**CORPORATE LAW—MAJORITY SHAREHOLDERS OF A CORPORATION OWE A FIDUCIARY DUTY TO MINORITY SHAREHOLDERS OF THE CORPORATION WHICH, IF BREACHED, MAY PROVIDE A BASIS OF RECOVERY DISTINCT FROM FRAUD. —*Linge v. Ralston Purina Co.* (Iowa 1980).**

In 1969, Ralston Purina Company (Ralston) acquired control of fifty percent of the stock of Keystone International, Inc. (Keystone), an Iowa corporation.[1] Through a subsequent stock issue and a tender offer in 1973, Ralston increased its ownership of Keystone stock to ninety-three percent.[2] In 1974, wishing to acquire one hundred percent ownership of Keystone, Ralston availed itself of Iowa's short-form merger statute[3] and merged Keystone into Ralston.[4]

The plaintiffs, former minority shareholders of Keystone, initiated a suit in state district court alleging that the majority shareholder, Ralston, wrongfully acquired the minority Keystone stock by way of the tender offer and subsequent merger.[5] Actual and punitive damages were prayed for on the basis of fraud and breach of fiduciary duty.[6] The district court acknowledged that Ralston, as a majority shareholder, owed a fiduciary duty to the plaintiffs.[7] Nevertheless, the court denied the plaintiffs' recovery on the fraud theory only and held that Ralston's fiduciary duty only affected the scope of disclosure and the burden of proof in a fraud action.[8]

The plaintiffs appealed and alleged, *inter alia*, that the district court misconstrued the nature of their complaint by failing to recognize the breach of fiduciary duty as a separate cause of action.[9] Because the question

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1. Linge v. Ralston Purina Co., 293 N.W.2d 191, 192 (Iowa 1980). Keystone was organized to develop a ski resort in Colorado. *Id.*

2. *Id.* at 193. Initially Ralston was a 50% shareholder and by exercising its preemptive rights in a second offer increased its holdings to 63%. It was by way of the tender offer which subsequently became the subject of dispute between the majority and minority shareholders that Ralston increased its ownership of Keystone stock to 93%. *Id.* at 192-93.

3. IOWA CODE § 496A.72 (1979).

4. Ralston incorporated for the sole purpose of merging with Keystone. The merger was completed and the name of Keystone was acquired for Ralston's new subsidiary. 293 N.W.2d at 193.

5. *Id.*

6. *Id.* The question of whether a breach of fiduciary duty should be recognized as a basis of recovery was one of the issues on appeal to the Iowa Supreme Court, and as noted by the court, was a question of first impression. *Id.* The court's decision to recognize breach of fiduciary duty with respect to majority shareholders of a corporation as a cause of action which may be plead separate from fraud is the subject of this casenote.

7. 293 N.W.2d at 194.

8. *Id. See also* Dawson v. National Life Ins. Co., 176 Iowa 362, 377, 157 N.W. 929, 934 (1916).

9. Two additional issues raised on appeal, but not discussed in this casenote, were: 1) Whether the trial court erred in not allowing plaintiffs' exhibit which contained historical data

of whether the plaintiffs in *Linge* could recover for breach of fiduciary duty by Ralston was not procedurally preserved for review, the Iowa Supreme Court did not decide the merits of that contention on appeal.[10] The Iowa Surpeme Court *held*, affirmed. Majority shareholders of a corporation owe a fiduciary duty to minority shareholders of the corporation which, if breached, may provide a basis of recovery distinct from fraud.[11] *Linge v. Ralston Purina Co.*, 293 N.W.2d 191 (Iowa 1980).

The *Linge* decison is a significant ruling in the area of Iowa corporate law because the supreme court ostensibly recognized the fiduciary relationship between majority shareholders and minority shareholders of a corporation.[12] In light of the recent Iowa case, *Rowen v. LeMars Mutual Insurance Co.*,[13] wherein the court recognized the fiduciary duty of corporate officers and directors in dealing with the corporation and its shareholders,[14] the rule adopted by the court in *Linge* was seemingly the next logical step. In both *Rowen* and *Linge* the court followed the majority rule which imposed a duty of good faith, honesty and loyalty to the corporation upon those controlling the corporation.[15]

The *Linge* court reasoned that because a majority shareholder and a minority shareholder occupy a relationship analogous to that of a director and a minority shareholder, the fiduciary duty of good faith, honesty and loyalty imposed upon those controlling the corporation should, therefore, be extended to majority shareholders of the corporation.[16] However, the court was neither required nor felt compelled to review the particulars of the tender offer and merger conducted by Ralston and thus made no determination of the rightness of the majority shareholder's conduct therein.[17] Therefore, an analysis of how other courts have perceived the fiduciary duty owed

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relating to the tender offer and merger because of lack of proper foundation and the attorney client privilege; and 2) whether the trial court erred in holding the short-form merger proceedings were not the result of a fraudulent scheme. 293 N.W.2d at 192.

10. *Id.* at 195. After reviewing the trial court's record the Iowa Supreme Court held that the breach of fiduciary duty action was never presented to the trial court and that the plaintiffs never filed a 179(b) motion asking for a ruling, therefore the court was not required to determine if the trial court erred in not recognizing the breach of fiduciary duty action. *Id.* at 195-96. *See* IOWA R. CIV. P. 179(b).

