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Appraisal of Shares of Dissenting Stockholders in Consolidation - American General Corporation v. Camp, et al.

APPRAISAL OF SHARES OF DISSENTING STOCKHOLDERS IN CONSOLIDATION — *AMERICAN GENERAL CORPORATION V. CAMP, ET AL.*[1]

Eight separate but allied corporations[2] consolidated into one corporation known as American General Corporation. The vote of the stockholders was not unanimous, but the dissentients (preferred stockholders) were the owners of much less than the amount required to prevent the consolidation. The dissenting stockholders demanded payment for their stock, but were unable to agree with the defendant upon the fair value and filed a petition in the Circuit Court of Baltimore City for the appointment of three disinterested commissioners to appraise the fair value of their stock. The commissioners determined the fair value of the stock to be its intrinsic value on a liquidation, and made an award based thereon including interest from the date of the consolidation. The dissenting stockholders and the defendant corporation each excepted to the award made by the Commissioners.

On appeal the award was modified. The award itself was proper but interest should not have been allowed.[3] The Commissioners properly found that the fair value of the stock was its intrinsic value in a liquidation.[3a] The award made by the Commissioners is presumed correct unless clear evidence shows that the award was incorrectly made.

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[1] 190 Atl. 225 (Md. 1937).

[2] Seven were Maryland corporations and one was a Delaware corporation.

[3] The decision of the court on this point has been changed by Acts, 1937, Chapter 504, which provides that interest shall be allowable from the date of the consolidation.

[3a] Throughout the opinion, however, the Court emphasized that value upon a liquidation was not the only factor to be considered in an appraisal.

Before the adoption of statutes authorizing the consolidation,[4] or merger[5] of assets of a corporation upon the consent of less than all of the stockholders, neither a solvent corporation nor one in failing circumstances, could merge or consolidate with any other corporation against the dissent of a single stockholder.[6] With the advent of such statutes and those giving to dissenting stockholders the right to receive the fair value of their stock, the problem of stock valuation and appraisal has arisen.[7]

The Maryland statute[8] provides that dissenting stockholders shall be entitled to receive the "fair value" of their stock, and if there is disagreement as to that value then, upon petition, the Court will appoint "three disinterested commissioners" to appraise the fair value "without regard to any depreciation or appreciation thereof in consequence of the said consolidation or merger."[9]

The opinion of the Court of Appeals in the principal case is careful to point out that the very nature of stock valuation precludes formulation of specific rules of uniform application and this statement is in accord with well-reasoned authorities.[10] But the Court continues in the following language: "So, when such a situation develops (termination of stock ownership by merger or consolidation) it is logical and consistent to infer that the fair value of such stock to a dissenting owner is its intrinsic value on a liquidation."

And in the preceding paragraph the following language was used: "Thus, by an ascertainment of all the assets and liabilities of the corporation, the intrinsic value of the stock, and not merely its market value, when traded in by

[4] Md. Code, Art. 23, Secs. 33-34.

[5] Ibid.

[6] Starret Corporation et al. v. Fifth Ave. & Twenty-ninth Street Corporation et al., 1 Fed. Supp. 868 (D. C. S. D. N. Y.) 1932; American Seating Co. v. Bullard, 290 Fed. 896 (C. C. A. 6th 1923); Lattin, *Remedies of Dissenting Stockholders under Appraisal Statutes* (1931) 45 Harv. L. Rev. 233, 234, notes 1 and 2; Ferguson, Ex'r. v. Meredith et al., 1 Wall. 25, 68 U. S. 25, 17 L. Ed. 604 (1863); Geddes v. Anaconda Copper Mining Co., 254 U. S. 590, 65 L. Ed. 425, 41 S. Ct. 209 (1921).

