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THE APPRAISAL REMEDY IN ILLINOIS UNDER THE 1983 BUSINESS CORPORATION ACT: SOME SUGGESTIONS FOR IMPROVEMENT

Under the early common law, the unanimous consent of corporate stockholders was needed to undertake a fundamental corporate change.¹ These fundamental changes included mergers, sales of assets, and amendments to the corporation's articles and by-laws.² It was later realized, however, that a single shareholder could control corporate action simply by dissenting from any of these proposed changes in the corporation.³ To avoid this result, state legislatures authorized corporate changes to be approved by only a simple majority of the stockholders.⁴ While abolition of the unanimous consent rule provided needed flexibility for corporate action, it did not adequately compensate dissenting minority shareholders for the loss of their veto power.

Once the unanimous consent rule was abolished, the dissenting minority shareholders were left with the following alternatives: to remain as shareholders and acquiesce in the majority's decision or sell their shares.⁵ If the minority shareholders decided to sell and there was no public market for their shares, as in the case of a closely held corporation,⁶ they soon discovered that the only prospective buyers were the majority shareholders. The availability of a public market which greatly undervalued the corporate shares was likewise not an economically fair alternative. In these situations, the dissenting minority shareholders were faced with the majority's price or a very weak market. Neither option provided the shareholders with a fair exchange for their stock certificates.

Accordingly, dissenting minority shareholders needed compensation for the loss of their rights and interests in the pre-existing corporation. They had a reasonable expectation to continue as own-

1. See Note, *Valuation of Dissenters' Stock Under Appraisal Statutes*, 79 HARV. L. REV. 1453 (1966).

2. See W. FLETCHER, *CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS* § 5906.1 (rev. perm. ed. 1970).

3. See Comment, *The Dissenting Shareholder's Appraisal Remedy*, 30 OKLA. L. REV. 629, 630 (1977).

4. See *Teschner v. Chicago Title & Trust Co.*, 59 Ill. 2d 452, 456, 322 N.E.2d 54, 56 (1974).

5. See Squires, *The Dissenting Shareholder's Appraisal Remedy Under the Illinois Business Corporation Act*, 53 ILL. B.J. 482, 483-84 (1965).

6. See Note, *A Reconsideration of the Stock Market Exception to the Dissenting Shareholders' Right of Appraisal*, 74 MICH. L. REV. 1023, 1026 (1976).

ers of the corporation as it had originally been formed. The dissenting minority had also lost the veto power which they possessed under the common law. To compensate for these losses, every state established the appraisal remedy which forces the corporation to purchase the dissenting minority's shares at a fair market value determined by a court.⁷

The Illinois Legislature recently enacted the Business Corporation Act of 1983 (I.B.C.A.), which includes a completely revised appraisal remedy.⁸ The I.B.C.A. establishes a single procedure which enables dissenting shareholders to perfect this important remedy. The previous Illinois corporation statute, the Business Corporation Act of 1933 (1933 Act), contained three separate procedures for dissenting shareholders to follow, depending on the type of corporate transaction involved.⁹ The I.B.C.A. substantially improves the appraisal remedy in Illinois by: 1) increasing the number of triggering transactions; 2) including a variation of the stock market exception; 3) improving notice to shareholders; 4) using a flexible approach to valuation; 5) allocating the costs of the appraisal proceeding against a corporation that has failed to bargain in good faith; and 6) providing for injunctive relief when a proposed corporate transaction is unfair. Despite these improvements, however, there are still some aspects of the appraisal remedy which should be revised to enhance its effectiveness.

Section 11.65 of the I.B.C.A. allows dissenting minority shareholders to demand payment for their shares in the event of a merger, sale or exchange of assets, or a short form merger.¹⁰ The I.B.C.A.'s triggering transactions also include any amendment to the articles of incorporation that has a material and adverse effect on the dissenter's shares.¹¹ It also includes any other corporate transaction that must be approved by shareholder vote if the corporation's articles or by-laws provide for the appraisal remedy for that particular transaction.¹² The former Illinois corporation statute, the 1933 Act, had as its triggering transactions only a merger, sale or exchange of assets, and short form merger.¹³

7. See Fischel, *The Appraisal Remedy in Corporate Law*, 1983 AM. B. FOUND. RESEARCH J. 875 n.1.

8. ILL. REV. STAT. ch. 32, §§ 11.65, 11.70 (Supp. 1983).

9. Business Corporation Act §§ 70, 73, 1933 Ill. Laws 308, 343-45 (codified at ILL. REV. STAT. ch. 32, §§ 157.70, 157.73 (1983) (repealed 1983); Act of Dec. 3, 1971, P.A. 77-1742 § 1, 1971 Ill. Laws Vol. II 3324 (codified at ILL. REV. STAT. ch. 32, § 157.66(a) (1983)) (repealed 1983).