11. 293 N.W.2d at 194.

12. Prior to the *Linge* decision, Iowa corporate law only went so far as to recognize fiduciary duties with respect to the officers and directors of a corporation. *See, e.g.*, Rowen v. Lemars Mut. Ins. Co., 283 N.W.2d 639, 649 (Iowa 1979); Holi-Rest, Inc. v. Treloar, 217 N.W.2d 517, 525 (Iowa 1974); Holden v. Construction Mach. Co., 202 N.W.2d 348, 356-58 (Iowa 1972); Gord v. Iowana Farms Milk Co., 245 Iowa 1, 16-17, 60 N.W.2d 820, 829 (1953).

13. 282 N.W.2d 639 (Iowa 1979). *See also* 29 DRAKE L. REV. 673 (1980).

14. 282 N.W.2d 639 (Iowa 1979).

15. *E.g.*, Perlman v. Feldmann, 219 F.2d 173 (2d Cir. 1955); Holi-Rest, Inc. v. Treloar, 217 N.W.2d 517 (Iowa 1974); Salvadore v. Connor, 87 Mich. App. 664, 276 N.W.2d 458 (1979).

16. 293 N.W.2d at 193-94.

17. *Id.* at 195-97.

to minority shareholders by majority shareholders will aid in determining the possible ramifications of the *Linge* holding and thus, will provide provisional guidelines for parties seeking to commence an action for a majority shareholder's breach of fiduciary duty.

The United States Supreme Court in two landmark decisions, *Southern Pacific Co. v. Bogart*[18] and *Pepper v. Litton*,[19] established that majority shareholders are fiduciaries of the corporation and thus owe a duty to the corporation and the minority shareholders.[20] In *Pepper*, the Court held that the majority shareholders' dealings with respect to the corporation will be rigorously scrutinized by the courts, and moreover, anytime their conduct is questioned they would have the burden "not only to prove the good faith of the transaction but also to show its inherent fairness from the viewpoint of the corporation and those interested therein."[21]

In reaching the standard enunciated in *Pepper*, the Supreme Court relied on its position taken in *Southern Pacific*,[22] which recognized that although the majority has the right to control, it has a fiduciary relationship with the minority shareholder similar to that of the corporation or its officers and directors when it chooses to act.[23] Likewise, the Court relied upon the holding in *Geddes v. Anaconda Copper Mining Co.*,[24] which placed the burden of showing good faith and inherent fairness in the performance of its corporate duties upon the majority shareholder.[25] The rationale for the imposition of this fiduciary obligation was to protect the corporate assets and interests, including those of the shareholders.[26] Most states that had not previously recognized the fiduciary duty that majority shareholders owe to minority shareholders have now adopted the standard set out in *Pepper*.[27] Accordingly, it is reasonable to conclude that Iowa will follow the trend of other jurisdictions and will adopt and apply the specific standards articulated in *Pepper*[28] when deciding cases that have an alleged breach of fiduciary duty.

For various reasons, breach of fiduciary duty actions have provided minority shareholders with a tactical advantage not afforded to them by alternative theories such as fraud.[29] One advantage appears to be that breach of

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18. 250 U.S. 483 (1919). *See* notes 22-23 and accompanying text *infra*.
19. 308 U.S. 295 (1939).
20. *Id.* at 306-08.
21. *Id.* at 306.
22. 250 U.S. 483 (1919).
23. *Id.* at 492.
24. 254 U.S. 590 (1921).
25. *Id.* at 599.
26. 308 U.S. at 307.
27. *See, e.g.*, Jones v. H.F. Ahmanson & Co., 1 Cal. 3d 93, 109, 460 P.2d 464, 471, 81 Cal. Rptr. 592, 599 (1969).
28. *See* notes 22-26 and accompanying text *supra*.
29. *See* F. HODGE O'NEAL, "SQUEEZE-OUTS" OF MINORITY SHAREHOLDERS, § 7.13 (1975)

fiduciary duty has been easier to prove than fraud because the fiduciary has the burden of showing the rightness of his conduct.[30] This relieves the minority shareholder from having to establish the hard-to-prove elements of common-law fraud which are: "(1) representation; (2) falsity; (3) materiality; (4) scienter; (5) intent to deceive; (6) reliance; (7) resulting injury and damage."[31] Furthermore, the party that alleges fraud carries the burden of establishing it by a preponderance of the evidence which is clear, satisfactory and convincing.[32] On the contrary, however, recovery may be easier in breach of fiduciary duty actions because the standard for determining good faith, honesty and loyal conduct varies with the occasion, and the courts are more capable of fashioning appropriate relief when the circumstances and equity so require.[33] Additionally, punitive damages are more readily recoverable by plaintiffs in a breach of fiduciary action than a fraud action,[34] especially where the court has ascertained deliberate behavior by the fiduciary which constitutes a breach of its duty.[35]

An important point to remember in asserting that a breach of fiduciary duty has occurred is that the scope of the duties owed by majority shareholders is broad.[36] Corporate fiduciaries conduct a wide range of management functions and activities[37] and the scope of these functions is not always carefully delineated.[38] Consequently, a ruling-out process has evolved from which the courts have proscribed vague parameters as to what is acceptable conduct for those who occupy a fiduciary position.[39] Therefore, whether or not relief will be granted for breach of fiduciary duty often depends upon the particular facts of the case.[40]

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[hereinafter cited as O'NEAL]. *See, e.g.*, Mardel Sec., Inc. v. Alexandria Gazette Corp., 320 F.2d 890 (4th Cir. 1963) (fraud is not required for breach of fiduciary duty to occur).