[7] For a general discussion of the problem see the following: Bonbright, Valuation of Property (1937), Vol. II, Ch. 25; Lattin, op. cit. supra note 6; Weiner, *Payment of Dissenting Stockholders*, (1927) 27 Col. L. Rev. 547; Levy, *Rights of Dissenting Shareholders to Appraisal & Payment*, (1930) 15 Corn. L. Q. 420; Robinson, *Dissenting Shareholders; Their Rights to Dividends and the Valuation of Their Shares*, (1932) 32 Col. L. Rev. 60.

[8] Md. Code Supp., Art. 23, Sec. 35.

[9] This section has been amended in regard to the interest provisions. See supra note 3.

[10] Lattin, op. cit. supra note 6, 270; Matter of Clark, 257 N. Y. 487, 178 N. E. 766, 79 A. L. R. 608 (1931).

the public, would be determined. If the dissenting owner receive this amount, so ascertained, he would receive the fair value of his stock."

It would seem that the Court has in one paragraph definitely refused to lay down any conclusive method of valuation and in the surrounding paragraphs has proceeded to hold that stock valuation in cases involving a merger or consolidation must always be based upon asset value in liquidation. If the Court is merely saying that in the particular circumstances of the principal case, asset value in liquidation corresponded to the fair value of the stock, the language employed would seem to be unfortunate since the clear import of the paragraphs cited is that the Court relies upon "intrinsic value on a liquidation" as the test of fair value.

If, as is indicated by the opinion, fair value of stock is to be determined by ascertaining the value of the stock as if the company were being liquidated, a number of vital criticisms appear. First, the company is not being liquidated and consolidation is frequently effected to prevent that very situation, thus a standard based on putative dissolution is paradoxical.[11] Second, as a practical matter, where the asset value is greater than the market value (and it was very much greater in this case[12]), such an attractive alternative is held out as to place a premium upon dissent and thus completely to thwart any efforts to consolidate. This fact is doubly apparent when it is realized that the dissenting stockholder is able materially to increase his position by taking the asset value and buying in stock in similar companies on the market. Third, as a matter of logic, it would seem that consistency would demand that in cases of investment trusts, asset value be used in determining the value to the company of stock held in its portfolio. If this had been done in the instant case, it is possible that the asset value of the stock would have been higher. The objection to this contention is sufficiently forceful to warrant its discard.[13] Fourth, appraisal on a strictly asset in liquidation basis leaves out of account all the elements

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[11] Robinson, op. cit. supra note 7, p. 75.

[12] As of November 22, 1935, the asset value of the International Securities Corporation was $91.47. The market value of the stock, the day the terms of the consolidation were made public (October 24, 1935), was 50 bid, 54 asked. The news of the consolidation caused a drop of almost $10 per share. See Record pages 30-34, 71, 87-88.

[13] Such an appraisal would lead logically to the Herculean task of delving into the value of each of the corporations whose shares are held by the corporation whose own shares are being valued.

which contribute to or detract from value as incidental to a going enterprise, since it is obvious that were a liquidation to take place, there could be no going concern value.

Although the Court of Appeals made no mention of the fact, the briefs and records in the case reveal that the charter of the corporation specifically provided that a consolidation or merger should not be treated as a liquidation.[14]

That this received no attention from the Court would seem proper in view of the fact that to decide otherwise would be in effect to say that the stockholders of a corporation might by charter provision prevent the dissenting stockholders from receiving what the court has otherwise determined constitutes fair value of stock. The decision, however, does not seem to impair these charter provisions, as the Court does not base its conclusion on the view that the consolidation is a liquidation-dissolution giving rise to the contract right of preferred stockholders to receive par and accumulated dividends.

The Court of Appeals repudiated market value as constituting fair value in the principal case for what are considered to be valid reasons. The evidence clearly showed that the stock of the corporation was seldom traded and that the market was so inactive as to afford no accurate basis for fair value. It was intimated that had the stock been active, market value would have been a definite but not conclusive indication of the stock's fair value.[15] That market value of stock should never be more than indicative of fair value would seem apparent when it is realized that there are infinite outside influences which affect the stock exchange. The market is so super-sensitive that the price of a particular stock at any particular time is bound to be conditioned by the mood of the buying and selling public at that instant.[16] In other words, it is obvious that human

[14] Defendant's Exhibit No. 3, Record, page 25. Note particularly that the provision had been placed in the charter by way of amendment a relatively short time before the consolidation was announced.

