GOING PRIVATE AFTER SINGER AND NAJJAR

BY WILLIAM KLEIN *

One of the banes of our existence—and not limited, I gather, to lawyers—is that we are plagued by "the assumption." You cannot live without some assumptions, and yet you cannot act professionally as a lawyer or a doctor or anything else if you bring into every situation a whole flock of assumptions which you are not continually reexamining. I hope the purpose of this discussion is to reexamine some of those assumptions.

Recently there was a story in the New York Times. I am smiling with tears in my eyes because it was a story about a fellow named Miller who had a poker game in his house, and as his guest threw down his hand, a fifth ace flew out. Miller took out his gun and shot him dead.

The corporate lawyers, as far as I know, have not been shooting the Delaware lawyers or the Delaware judges because of Singer ¹ or Najjar ² and their progeny. However, they have been very, very upset because the Delaware deck—Delaware always the haven, the mother of American corporations—all of a sudden has a new card in it called "entire fairness." There are a lot of lawyers all over the country who are beginning to reconsider whether to continue to recommend incorporating in Delaware. It is almost an obscenity that Delaware should be a liberal state.

I respectfully suggest that it is a little premature to give the last rites to Delaware as the Switzerland of American corporations. My answer to the question as to "Going private after Singer and Najjar—purpose and entire fairness—what are they?" is that I think they are unchanged from what they were before Singer and Najjar. I do think we have some new words. They are interesting words, because they are all moral words, and it is awfully tough to fight them.

We are talking about fairness and purpose, but I suggest that, in terms of fairness and entire fairness, the translation in Delaware and elsewhere is "going concern value up to 60% for assets, the balance divided between market and earnings." As the Vice Chancellor said

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(583)
in that seventy-nine page opinion in *Weinberger v. UOP,* a fair price is appraisal, which is going concern value, but appraisal is an exact price, and when you are talking about going private, it is an inexact price.

Another "but" is that on top of an inexact appraisal price, we might give some weight to what the majority shareholder is getting the day after the merger is consummated, so that there is no synergistic value.

I do not know what that means, except that there has probably been very little change at all. I would suggest to you no change in what Billy Rose used to call "the hot buck," because that is what we are talking about; What is it going to cost the majority shareholder before *Singer* and *Najjar* and what is it costing him now? I suggest to you nothing more, or maybe, as in a recent case, a quarter a share.

What is the minority shareholder getting now that he did not get before *Singer* and *Najjar*? What my partner calls it, and what the minority shareholder has always received and is still getting in Delaware and everywhere else, is the shaft. Fairness indeed.

We then go from fairness to an examination of what we are really talking about, which I think is a label change. We are now, in Delaware, putting another label on the bottle. It is no different than the shock I got as a young boy when my mother sent me down to the grocery store the day before the first day of Passover. The grocery store was closed, but the grocer knew me and let me in. I walked in and there was the owner of the grocery store, his wife, and their children busy with "Kosher for Passover" labels which they were sticking on the asparagus cans and the coffee and the other products.

As far as I can see, from "the hot buck" point of view, Delaware is Kosher for Passover, but the can of beans is the same can of beans before as well as after.

As a matter of fact, the way Billy Rose hired waiters is appropriate to going private. Billy Rose, as you may know, was not only one of America's great popular songwriters, but also a theatrical producer and promoter. He owned the Diamond Horseshoe in New York, which was, in its time, a well-known and a great nightclub. Somebody once asked him, "Billy, how do you keep the waiters from stealing?" He said, "I don't. I'll tell you what I do. When I come in to hire a waiter or a waiter comes to me to be hired, I say to him, 'How much do you steal?' If he says to me, 'Who me?' I

never steal,' I won't hire him. If he says to me—remember this is back in 1940 or '45—I steal $100 a week, never more,' I wouldn't dream of hiring him, because it's too much and I can't afford it. But if he says, '$25,' I can live with that."

I think that Billy Rose's rule is what is really applicable to going private and to the cashout merger. I might add that the cashout merger also has a little twist. I pose this one to you as fellow students because I do not have an answer to it. I was submitted a merger just the other day; as a matter of fact, on Wednesday, I turned it down. The assets were book value $6 a share; 425,000 shares outstanding. The earnings averaged about 60¢-70¢ a share. Market value was $3.25. The fact that there were 425,000 shares outstanding would indicate to you, with those kinds of figures, why I turned it down, and I do not think that is funny because I really think it is unfortunate that a man with a small investment has no remedy in our law. He has no redress because lawyers cannot afford to take the case, not in Delaware or any other state.

