 11 N.Y.2d 960, 961, 183 N.E.2d 325, 326, 229 N.Y.S.2d 10, 11 (1962).

61. *Id.* at 961-62.

62. *Id.* at 962.