10. ILL. REV. STAT. ch. 32, § 11.65 (Supp. 1983). This section replaces sections 66a, 70, and 73 of the 1933 Act. See *supra* note 9.

11. ILL. REV. STAT. ch. 32, § 11.65(a)(3) (Supp. 1983).

12. *Id.* § 11.65(a)(4).

13. See *supra* note 9.

Another variation between the I.B.C.A. and the 1933 Act concerns the former's inclusion of the stock market exception. The stock market exception operates to completely exclude the appraisal remedy from the dissenting shareholder if the shareholder's stock is listed on a national stock exchange, and if the state of incorporation's laws provide for the exception.¹⁴ The rationale behind this exception is that an appraisal is not necessary when minority shareholders are able to sell their shares on a national stock exchange.

If the stock market greatly undervalues the stockholder's shares, it would usually preclude dissenting minority shareholders from selling their stock. To avoid the harsh effects of the stock market exception when the market does not reflect the fair value of corporate shares, the Illinois Legislature has taken a middle ground position regarding the stock market exception. This modified version of the stock market exception combines the use of the stock market and an appraisal. Section 11.70 of the I.B.C.A. provides that the corporation may instruct the dissenting shareholders to sell their shares on a public market, if there is one available.¹⁵ The shareholders then have ten days to sell their shares, and if they fail to sell them, they are then deemed to have sold their shares at the average closing price during the ten day period. After the shares are sold, the shareholders are not foreclosed from the appraisal remedy. If they think that they have not received the true value of their shares in the sale, the dissenting shareholders may still assert the appraisal remedy for the "difference" between the sale price and what they believe the stock was worth.

An ambiguity arises in the I.B.C.A., however, when a shareholder who was instructed to sell his or her shares on the public market fails to do so within the ten day period. The I.B.C.A. provides that the shareholder is deemed to have sold his or her shares at the average price which prevailed on the public market during that ten day period.¹⁶ This language implicitly requires that this "average price" will later be used in an appraisal proceeding. If an appraisal proceeding is requested, the shareholder who failed to sell his or her shares on the stock market, now must demand payment for the "difference" between the shareholder's estimate of value and the proceeds of the sale. A problem arises in this situation because there has been no actual sale of the shares nor any proceeds. Thus, if the shareholder is only entitled to demand the "difference" in exchange for his or her stock certificates, he or she will forfeit the entire amount that would have been received in the sale.

14. For a list of the states that have adopted the stock market exception, see Note, *supra* note 6, at 1024 n.4.

15. ILL. REV. STAT. ch. 32, § 11.70(c) (Supp. 1983).

16. *Id.*

Such an approach is inequitable because it penalizes the shareholder by the amount of the average market price of the shares during the ten day selling period. It is economically impractical for a shareholder to demand only the difference and be willing to tender his or her stock certificates for this amount. It would be better to forego an appraisal and remain a shareholder, in order to retain the market value of the shares. Otherwise, dissenting minority shareholders would not be receiving the fair value of their shares. This development circumvents the underlying rationale of fair valuation in the appraisal remedy. Surely this is not the intended result of the I.B.C.A.¹⁷

A second interpretation of section 11.70 of the I.B.C.A. is that the dissenting shareholder does not have to transfer his or her stock certificates in return for payment of only this "difference."¹⁸ Assuming the shareholder has failed to sell his or her shares and demands the "difference," the corporation can then pay this amount or seek an appraisal of the fair value of the shares. Upon payment of the difference, without tendering his or her stock certificates, the dissenting shareholder would retain an interest in the corporation even though he or she would have already received payment from the corporation under the appraisal remedy. This outcome is also contrary to the underlying rationale of the appraisal remedy: to facilitate the exchange of the dissenting shareholder's stock certificates for payment of fair value from the corporation. The silence of section 11.70 of the I.B.C.A. regarding the transfer of certificates when a sale has not taken place results in a major pitfall for an unwary shareholder attempting to use the appraisal remedy. An amendment is needed, therefore, to clarify this section.