[15] Robinson, op. cit. supra note 7, p. 74, suggests that objections to the market value standard "should perhaps be waived in the instances when the sole assets of a corporation are shares of stock of other corporations. Market prices as the standard would then be more desirable and expedient."

[16] The Chancellor, in Chicago Corporation v. Munds, 172 Atl. 452, 455 (Del. Ch. 1934), used the following language: "The experience of recent years is enough to convince the most casual observer that the market in its appraisal of values must have been woefully wrong in its estimates at one time or another within the interval of a space of time so brief that fundamental conditions could not possibly have become so altered as to affect true worth. Markets are known to gyrate in a single day. The numerous causes that contribute to their nervous leaps from dejected melancholy to exhilarated enthusiasm and then back again from joy to grief, need not be

psychology plays such an important role that the stock market prices from day to day reflect factors utterly divorced from the actual value of the stock.[17] It is submitted that stock market value is properly indicative only over a relatively lengthy period; it is the average market value alone which becomes significant. To the criticisms of market value suggested by the Court, there should be added one which the Court failed to mention but which would seem the most compelling. "Overlooking entirely the question whether the market prices are 'fair' in the sense that they reflect the bids and offers of intelligent investors, the total objection to market value is that it reflects the influence of the very sale or merger against which the dissenter is seeking a remedy. The market does not wait until the corporate action has taken place before it discounts the event. Often the transaction will be anticipated months, occasionally years, in advance. Moreover, it is the frequent practice of bankers and promoters of mergers themselves to peg the market for the stocks of the constitutent companies in order to make the transaction seem equitable and advantageous to all interests."[18] The above quotation is particularly penetrating when considered in the light of the Maryland statute which expressly provides that the fair value of the stock shall be ascertained entirely apart from any increased or diminished value occasioned by the merger or consolidation.[19]

One thing more might be said in regard to market value as a standard. The purpose of the statute is to give a specific right to non-assenting shareholders. Yet if the anticipated merger or consolidation has resulted in a rise in the price of the stock, then, if the stock has a ready market, the dissenter will dispose of his shares without resorting to his statutory remedy. "It is thus only when the market price goes down that the dissenter is likely to seek payment from

reviewed. . . . The relation of supply to demand on a given day as truly affects the market value of a stock as it does of a commodity; and temporary supply and demand are in turn affected by numerous circumstances which are wholly disconnected from considerations having to do with the stock's inherent worth."

17 The Committee on Valuation of Secuities of the National Convention of Insurance Commissioners adopted the following resolutions in 1931: "Resolved, that the Committee . . . is of the opinion that under present conditions the market quotations on stocks and bonds for a particular day are not a fair standard for the ascertainment of fair market value of such securities and recommends as a present substitute therefor the average price of stocks and bonds as reflected by the exchanges for a range of five quarterly periods ending September 30, 1931."

18 Bonbright, op. cit. supra note 7, p. 828.

19 Supra note 8.

the corporation and then only if he feels that the intrinsic value will prove sufficiently greater than what the shares can bring on the market to warrant the trouble of starting the necessary proceedings.[20] It is submitted, therefore, in the light of these factors that the statute loses most of its efficacy if the fair value of the stock is to be the market value.

