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# R.C.M. 1947, SEC. 15-2272(e); A MEANS TO AVOID THE DISSENTING SHAREHOLDER'S RIGHT TO AN APPRAISAL REMEDY

Bruce MacKenzie

## INTRODUCTION

With the development of modern corporate law, minority interests were given a measure of protection through the appraisal remedy. This remedy, initiated by a shareholder who dissents to a fundamental change undertaken by a corporation, allows the dissenting shareholder to force the corporation to purchase his shares at an appraised value determined at the time the change is approved. Such recompense is based upon the theory that a person purchasing shares in a corporation does so with an understanding amounting to an implied contract that the corporation would continue in the same form to fulfill the purposes for which it was created.<sup>1</sup> A fundamental change in the corporate form would in effect be a violation of this contractual understanding.

The changes considered to be of such a fundamental nature as to trigger the appraisal remedy vary from state to state.<sup>2</sup> Under Montana's corporate law, the appraisal remedy is provided in cases of corporate merger, consolidation, or the sale of corporate assets other than in the ordinary course of business.<sup>3</sup> A recent amendment to that section of Montana's law granting the appraisal right for the sale of assets other than in the ordinary course appears to provide corporations with the opportunity of avoiding these protections. The amendment, unique to Montana, allows the shareholders to amend the articles of incorporation to give the board of directors general authority to sell or dispose of all the corporate assets.<sup>4</sup>

<sup>1</sup>See *e.g.*, *Lauman v. Lebanon Valley R.R.*, 30 Pa. 42 (1858); *International & G.N.R.R. v. Bremond*, 53 Tex. 96 (1880).

<sup>2</sup>Model Business Corporation Act Annotated 2nd. § 80 para. 3.03 (1971) [hereinafter cited as *M.B.C.A.*].

<sup>3</sup>REVISED CODES OF MONTANA, § 15-2273 (1947) [hereinafter cited *R.C.M. 1947*]. The pertinent portion of this section reads as follows:

Any shareholder of a corporation shall have the right to dissent from any of the following corporate actions:

(a) Any plan of merger or consolidation to which the corporation is a party; or

(b) Any sale or exchange of all or substantially all of the property and assets of the corporation not made in the usual course of its business. . . .

<sup>4</sup>R.C.M. 1947, § 15-2272(e). This section provides as follows:

Sale of assets other than in the ordinary course of business.

The shareholders of a corporation may, by a vote of the holders of the number of shares required to change the articles of incorporation of such corporation at a meeting duly called upon not less than thirty (30) days' notice, amend the articles of incorporation to give the board of directors general authority to sell, lease, exchange, or otherwise dispose of all, or substantially all, of the property and assets, with or without the good will, of a corporation, upon such conditions, and for such consideration, which may consist in whole or in part of money or property, real or personal, including shares of any other corporation, domestic or foreign, as shall be authorized by the board of directors.

This note explores the impact this amendment has upon the dissenting shareholder's appraisal remedy and the opportunities it presents of removing the protections which the remedy provides.

## HISTORICAL DEVELOPMENT

### A. GENERAL PERSPECTIVE

The corporations of a century ago were radically different from the modern corporation. In the past, corporations resembled the ordinary partnerships and closed corporations of today; a few shareholders took an active interest in corporate affairs. As a result of this close-knit atmosphere, many jurisdictions adopted the common law rule requiring unanimous consent of stockholders for the sale of all corporate assets of a solvent corporation,<sup>5</sup> to effect a consolidation or merger,<sup>6</sup> or to bring about a change in the corporation's financial structure.<sup>7</sup>

With the expanded use of the corporate form, the corporation itself changed; rules which had developed at the common law became ill suited for the complex organism the corporation had become. The restrictions that the common law rule of unanimity placed upon the majority shareholders seriously hindered the reorganizations of corporate structure which the modern business community demanded.

This hampered corporate development called for statutory aid. Consequently, statutes were passed in many states conferring wide powers on the majority to amend the charter, sell assets, merge, consolidate, and make other fundamental changes in the corporate structure.<sup>8</sup> In enacting such statutes, however, legislators realized that it was necessary to afford some relief to dissenters so that the minority would not be forced to continue in an enterprise vastly different from the venture upon which they originally embarked.<sup>9</sup> The resulting compromise conferred on the dissenters the right to receive the cash value of their shares and also provided for an appraisal where no agreement could be reached concerning the value of the shares. Thus, the appraisal remedy is the product of statutory law.