30. O'NEAL, *supra* note 29, § 7.13, at 511. *See, e.g.*, Pepper v. Litton, 308 U.S. 295, 307-08 (1939) (majority shareholder who dealt with the corporation had the burden of proving good faith and the inherent fairness of the transaction).

31. First Nat'l Bank v. Brown, 181 N.W.2d 178, 181 (Iowa 1970). *See also* Hall v. Wright, 261 Iowa 758, 766, 156 N.W.2d 661, 666 (1968).

32. *See, e.g.*, Hall v. Wright, 156 N.W.2d 661, 666 (Iowa 1968) (plaintiff in fraud action has burden of proving essential elements of fraud).

33. *See, e.g.*, Singer v. Magnavox, 380 A.2d 969, 977 (Del. 1977).

34. International Bankers Life Ins. Co. v. Holloway, 368 S.W.2d 567, 584 (Tex. 1963) ("It is consistent with equitable principles for equity to exact of a defaulting corporate fiduciary not only the profits rightfully belonging to the corporation but an additional exaction for unconscionable conduct. There should be a deterrent to conduct which equity condemns. . . .").

35. *See* Holden v. Construction Mach. Co., 202 N.W.2d 348 (Iowa 1972).

36. *See* Heatherington, *The Minority's Duty of Loyalty in Close Corporations*, 1972 DUKE L. J. 921, 922. [hereinafter cited as Heatherington].

37. *Id.*

38. Jacobs, *Business Ethics and the Law: Obligations of a Corporate Executive*, 28 BUS. LAW. 1063, 1066 (1973) (legal theories upon which fiduciary liabilities are based are so varied that in a single case many theories may be applicable).

39. Heatherington, *supra* note 36, at 922.

40. O'NEAL, *supra* note 29, § 7.13, at 509.

Traditionally, cases which involved breach of fiduciary duty by majority shareholders of a corporation have dealt with situations where the majority shareholders manipulated corporate affairs to further their own interests rather than those of the entire body of shareholders[41] or where the share-dealings of the majority caused injury to the corporation itself.[42] In these cases any relief afforded to the minority shareholder was incidental to and dependent upon the corporation initiating an action against the majority for its misconduct.[43] If the corporation failed to bring an action against the majority, the aggrieved minority shareholder could bring a suit against the majority *and* the corporation.[44] However, traditional fiduciary law required complaints to contain allegations that the corporation had suffered injury, therefore, whether or not the minority shareholder could recover was contingent upon proof of injury to the corporation.[45] The pragmatic effect of these earlier cases[46] was to preclude minority shareholders from protecting their interests in the corporation absent a showing of injury to the corporation.[47]

The inadequate protection afforded minority shareholders by the conventional theories of fiduciary obligation was first observed by Justice Traynor in *Jones v. H. F. Ahmanson & Co.*[48] In *Ahmanson*, the majority shareholders of a closely-held savings and loan (S & L) formed a holding company and exchanged their S & L shares for derived blocks of holding company shares.[49] This was done in order for the majority shareholders to take advantage of the market then existing for public savings and loan shares.[50] However, the minority shareholders were excluded from the matters involving the holding company.[51] Shortly after the formation of the

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41. *E.g.*, Zahn v. Transamerica Corp., 162 F.2d 36 (3d Cir. 1947).

42. *E.g.*, Perlman v. Feldmann, 219 F.2d 173 (2d Cir. 1955) (controlling shareholder accountable to corporation for premium received in sale of control to a corporate buyer which allocated the acquired corporation's product to itself rather than to the market in time of shortage).

43. *See* Jones v. H.F. Ahmanson & Co., 1 Cal. 3d 93, 460 P.2d 464, 81 Cal. Rptr. 592, *rev'd*, 76 Cal. Rptr. 293 (1969).

44. *Id.* at 107, 460 P.2d at 470, 81 Cal. Rptr. at 598.

45. *See generally* Note, *Jones v. Ahmanson: The Fiduciary Obligations of Majority Shareholders*, 70 COL. L. REV. 1079, 1083 (1970). [hereinafter cited as 70 COL. L. REV. (1970)].

46. *See* Shaw v. Empire Savings & Loan Ass'n, 186 Cal. App. 2d 401, 9 Cal. Rptr. 204 (1960).

47. *See* 70 COL. L. REV. (1970), *supra* note 45, at 1083.

48. 1 Cal. 3d 93, 460 P.2d 464, 81 Cal. Rptr. 592 (1969).