Section 11.70(c) should be amended to clearly state the consequences of the dissenting shareholders' failure to sell their shares on the public market. This objective could easily be achieved by incorporating an amendment which states that shareholders must transfer their stock certificates upon receiving payment of the appraised fair value less the amount they *would* have received in the public market sale. Such an amendment would inform shareholders that if they fail to sell their shares on the market after being instructed to do so, and elect to proceed with appraisal, the result will be the transferring of their stock certificates for only the difference in value as determined in the appraisal proceeding.

Another innovation instituted by the I.B.C.A. places the burden

17. See 2 THE ILLINOIS BUSINESS CORPORATION ACT ANNOTATED WITH FORMS 59 (3d ed. 1984 Supp.).

18. This would certainly be the case had the shareholder sold his or her shares on the stock market.

of initiating the appraisal procedure upon the corporation. The 1933 Act placed the initiation of the appraisal procedure upon the shareholder.¹⁹ Section 11.70 of the I.B.C.A. requires that if the corporate action is to be approved at a shareholder meeting, the corporation must inform all shareholders of their right to dissent and the procedures which must be followed to exercise that right.²⁰ This information is sent to the shareholders along with notice of the shareholder meeting. The I.B.C.A. further requires the corporation to furnish all shareholders with any material information regarding the proposed transaction that would objectively enable the shareholder to vote on the transaction. The information also serves to enable shareholders to objectively decide whether to exercise their dissenters' rights. However, section 11.70 only requires that this material information be furnished to the shareholders prior to the meeting.²¹ It does not state when it must be given to them. The corporation has the option, therefore, to send the information along with the notice of the shareholder meeting, or to wait until the shareholders are about to walk into the meeting. Thus, the information may not reach the shareholders in sufficient time, prior to the meeting, to allow them to objectively decide the merits of the proposed corporate action. An amendment to section 11.70 is, therefore, necessary to improve the notice given to shareholders.

Section 11.70 should be amended to require that the material information regarding the proposed corporate action be included in the notice of the meeting sent to all shareholders. This would allow them sufficient time to study the proposed transaction and make an informed decision regarding it.

After the corporation has complied with the notice requirement, the shareholders must satisfy two conditions to assert their dissenters' rights. The first condition is that they deliver to the corporation a written demand for payment for their shares prior to the meeting. The second condition is that the shareholders must not vote in favor of the proposed transaction at the meeting. The corporation must then send each shareholder, who has delivered a written demand for payment, a statement of the corporation's estimate of the value of the shares.²² Upon receipt of this information, if the dissenting minority shareholders disagree with the corporation's estimated share valuation, they must provide the corporation with their own written estimate of value.

19. See *supra* note 9.

20. ILL. REV. STAT. ch. 32, § 11.70(a) (Supp. 1983).

21. *Id.*

22. The corporation must also either commit to pay for the shares at the estimated value or instruct the dissenting shareholder to sell his or her shares on a public stock market. *Id.* § 11.70(c).

After delivery of the shareholder's estimate, the I.B.C.A. provides for a sixty day period of negotiations. If within the sixty day period both parties do not agree in writing upon the value of the shares, the corporation then has the option to pay the difference in value demanded by the shareholder or file a petition in court. The I.B.C.A. further states that even if the corporation fails to commence an action in court, the dissenting shareholder may still file an action to have the stock value appraised. The I.B.C.A. fails to set a time limit for the corporation regarding when it must file this action. An amendment to section 11.70 is necessary to provide an incentive for the corporation to file an action in court within a specified period of time.

Section 11.70(e) should be amended to state that if the corporation fails to file an action in court within a specified time limit, it is then required to pay the shareholder's estimate of value.²³ This would provide an incentive for the corporation to file suit within the required time limit. This policy would, in some cases, promote judicial economy by eliminating the court's appraisal of fair value and allow a judgment to be entered in favor of the shareholder for the amount the shareholder originally requested.

Once the corporation has filed the action in court, the I.B.C.A.²⁴ provides that the court shall determine the "fair value" of the shares.²⁵ Section 11.70(f) states that the court may appoint one or more persons, as appraisers, to aid the court in determining the fair value of the shares. This flexibility in the I.B.C.A. regarding appraisal is necessary considering the many factors that must be taken into account in determining fair value.²⁶ As a result, an Illinois court can rely on the most recent methods available in the financial community to determine fair value of the shares. Moreover, because of the broad language of the I.B.C.A. regarding valuation, it can never become obsolete in this regard.