### B. MONTANA LAW

The scope of the appraisal remedy, as has been previously stated, varies from state to state.<sup>10</sup> The Montana law, however, is in accord with the majority of jurisdictions in providing for dissent and payment

<sup>5</sup>Abbot v. American Hard Rubber Co., 33 Barb. Ch. 578, 583 (N.Y. 1861); *Theis v. Spokane Gas Co.*, 34 Wash. 23, 74 Pac. 1004, 1006 (1904).

<sup>6</sup>Geddes v. Anaconda Mining Co., 254 U.S. 590, 595 (1920).

<sup>7</sup>Cambell v. American Zylonite Co., 122 N.Y. 455, 25 N.E. 853, 854 (1890).

<sup>8</sup>See Levy, *Rights of Dissenting Shareholders to Appraisal Payment*, 15 CORNELL L.Q. 420 (1939).

<sup>9</sup>See FLETCHER, *CYCLOPEDIA CORPORATIONS* § 5906.1 (Rev. ed. 1970).

<sup>10</sup>*Company Delaware Code Annotated* title 8, § 262; *with R.C.M. 1947*, § 15-2273.

in the event of merger, consolidation, or the sale of assets other than in the ordinary course of business.<sup>11</sup> The substance and procedure of Montana's remedy are outlined in REVISED CODES OF MONTANA 1947, §§ 15-2273 and 15-2274. Section 15-2273 merely grants the shareholder the right to dissent upon the occurrence of specified corporate actions. Section 15-2274 details the procedure for exercising the shareholder's right of dissent.<sup>12</sup>

Montana, by granting the appraisal remedy for both merger and sale of all corporate assets,<sup>14</sup> provided adequate protection to the minority shareholder and effectively avoided the dilemma of defacto mergers. A defacto merger is achieved when a corporation sells all of its assets and property to another corporation in exchange for stock in the purchaser. This stock is then distributed to the selling corporation's shareholders. After distribution the selling corporation dissolves, leaving one corporation: the purchasing corporation.

The defacto merger allows corporations to avoid the dissenting shareholder's appraisal remedy for a corporate merger in those jurisdictions where there is no appraisal remedy for the sale of assets not in the ordinary course of business. This avoidance is achieved by meeting the statutory requirements for the sale of all the corporate assets even though in fact the transaction has all the characteristics of a statutory merger. Courts have held that such a transaction should be judged by the statutory provisions with which the corporation complied and, if no appraisal remedy is statutorily available for such a transaction, none can be granted.<sup>15</sup>

Montana, by providing the protection of the appraisal remedy in the case of a sale of assets other than in the ordinary course, effectively eliminated this loophole. A shareholder would be capable of invoking his right of dissent to such a sale regardless of whether it was ever intended to accomplish a merger.

#### *THE IMPACT OF § 15-2272(e)*

With the passage of § 15-2272(e) it appears that a Montana corporation may now avoid the shareholder's right to an appraisal remedy

<sup>11</sup>M.B.C.A. § 80 para. 2 (1971).

<sup>12</sup>See R.C.M. 1947, § 15-2273.

<sup>13</sup>R.C.M. 1947, § 15-2274. The pertinent portion of this section reads as follows:

Any shareholder electing to exercise such right of dissent shall file with the corporation, prior to or at the meeting of shareholders at which such proposed corporate action is submitted to a vote, a written objection to such proposed corporate action. If such proposed corporate action be approved by the required vote and such shareholder shall not have voted in favor thereof, such shareholder may, within ten (10) days after the date on which the vote was taken. . . .

<sup>14</sup>It is important to note that R.C.M. 1947, § 15-2272 provides that a sale of all or substantially all of the corporate assets is a sale of assets made other than in the ordinary course of business.

<sup>15</sup>Orzech v. Englehart, 41 Del. Ch. 361, 195 A.2d 375, 377 (1963).

through a sale of all the corporate assets and, by so doing, effect a defacto merger without fear of the appraisal remedy.