49. *Id.* at 103, 460 P.2d at 467, 81 Cal. Rptr. at 595.

50. The stock of S & L was relatively inactive because of its high book value, the fact that the corporation was closely held and because management did not disclose investment information regarding the stock to the shareholders or the public. Therefore, the majority sought a method by which they could use their S & L shares to benefit from the sudden upsurge in activity for public savings and loan shares. *Id.*

51. Throughout the disposition of the case the majority shareholders contended that they had no duty to include the minority in matters concerning the holding company. *Id.* at 109, 460 P.2d at 471, 81 Cal. Rptr. at 599.

holding company, and as a result of several transactions inconsequential to S & L corporate affairs,[52] the majority was able to sell some holding company stock on the public market well in excess of its book value, thereby reaping substantial gains from which the minority was precluded.[53] Additionally, as a consequence of the majority shareholders' conduct, the minority S & L stock lost its value and became virtually unmarketable except to the holding company.[54]

Specifically, the minority shareholders in *Ahmanson* alleged that the majority shareholders breached their fiduciary duty in the creation of and the operation of the holding company in that "they used their control of the [S & L] for their own advantage to the detriment of the minority . . . ."[55] In reversing the trial court's ruling that the plaintiffs had failed to allege an individual cause of action, Justice Traynor remanded the case for a trial on its merits.[56] Nonetheless, the *Ahmanson* decision, unlike the *Linge* decision, specifically discussed the standard to be applied in breach of fiduciary duty actions and specifically in the context of majority shareholders and their use of the control element of the corporation.[57]

The defendant majority shareholders contended that in the use of their own shares of S & L stock they owed no fiduciary duty to the minority shareholders.[58] However, this so-called majority rule urged by the majority shareholders was rejected by the court since it had been significantly qualified by later cases.[59] The applicable rule, the court held, subjects the majority shareholders to a standard of good faith and inherent fairness in transactions involving control of the corporation.[60]

Nonetheless, in the court's view, the traditional theories of fiduciary obligation failed to afford adequate protection to the minority in situations as in *Ahmanson*, where there was "no sale or transfer of actual control."[61] The court recognized that minority shareholders may be injured by acts of the

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52. *Id.* at 103-04, 460 P.2d at 467, 81 Cal. Rptr. at 595.

53. *Id.* at 103-06, 460 P.2d at 467-69, 81 Cal. Rptr. at 595-97.

54. *Id.* at 106, 460 P.2d at 469, 81 Cal. Rptr. at 597.

55. *Id.*

56. *Id.* at 115-16, 460 P.2d at 476, 81 Cal. Rptr. at 604.

57. *Id.*

58. The majority maintained that they made complete disclosure of the circumstances surrounding the formation of the holding company, that the creation of the holding company in no way affected control of S & L, that S & L was not harmed, and that the market for S & L stock was not affected, therefore they did not breach their fiduciary duty to the minority. *Id.* at 110, 460 P.2d at 472, 81 Cal. Rptr. at 600.

59. *Id.* Although the rule advanced by the majority shareholders had been applied in earlier cases, the court relied on the rulings of later cases which held that majority shareholders did not have an absolute right to use their corporate share. For all practical purposes, the court held, the majority becomes the corporation and therefore occupies a trust relationship with the corporation's shareholders. *Id.* at 111-12, 460 P.2d at 473, 81 Cal. Rptr. at 601.

60. *Id.* at 111, 460 P.2d at 472, 81 Cal. Rptr. at 600.

61. *Id.* at 113, 460 P.2d at 474, 81 Cal. Rptr. at 602.

majority in situations which did not necessarily involve stock transactions or injury to the corporation, but which nevertheless should be neither overlooked nor permitted.[62]

The court perlustrated the circumstances surrounding the formation of the holding company and the subsequent marketing of its shares, from which the minority had been precluded, in search of good faith and fairness on the part of the majority S & L shareholders.[63] The *Ahmanson* court reasoned that there were two alternatives available to the majority in their quest to benefit from the active market of savings and loan shares, by which all the shareholders would profit.[64] Nevertheless, the majority opted for a course of action which imposed a detriment upon the minority shareholders of S & L.[65]

Ultimately, the comprehensive rule which evolved from the *Ahmanson* decision was that the controlling shareholders of a closely held corporation must show good faith and inherent fairness in transactions where control of the corporation is material or they must prove that their actions were necessary for a compelling business purpose so as to render their actions fair under the facts of the case.[66] This rule has since been expanded to reach controlling shareholders of publicly held corporations as well.[67]

Inherent in the duty of good faith and fairness is the duty of full disclosure,[68] particularly in stock transactions between majority and minority shareholders.[69] An illustrative case in this context is the recent Kansas decision, *Blakesley v. Johnson*,[70] in which the majority shareholder was found to have breached his fiduciary duty in failing to disclose material information affecting the value of the corporate stock before an agreement between the majority shareholder and a minority shareholder was executed for the sale

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62. *Id.*

63. *Id.* at 113-16, 460 P.2d at 474-76, 81 Cal. Rptr. at 602-04.

64. *Id.*

65. *Id.*

66. *Id.* at 113, 460 P.2d at 474, 81 Cal. Rptr. at 602.