Another determination of value that is left to the court is the costs of the appraisal proceeding. The I.B.C.A.²⁷ provides that the court should determine all costs of the proceeding. These costs include the reasonable compensation and expense of any court appointed appraisers or expert witnesses employed by the parties, but excludes the fees and expenses of counsel for the parties. If the

23. This suggestion has been adopted in the Model Business Corporation Act. MODEL BUSINESS CORP. ACT § 81(h)(6). See Conard, *Amendments of Model Business Corporation Act Affecting Dissenters' Rights*, 33 BUS. LAW. 2587, 2604 (1978) (author comments on effect of corporation's failure to file suit).

24. ILL. REV. STAT. ch. 32, § 11.70(f) (Supp. 1983).

25. See Note, *supra* note 1, at 1456.

26. See Banks, *A Selective Inquiry into Judicial Stock Valuation*, 6 IND. L. REV. 19 (1972).

27. ILL. REV. STAT. ch. 32, § 11.70(h) (Supp. 1983).

court determines that the fair value of the shares materially exceeds the amount which the corporation offered to pay, or if no offer was made, then all or any part of the costs of the proceeding may be assessed against the corporation. The I.B.C.A., however, does not allow the court to assess these expenses as a penalty against the dissenting shareholder. An amendment to section 11.70(h) of the I.B.C.A. should be adopted to equalize the possibility that costs may be assessed against the dissenting shareholder in addition to the corporation.

Section 11.70(h) should be amended to provide that the court may assess the costs of the proceedings, as equity may require, against the dissenting shareholder if he or she rejects a settlement offer in bad faith.²⁸ This approach would create an incentive to settle prior to the appraisal proceeding. Likewise, the court would then have greater flexibility in assessing costs against the party that has acted in bad faith. A policy emphasizing settlement prior to the appraisal proceeding would benefit both parties. The dissenting shareholder would benefit by receiving payment for his shares in a relatively short period of time. The corporation would benefit by meeting its statutory obligation to purchase the shares, while avoiding adverse publicity, costly proceedings, and unwelcomed inspection of corporate records.²⁹ Such an approach would effectively promote the intent of the I.B.C.A. Advisory Committee to promote settlement prior to court appraisal.³⁰

Once the dissenting shareholder elects to utilize the appraisal remedy, he or she is not thereafter precluded from other forms of relief. The I.B.C.A. explicitly states that a dissenting shareholder may challenge the corporate action if that action is fraudulent or constitutes a breach of the fiduciary duty owed to the shareholders.³¹ This language adopts the "fairness" test enunciated in a recent Delaware Supreme Court decision, *Weinberger v. UOP, Inc.*³² The *Weinberger* "fairness" test³³ requires that the fiduciary duty the majority stockholders owe to the minority stockholders must be proved. This "fairness" requirement focuses on whether the proposed transaction is equitable to the minority shareholders. Incorporation of the "fairness" requirement as an alternative to the appraisal remedy is equitable to all parties concerned.³⁴

28. See Note, *Appraisal of Corporate Dissenters' Shares: Apportioning the Proceeding's Financial Burdens*, 60 YALE L.J. 337, 344 (1951).

29. *Id.* at 346.

30. See 2 THE ILLINOIS BUSINESS CORPORATION ACT ANNOTATED WITH FORMS 59 (3d ed. 1984 Supp.).

31. ILL. REV. STAT. ch. 32, § 11.65(b) (Supp. 1983).

32. 457 A.2d 701 (Del. 1983).

33. *Id.*

34. Delaware law is considered important because a great number of publicly

The Illinois Business Corporation Act of 1983 includes a comprehensive revision of the dissenting minority shareholder's appraisal remedy. Many improvements have been made in the appraisal remedy under the I.B.C.A., yet there is still room for improvement. The amendments suggested above would improve its effectiveness and remove certain ambiguities. Incorporating these suggested amendments into the I.B.C.A. would materially enhance its effectiveness as an equitable tool of the dissenting minority shareholder.

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traded corporations are incorporated in that state. See Herzel & Colling, *Squeeze-Out Mergers in Delaware-The Delaware Supreme Court Decision in Weinberger v. UOP, Inc.*, 7 CORP. L. REV. 195-96 (1984). Also, other states monitor the Delaware decisions and adopt most of the corporate decisions into their own laws. *Id.*