It is not all that different from your wife coming to you and saying, "Let's sue the dry cleaner because the curtains have been damaged for $125." You will pay her $250 to go away because you cannot afford it.

This is different. It is different because going private is the capital punishment of the economic area. You are dead. Freezing out is killing out, and killing out is a type of inequality that more or less begs description. The reason for the development of the language in Delaware—I submit not the change in law in Delaware, but the change in language in Delaware—is that the Delaware courts (and other courts also) are talking increasingly about the majority shareholder sitting on both sides of the fence, who says, "I'll take him on, any day of the week, because I've gone a cannon."

It is not true. He is not just sitting on both sides of the fence. He is sitting on both sides of the fence with a cannon and, as the minority shareholder, I am not there. But—and I think it is an important "but"—the majority shareholder is being put in the position of a greedy fellow—the tyranny of the majority. And we are using all these moral terms.

The majority shareholder, as is the minority shareholder, is a captive of a 100 or 125 year old legal situation, namely, the corporate laws of the various fifty states which were never designed—if they were designed with anything at all in mind in the 1850s, '60s, and '70s—with the cashout merger in mind.

I am not saying that if our law and our concepts were different, the majority shareholder would not try to conform the laws to give
him the power that they now give him, but, in fairness, I think both
the majority shareholder and the minority shareholder are the cap-
tive of something as American as apple pie. Our laws are 20, 30, 40,
50, 60 years behind the times.

How long did it take for the consumer laws to catch up? And
they did it very quickly. They did it in the 1950s and '60s and
'70s, much more quickly than our legislatures are catching up.

I want to come back to the question of morality. The minute
you talk “fair” you are making a moral judgment. I like—and I
think we all do because we are business people—Billy Rose’s attitude
much better. “How much are you going to steal?” He did not
make a moral judgment about the waiter’s theft. We are not in
the business of making those kinds of moral judgments. Yet the
legislature many years ago started with a precatory word which car-
rries within it a value judgment—and that word was “appraisal.”

It anticipated a right on the part of a corporation. We are en-
couraging the free enterprise system. We are encouraging capital.
We are encouraging capital in our state. At the same time, part of
that mobility is to merge, but at the same time as you are merging,
what happens to the fellow who is going to get merged out?

I was not there in 1870, but I would suggest to you that the ap-
praisal concept was a “making whole” concept. I would suggest to
you that appraisal has been distorted and malformed into a constricted
and restricted non-whole. It is the economic doughnut.

Why should the majority shareholder be in the position of deter-
mining what is fair? Yet he is forced into that position by state laws
in all states—not only in Delaware. He has no alternative.

Nobody that I know of in this room or anywhere else confesses
that he is going to beat his wife. Not only that, but he dresses her
up in mink coats, if he can afford it, and he gives her jewelry. So
the majority shareholder gets himself an investment advisor or gets
himself an audit committee. I was very interested in that discussion
about audit committees and independent directors. I disrespectfully
suggest one word: baloney.

I just came from a $3.5 million situation with an audit com-
mittee. One guy is a house man, but the other two fellows are not
house men. They receive directors’ fees, $100,000 a year each. One
of them got $30,000 from each of two different consulting firms con-
trolled by the majority shareholder and the other fellow got $20,000
in legal fees. Could I ever be independent for that amount of money?

I might incidentally suggest to you that that is why I think we
are really being very unfair to poor old Delaware. Take the SEC
in that situation. The SEC had brought an action against the com-
pany and they settled it, and they forced the insiders to pay back $1,400,000 because they were dealing inside. The SEC said: "You know what you fellows ought to have? An audit committee. And you submit the names of the audit committee to us"—or so we were told on discovery. So, not only do we have the blessing of former Commissioner Wheat to the audit committee, but we have the Securities and Exchange Commission itself.

Again, it is unfair and unfunny. It is not funny because we are in a bind on a process and a conception over which we have no control. Basically, I would suggest to you that the law in Delaware, and in most other states of the United States, is little different from what New York Court of Appeals described when it said:

[T]he merged corporation's shareholder has only one real right: to have the value of his holding protected, and that protection is given him by his right to an appraisal. . . . He has no right to stay in the picture, to go along into the merger, or to share in future benefits. He has no constitutional right to deliberate, consult, or vote on the merger, to have prior notice thereof or prior opportunity to object thereto. His disabilities in those respects are the result of his status as a member of a minority, and any cure therefor is to be prescribed by the legislature, if it sees fit. In none of this do we see any deprivation of due process, or of contract right. 4

Although it is a New York case, it correctly describes the position of the relationship between the majority and the minority in most of the states.