67. *See* Fisher v. Pennsylvania Life Co., 69 Cal. App. 3d 506, 514, 138 Cal. Rptr. 181, 185 (1977)(although the California Supreme Court in *Ahmanson* demonstrated a particular concern for minority shareholders in close corporations, the comprehensive rule of good faith and inherent fairness applies to actions of all controlling shareholders and directors, even in corporations that are not closely held).

68. *See* note 70 and accompanying text *infra*.

69. Circumstances surrounding a stock transaction may, likewise, give rise to insider trading duties of disclosure under 17 C.F.R. section 240.10b-5 (1977), promulgated by the Securities and Exchange Commission pursuant to 15 U.S.C. section 78w(a)(1976). *See* Ritchie v. McGrath, 1 Kan. App. 2d 481, ___, 571 P.2d 17, 22 (1977)("Breaches of duty have also been found in sales involving 'fraud, misuse of confidential information . . . siphoning off for personal gain a business advantage rightfully belonging to the corporation and shareholders in common, or wrongfully appropriating corporate assets.' " McDaniel v. Painter, 418 F.2d 545, 548 (10th Cir. 1969)).

70. 227 Kan. 495, 608 P.2d 908 (1980).

of the minority's stock to the corporation.[71] The majority shareholder neglected to inform the minority shareholder that a pending sale of the corporation to a third party would be completed only if the buyers received one hundred percent control of the corporate stock.[72] As a result of this nondisclosure, the minority shareholder relinquished his stock to the majority shareholder at a price substantially below the price received by the majority shareholder in the subsequent sale of the corporation.[73]

The majority shareholder as a fiduciary has the duty to disclose any superior knowledge regarding the corporation which effectually could influence the price of the corporation's stock.[74] Accordingly, the minority shareholder has the right to rely on full disclosure by the majority shareholder.[75] The *Blakesley* court, in holding as it did, followed its rulings in two comparable decisions which imposed an analogous duty of full disclosure upon corporate officers and directors.[76] Generally, when a majority shareholder occupies a position as director or officer of the corporation, the courts are more likely to scrutinize the alleged incredulous behavior in light of fiduciary law governing officers and directors.[77] However, it is from those cases and the principles developed therein that the courts have sought to impose a fiduciary obligation upon majority shareholders who are neither directors nor officers.[78]

Although the majority and minority shareholders in the *Blakesley* case were either an officer or director of the corporation,[79] it reasonably could be concluded that the court intended to impose a fiduciary duty upon the majority shareholder despite the officer or director status.[80] Likewise, the ma-

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71. *Id.* at _, 608 P.2d at 915.

72. *Id.* Likewise, the majority shareholder told the prospective buyer that the minority shareholder did not want to exercise his first right to purchase the business and, moreover, that the stock necessary for complete control of the corporation was available. However, the trial court found that the majority shareholder had not discussed any matters pertaining to the sale of the corporation with the minority shareholder at that time. *Id.* at _, 608 P.2d at 911.

73. *Id.* at _, 608 P.2d at 915. The majority shareholder's shares were purchased by the corporation (majority shareholder) for approximately $1,389 each and subsequently the shares were sold to buyers the following day for prices ranging from $2,500 to $3,125 for each share of stock. *Id.*

74. *Id.*

75. *Id.*

76. *Id.* at _, 608 P.2d at 914. *See also* Newton v. Hornblower, Inc., 224 Kan. 506, 582 P.2d 1136 (1978); Sampson v. Hunt, 222 Kan. 268, 564 P.2d 489 (1977).

77. *See generally* H. HENN, CORPORATIONS, §§ 239-41 (1970) (directors of a corporation are subject to a stricter standard of loyalty in dealing with the corporate interests than are non-director majority shareholders, because of the directors' ability to influence the everyday transactions more readily than a non-director shareholder).

78. The *Linge* court, following the rationale for imposing a fiduciary duty upon directors and officers of the corporation, likewise extended it to majority shareholders. 293 N.W.2d at 193-94.

79. 227 Kan. at _, 608 P.2d at 915.

80. *Id.*

jority stockholder carried the burden to prove by clear and satisfactory evidence that the transaction was neither tainted by bad faith nor unfairness.[81] The majority shareholder was ordered to account to the minority shareholder for the latter's share of the profits from the sale of all the corporate stock realized by the majority shareholder in the sale of the corporation.[82]

Four recent Delaware decisions[83] explored the scope of the majority shareholder's duty to minority shareholders in situations involving statutorily regulated tender offers and mergers.[84] In *Singer v. Magnavox Co.*,[85] minority shareholders brought an action based on breach of fiduciary duty against majority shareholders and sought nullification of a merger allegedly made for the sole purpose of freezing-out the minority shareholders of the corporation.[86] The court of chancery granted the defendants' motion to dismiss on the grounds that the plaintiffs' claim failed to state a cause of action.[87] Additionally, the lower court held that since the defendants had complied with the statutory provisions regulating the merger their conduct was not fraudulent, notwithstanding the fact that the merger was accomplished without any business purpose other than to eliminate the minority.[88]