To explain the opportunity the amendment presents of avoiding the shareholder's appraisal remedy, it is first necessary to outline the procedure required to invoke the shareholder's right to dissent. In order for a shareholder to obtain an appraisal remedy either to a merger, consolidation, or a sale of assets other than in the ordinary course, he must file with the corporation a written objection to the proposed action. This objection must be filed prior to or at the shareholder meeting to which the action is submitted for approval and the shareholder must vote against the action to preserve his right to payment. Once these preliminaries have been complied with, he may, within ten days of the vote authorizing the action, demand that the corporation pay the fair value of his shares.<sup>16</sup>

Since the proceedings for appraisal remedies evolved in derogation of the common law and are purely statutory, the courts have demanded strict compliance with their requirements. Unless the provisions of the statute are met, the proceedings must fail.<sup>17</sup> With this in mind, it is clear that a corporation which has taken advantage of § 15-2272(e) may avoid a shareholder's right to an appraisal remedy in the case of a proposed sale of assets not in the ordinary course of business. This opportunity is illustrated first by the fact that although the provision gives the directors the authority to sell all of the corporate assets, this authority is achieved through an amendment to the corporate charter to which there is no right of dissent. Secondly, the fact that the amendment to the charter itself gives the directors the authority to sell all of the corporate assets precludes the requirement that such an action be submitted to the shareholders for a vote authorizing the sale. Since the right to dissent may be exercised at a meeting to which the proposed action allowing such dissent is submitted, § 15-2272(e) eliminates the shareholder's opportunity of ever properly objecting to a sale of all the corporate assets. Therefore the dissenting shareholder's right to an appraisal remedy for a sale of all the corporate assets is effectively obviated by a corporation's compliance with § 15-2272(e).

Section 15-2272(e) also provides corporations the possible opportunity of effecting consolidations or mergers by the means of a defacto merger. As has been previously discussed, recognition of the defacto merger does have a definite affect on the dissenter's rights where there is no right to an appraisal remedy for a sale of assets other than in the ordinary course of business. Before § 15-2272(e), dissenting shareholders in Montana could have defeated any attempted defacto merger by merely invoking their right to dissent to the sale of all the corporate

<sup>16</sup>See R.C.M. 1947, § 15-2274.

<sup>17</sup>Application of Gerstle—Rhein S.A., 194 Misc. 795, 87 N.Y.S.2d 778, 781 (1949); Roselle Park Trust Co. v. Ward Baking Corp., 177 Md. 212, 9 A.2d 228, 231 (1939).

assets. Section 15-2272(e) provides that the sale of all corporate assets may be made for such consideration as shares of another corporation—an integral element of effecting a defacto merger. Further, as developed above, the amendment eliminates the dissenter's right to such a sale. The dissenting shareholder, therefore, is forced into the position of proving that the sale of all the corporate assets was in actuality a merger since the right of dissent to a merger is the only right the dissenter has remaining.

There is some authority which allows shareholders who have carried this burden of proof to recover for such a transaction.<sup>18</sup> An amendment to the charter under § 15-2272(e), however, gives the directors general authority to sell all of the corporate assets as they see fit. This authority appears to clothe any sale—even if the sale effects a merger—with the blessing of all the shareholders. Therefore, § 15-2272 (e) not only eliminates the minority shareholder's right of dissent to a sale of all the corporate assets, but also precludes his right to a merger which is achieved through a sale of corporate assets.

### CONCLUSION

It is not clear why § 15-2272(e) was added to what previously had been a Model Act provision. It may have been added as an aid to failing corporations, allowing them to avoid the time consuming procedures required for authorization of a sale of all the corporate assets. Alternatively the amendment may have been aimed at speeding corporate development within the state. Whatever the intent, it is clear that the amendment has a definite impact upon the dissenting shareholder's right to an appraisal remedy.

With the addition of § 15-2272(e) to Montana's corporate law, the state has provided corporations taking advantage of the section's provisions with the unique opportunity of removing the protections provided minority interests. Montana's attorneys, therefore, should be aware of the amendment's implications not only upon the rights of the dissenting shareholder, but also the freedom of development it provides corporate management.