The windup, in another New York case, with regard to appraisal, was: "The remedy of an appraisal and payment for one's shares affords fair and just compensation to dissenting shareholders while allowing the overwhelming majority to proceed with the merger. . . . So long as the value of petitioner's interest is compensable, he has no constitutionally protected right to continue as a stockholder." 5

Wow! "So long as [it] is compensable, . . ." Does that mean compensable in any amount?

There has been some discussion about premiums over market. That is one of the things where there may be something of an advance in Delaware that may not be true in other states. Believe it or not, this is in an area where maybe you won't agree with me.

Delaware is developing a somewhat more expansive view regard to valuation in an appraisal proceeding. In most states appraisal is a guide.

In 1776, we gave up in this country a monarchy and in its place we replaced the monarchy with a number of different kinds of idols—whether the baseball player or the football player or the President of the United States. One of the idols on the economic scene, all praise and God bless it, is market value.

Take my case that I turned down: six bucks assets, 3\% market; or take another one that I am working on now: market 9, assets 30, earnings minus zero. What do you want from the poor majority shareholder? He owns it. He has it. Not only that, but he is encased in concrete by the law of the state. You want him to be generous? It defies human nature.

A lot of what we are doing and a lot of what we are talking about is the question of business purpose. Business purpose is a decoy in that dog race in Florida.

I tell you, honestly, the question is: "Purpose and entire fairness—what are they?" I think I have answered the question, and I think you really can go home and be reasonably guided. Fairness, an entire fairness (and I do not think there is any difference), is going concern value, depending upon how outrageous the fact, how upset the judge is, how well you present it, and how well the judge is able to resist your presentment of how really egregiously this majority shareholder acted. The bottom line is going to be the "hot buck"—how many "hot bucks" are you giving. I think that is the answer, and I think it was the answer in 1976. I think it was the answer prior to the Mayflower case. It is the answer in most of the states and it is the answer here.

We have dust in our eyes called "purpose", and I do not know what it means. "Although we have stated," says the Supreme Court of Delaware, "that IGI is entitled as majority stockholder to vote its own corporate concerns, it should be clearly noted that IGI's purpose in causing the Kliklok merger must be bona fide." ⁸

What was so bona fide about it? They had approximately eighty-one percent of the stock and then they decided to go private.

The court continued: "As a stockholder, IGI need not sacrifice its own interest in dealing with a subsidiary; but that interest must

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not be suspect as a subterfuge, the real purpose of which is to rid itself of unwanted minority shareholders in the subsidiary."

When my young children were very young, I had a very nasty habit of saying "nonsense," meaning no sense. They never liked it, but it is something I cannot get away from here. Every going-private merger is getting rid of the minority.

In the facts of all of the cases, what are we dealing with? In the Valhi case,\textsuperscript{10} the Delaware Court of Chancery stopped the merger dead in its tracks because Conran picked up fifty or sixty percent of the stock of Valhi, and from the moment it acquired the stock, around 1975, it tried to merge. It ran into a little sticky problem. There was a provision in the certificate of incorporation that you needed eighty percent majority vote where the company that you were being merged into or which was causing the merger had five percent or more. Of course, Conran had five percent or more.

So what did Conran do? It just caused another corporation to be organized that did not own anything and then slipped this company into that company and in that way they got away from the provision. What does Delaware say? It is a no-no. You cannot do it.

The reason why my tongue is deep in my cheek is that the Vice Chancellor did not stop at saying that you cannot merge where there is no purpose. If he had done that, I would say you've got some \textit{bona fides}. This is what he said: "I accordingly conclude that the appropriate relief to be granted by this Court, insofar as the merger plan now before it is concerned, is the entry of an injunction against its consummation."

I have just done what defendants are constantly accusing me of—what I never do, but did here—namely, quoting out of context. Indeed I am. But I did so deliberately because that last sentence was preceded by two sentences which I would like to give you now:

The merger here in issue, which has been found to be unfair to minority stockholders, remains unconsummated. In my opinion, it is for the majority stockholder and not for the Court to devise an alternate form of merger which may be either acceptable to all minority stockholders or found by the Court to be entirely fair to the minority.\textsuperscript{12}

What do you mean? If you cannot do it for the purpose of freezing out, why can you come back in again? The answer is simple: "Hot bucks."

\textsuperscript{9} Id.
\textsuperscript{10} Young v. Valhi, Inc., 382 A.2d 1372 (Del. Ch. 1978).
\textsuperscript{11} Id. at 1379.
\textsuperscript{12} Id.