On appeal, the Supreme Court of Delaware reversed the lower court's finding[89] and in doing so, held that the minority's complaint was actionable under the law governing corporate fiduciaries and that the lower court incorrectly applied the theory of fraud to the case.[90] In reaching its decision, the *Singer* court rejected the defendants' contention that statutory compliance with the merger statute was sufficient to render their conduct immune from judicial scrutiny.[91] The court stated that the duty owed to the minority cannot be circumvented by merely comporting with procedures permitted

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81. *Id.*

82. *Id.*

83. Roland Int'l Corp. v. Najjar, 407 A.2d 1032 (Del. 1979); Lynch v. Vickers Energy Corp., 383 A.2d 278 (Del. 1977); Singer v. Magnavox Co., 380 A.2d 969 (Del. 1977); Tanzer v. International Gen. Indus., Inc., 379 A.2d 1121 (Del. 1977).

84. Had the *Linge* court been required to determine the validity of the tender offer effected by Ralston, the principles and parameters established and applied by the Delaware courts with respect to tender offers seem to delineate plausible guidelines which the court could have used in making its determination. *See* Cohen, *Tender Offers and Take-over Bids*, 23 Bus. Law. 611 (1968); Fleischer & Mundheim, *Corporate Acquisitions by Tender Offer*, 115 U. Pa. L. Rev. 317 (1967).

85. 380 A.2d 969 (Del. 1977).

86. *Id.* at 971.

87. *Id.* at 972. The defendants maintained that their actions were authorized by statute, that the minority's exclusive remedy for dissatisfaction with the merger was an appraisal and that the minority was not entitled to relief because they did not rely on any purported misrepresentations. *Id.*

88. *Id.*

89. *Id.* at 969.

90. *Id.* at 975.

91. *Id.*

under and required by corporate statutes.[92] The rationale for this stance was supported by a standard adopted in *Sterling v. Mayflower Hotel Corp.*,[93] which recognized that "a majority stockholder standing on both sides of a merger transaction, has 'the burden of establishing its entire fairness' to the minority stockholders, sufficiently to 'pass the test of careful scrutiny by the courts.' "[94]

Specifically, the plaintiffs in *Singer* alleged that the merger was executed by the majority shareholders without a valid business purpose and only for the purpose of freezing-out the minority shareholders from the corporation in order to enable the majority to obtain sole ownership in the corporation.[95] Since "the [Delaware merger] statute is silent on the question of whether a merger may be accomplished only for a valid business purpose,"[96] the court looked to two unreported Delaware decisons[97] and concluded that such a showing was necessary.[98] On the contrary, the defendants urged that based upon prior merger law,[99] it was inapposite for the court to apply the business-purpose rule in determining the validity of their merger.[100]

The Supreme Court of Delaware denied the defendants' theory and held that the court will closely scrutinize a complaint containing allegations that a merger was executed solely for the purpose of freezing-out the minority.[101] In so holding, the court relied on its ruling in *Bennett v. Breuil Petroleum Corp.*,[102] which held that a cause of action will arise if the "pleadings and affidavits have raised a substantial factual dispute as to the legal propriety of the motives of the corporate defendant and its controlling stockholder which can only be resolved by a hearing."[103] The general proposition derived from the analysis of the facts in *Singer* is that a merger effected by majority shareholders for the sole purpose of freezing-out the minority is intolerable, and that allegations containing indicia of such, state a cause of action for which relief may be granted. Likewise, the fiduciary has the burden to show

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92. *Id.* at 975-76.

93. 33 Del. Ch. 293, 93 A.2d 107 (1952).

94. *Id.* at _, 93 A.2d at 109-10, *cited in* Singer v. Magnavox Co., 380 A.2d 969, 976 (Del. 1977).

95. 380 A.2d at 975.

96. *Id.* ("The 'business judgement' rule sustains corporate transactions and immunizes management from liability where the transaction is within the powers of the corporation (intra vires) and the authority of management, and involves the exercise of due care and compliance with applicable fiduciary duties." HENN, *supra* note 77, § 242, at 482.

97. *See* Pennsylvania Mutual Fund, Inc. v. Todhunter Int'l, Inc., No. 4845 (Del. Ch. C.A. Aug. 5, 1975); Tanzer v. International Gen. Indus., Inc., No. 4945 (Del. Ch. C.A. Dec. 23, 1975). *See* notes 105-11 and accompanying text *infra* discussing the *Tanzer* decision on appeal.

98. 380 A.2d at 975.

99. *Id.* at 978-79.

100. *Id.*

101. *Id.*

102. 34 Del. Ch. 6, 99 A.2d 236 (1953).

103. *Id.* at _, 99 A.2d at 239.

that not only a valid business purpose existed, but that there was entire fairness in their conduct.[104]

A second Delaware case, handed down the same year as *Singer*, was *Tanzer v. International General Industries, Inc.*[105] In *Tanzer*, the court addressed the question of whether a parent corporation, as a majority shareholder of its own subsidiary, could cause a merger solely for its own business purpose, or whether such conduct violated the fiduciary duty of majority shareholders imposed by corporate law.[106] The defendants argued that since the merger was for a valid business purpose, they did not breach their fiduciary duty.[107] The plaintiffs alleged that a merger which benefitted only the parent corporation was impermissible.[108]

In deciding *Tanzer*, the court pointed out that the competing interests of the majority and minority shareholders were at stake.[109] On the one hand, it was apparent that courts have become increasingly mindful of the rights of the minority shareholders in situations involving their corporate interests and the need for adequate protection of those rights.[110] On the other hand, the court readily recognized the principle that the majority shareholder has the right to vote its shares as it pleases, and likewise, it has the right to sell the corporate assets over the objection of the minority provided "entire fairness" is shown.[111] The court applied the rule articulated in *Singer*,[112] and held that the majority shareholder would have violated its fiduciary duties if it were shown that the real reason of the merger was to rid itself of unwanted minority shareholders in the subsidiary.[113] The trial court found, and the minority conceded, that the principal purpose of the merger was to facilitate long-term debt financing by the parent corporation.[114] Consequently, the court held that the rule of *Singer* had not been violated by effecting the merger and that the majority met their burden of establishing a *bona fide* purpose for the merger.[115]

In 1979, *Roland International Corp. v. Najjar*[116] was decided by the Supreme Court of Delaware. The pertinent facts presented to the court were

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104. *Id.*
105. 379 A.2d 1121 (Del. 1977).
106. *Id.* at 1123. *See also* Comment, *Survival Rights of Action after Corporate Merger*, 78 MICH. L. REV. 250 (1979); Note, *Assuring Fairness in Corporate Mergers: Recent State Trends*, 35 WASH. & LEE L. REV. 927 (1978).
107. 379 A.2d at 1123.
108. *Id.*
109. *Id.*
110. *Id.*
111. *Id.* at 1123-24.
112. *See* note 95 and accompanying text *supra*.
113. 379 A.2d at 1124.
114. *Id.*
115. *Id.* at 1125 (emphasis in original).
116. 407 A.2d 1032 (1979).

basically the same as in *Tanzer*,[117] except that the majority shareholders in *Roland* claimed that they had acted fairly by the terms of the merger.[118] If the minority was not satisfied with the cash price offered they could seek an appraisal remedy.[119] Likewise, majority shareholders urged that the merger statute concerned in the case[120] presumed a valid purpose for the merger and any inquiry by the court was unwarranted.[121] The court held that the defendants' reliance was misapplied[122] and that the fiduciary duty owed by the majority was based not on the merger statute itself, but on the long-standing principles of equity which impose a duty of good faith and fairness upon the majority.[123]

Citing *Stauffer v. Standard Brands, Inc.*,[124] the majority shareholders in *Roland* further maintained that the merger statute was a device to enable the parent to eliminate the minority shareholders in a subsidiary.[125] The court agreed with the defendants' contention; however, and relying on the principles in *Singer*,[126] the court held that a merger without a valid business purpose which freezes-out the minority was not acceptable.[127] The plaintiffs' complaint alleged that the terms of the merger were grossly inadequate and unfair to the minority shareholders and that the merger had no purpose other than to eliminate the minority.[128] In finding that the plaintiffs' complaint did state a cause of action for breach of fiduciary duty, the court held that the defendants would have to establish a proper purpose for the merger

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117. Majority shareholders of Roland chartered a corporation for the purpose of merging it with Roland. The majority then exchanged their Roland shares and subsequently merged it with Roland. The minority shareholders of Roland were informed that they could either accept a cash offer for their Roland shares or seek an appraisal remedy. *Id.* at 1033.

118. *Id.* at 1035.

119. *Id.* Appraisal remedies have not been recognized to be the only remedy where fraud or illegality is alleged. Robb v. Eastgage Hotel, Inc., 347 Ill. App. 261, 106 N.E.2d 848 (1952). Likewise, the Delaware courts have refused to recognize appraisal as the exclusive remedy where claims of fairness or lack of business purpose are involved. *See* Roland Int'l Corp. v. Najjar, 407 A.2d at 1032 (1979); Singer v. Magnavox Co., 380 A.2d 969 (1977).

120. The court's analysis and decision regarding the purpose of the short-form merger and the appropriate uses of it could likewise be applicable to the facts of *Linge* insofar as the question of whether the majority shareholder Ralston did have a bona fide business purpose as required by both *Singer* and now *Roland*.

121. This argument is *contra* to the Court's finding in *Singer*, which involved Delaware's short-form merger statute. The *Singer* court held that a *bona fide* business purpose had to be shown for the merger to be valid. *See* note 106 and accompanying text *supra*.

122. 407 A.2d at 1036.

123. *Id.*

124. 41 Del. Ch. 7, 187 A.2d 78 (1962).

125. 407 A.2d at 1036.

126. *Id.* at 1036-37. The court distinguished the merger in *Singer* and *Roland*. The *Singer* merger involved unrelated corporations, however, the merger in *Roland* presented a "classic" going-private transaction which the court believed called for the strictest observance of the law of fiduciary duty. *Id.* at 1037.

127. *Id.*

128. *Id.*

and proof of entire fairness in all aspects of the merger.[129]

In *Lynch v. Vickers Energy Corp.*,[130] the plaintiffs, former majority shareholders of a corporation, filed a complaint charging that the defendant majority shareholders violated their fiduciary duty by making less than full and frank disclosure in a tender offer in which the minority sold their minority stock at "a grossly inadequate price."[131] Additionally, the claim alleged that the majority breached their fiduciary duty by use of their superior bargaining position and control over the corporate assets to their advantage and to the detriment of the minority.[132] The lower court entered judgment for the defendants, ruling that the plaintiff had failed to establish coercion or fraud.[133]

On appeal, the Supreme Court of Delaware disapproved the trial court's application of law[134] and in doing so affirmed its ruling in *Allied Chemical & Dye Corp. v. Steel & Tube Co.*,[135] which held that a majority shareholder owed a fiduciary duty to the minority which required total candor and full disclosure of all the facts and circumstances surrounding the tender offer.[136] It is the court's duty to examine the information held by the defendants and to measure it against what was disclosed to the plaintiffs.[137] The standard to be applied in examining the matters surrounding the tender offer requires full disclosure of all "germane" facts.[138] Germane was defined to mean "information such as a reasonable shareholder would consider important in deciding whether to sell or retain stock."[139] The rationale of the court for requiring complete disclosure of germane facts was to prevent insiders from availing themselves of special knowledge which they may use to their advantage and to the detriment of the minority in effecting a tender offer.[140]

It is apparent from the foregoing review of cases that an action predicated on breach of fiduciary duty affords minority shareholder litigants a basis of recovery superior to the traditional theory of fraud. A complaint that alleges breach of fiduciary duty need only set forth a "substantial factual dispute as to the legal propriety of the motives of the corporate defendant and its controlling stockholder."[141] Furthermore, because of the major-

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129. *Id.*
130. 383 A.2d 278 (Del. 1977).
131. *Id.* at 279.
132. *Id.*
133. *Id.*
134. Fraud was the correct theory to be applied. *Id.*
135. 14 Del. Ch. 1, 120 A. 486 (1923).
136. 383 A.2d at 279 (citing Allied Chemical & Dye Corp. v. Steel & Tube Co., 14 Del. Ch. 1, 120 A. 486 (1923)).
137. 383 A.2d at 281. *See also* Singer v. Magnavox Co., 380 A.2d 969 (Del. 1977).
138. 383 A.2d at 281.
139. *Id.*
140. *Id.*
141. Bennett v. Breuil Petroleum Corp., 34 Del. Ch. 6, 99 A.2d 236, 239 (1953).

ity shareholders' fiduciary position, they carry the burden of proving that the alleged wrongful conduct was done in good faith and with inherent fairness with respect to the minority's corporate interests, thereby alleviating the need for proof of the elements of fraud by the minority shareholders.[142] Since the standard of good faith, honesty and inherent fairness is not a hard-fast rule which may be readily applied to any breach of fiduciary duty action, whether or not relief will be granted rests within the ability of the fiduciary to prove the rightness of his conduct within the particular set of facts giving rise to the cause of action.[143] As illustrated by the cases examined above, the question of whether a majority shareholder has breached his fiduciary duty owed to the minority often arises in circumstances surrounding stock transactions,[144] mergers,[145] tender offers[146] and misuse of corporate control.[147]

The language in the *Linge* decision is neither encouraging nor discouraging for future shareholder litigants. The neutral stance taken by the Iowa Supreme Court as implied by the court's failure to discuss the nature, scope and limitations of the majority shareholder's fiduciary duty leaves those wishing to avail themselves of this remedy without any concrete direction in which way to proceed. Although the court should be commended for adopting the majority rule which recognizes breach of fiduciary duty as a basis of recovery, the court would have performed a greater service by setting out the precise scope of the duty owed. Until the occasion arrives when the court has the opportunity to review another case involving the fiduciary duty of majority shareholders, litigants initiating a suit in Iowa are left with the holdings and interpretations of other courts as guidelines in pursuing and maintaining a breach of fiduciary duty action.

*A. Patricia Houlihan*

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142. *See* notes 29-35 and accompanying text *supra*.

143. Guth v. Loft, Inc., 23 Del. Ch. 255, __, 5 A.2d 503, 510 (1939).

144. Blakesley v. Johnson, 608 P.2d 908 (Kan. 1980). *See* notes 70-81 and accompanying text *supra*.

145. Singer v. Magnavox Co., 380 A.2d 969 (Del. 1977); Tanzer v. International Gen. Indus., Inc., 379 A.2d 1121 (Del. 1977). *See also* Carney, *Fundamental Corporate Changes, Minority Shareholders, and Business Purpose*, 1980 Am. Bar Foundation Research J. 69.

146. Lynch v. Vickers Energy Corp., 383 A.2d 278 (Del. 1977). *See* notes 130-40 and accompanying text *supra*.

147. Jones v. Ahmanson & Co., 1 Cal. 3d 93, 460 P.2d 464, 81 Cal. Rptr. 592 (1969). *See* De La Garza, *Conflict of Interest Transactions: Fiduciary Duties of Corporate Directors Who are also Controlling Shareholders*, 55 Den. L. J. 609 (1980).