An analysis of the cases reveals only one court which has held market value alone to be the test and the result in the cases from that jurisdiction depends upon the specific provision in the New Jersey statute that the dissenter shall be entitled to the full market value of his stock.[21] It is true that a majority of courts consider market value as an important indication of value,[22] but those courts correctly recognize that modifying factors[23] may render that indication of little value.[24]

Ultimately it should be borne in mind that the shareholder in a corporation generally has purchased his stock as an investment. He realizes that the stock may go down, perhaps he visualizes a temporary suspension of dividends, but he feels that over a period of time his purchase will yield valuable returns. With this in mind it would seem particularly important to minimize market value as an indication of true value. The stockholder was a part of a going business which he felt would be financially successful and through no fault of his own and over his protest he has suddenly found himself offered the market value of his stock or stock in a new corporation having rights of lesser value than his original purchase.[25]

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[20] Levy, op. cit. supra note 7, p. 438.

[21] Matter of Morris Canal & Banking Co., 104 N. J. L. 526, 141 A. 784 (1928); Prall v. United States Leather Co., 6 N. J. Misc. 967, 143 Atl. 382 (1928) aff'd., 105 N. J. L. 646, 146 Atl. 916 (1929).

[22] Cole v. Wells, 224 Mass. 504, 113 N. E. 189 (1916); Republic Finance & Investment Co. v. Fenstermaker, 6 N. E. (2d) 541 (Ind. 1937).

[23] Particularly obvious factors are those such as existed in principal case, i. e. where there is no readily ascertainable market value due to the scarcity of transactions and where there is evidence that the public was hostile to and had lost confidence in stocks of the nature in question.

[24] The language of the Indiana court in the most recent case on this subject, Republic Finance & Investment Co. v. Fenstermaker, supra note 22, was as follows: "Stock market value is not necessarily a true criterion, since fluctuations are sometimes attributable to causes other than changes in the value of the shares, but it may be of some assistance in determining values."

[25] "The minority should not be forced to continue in an enterprise radically different from the venture on which they originally embarked, or in an essentially altered status." Levy, op. cit. supra note 7, p. 421; in Chicago Corporation v. Munds, supra note 16, the Chancellor pointed out that while market value may be a proper measure in an action for the tortious

The Commissioners found that "prices obtainable for the shares of preferred stocks were so much below the net asset values that neither good will nor going business value could be assumed to exist." To attempt to analyze the problem of the good will or the going concern value of an investment trust is beyond the scope of this note, but it would seem that a company whose sole assets consist of securities would have a going concern value of some importance since it is admitted that even a small degree of appreciation of the company's portfolio would have put the concern into a sound financial position. Statistics[26] reveal that a rise of 11% in the asset value would have enabled the company to pay par and accrued dividends. While it is also true that a 28% decrease in asset value would have wiped out all asset value applicable to preferred stock, nevertheless at the time of valuation it was generally conceded by economists and statisticians that we were experiencing a rising market. In view of the foregoing there would seem to be merit in ascribing to the corporation some value as a going concern. However, as previously pointed out it should be noted that no going concern value could be properly allowed if the court persists in treating the problem from the standpoint of liquidation, for in the case of a liquidation there is no going concern value.

While there are a number of cases on the subject of valuation of dissenters' shares within the appraisal statutes[27] there are only two precisely in point with the principal case in dealing with preferred stock in a so-called investment trust.[28] In the *Chicago Corporation case*[29] the court rejected the contention that merger in effect amounted to dissolution pointing out that an appraisal of portfolio value alone is deficient in not considering value as a going

conversion of stock by an outsider, such rule would not be a proper solution of . . . controversies between stockholders. He said: "But how can the payment to the holder of stock of its market value put him in the way of restoring his position as a continuing part owner of a going corporation, when a merger has destroyed its individual identity and wiped out of existence all the stock of the kind he owned. As there is none in existence, none is available to be bought. The only restoration that can be made to him is to substitute for the vanished stock its intrinsic worth . . ."

[26] Record, pp. 44-51, 111, 116.

[27] For a collection of these cases see 45 Harv. L. R. 233, 258; 15 Corn. L. R. 420, 436; 32 Col. L. R. 60, 66. A Maryland case not arising under Md. Code, Art. 23 Sec. 35 but interesting for its discussion of corporate values is Homer, et al. vs. The Crown Cork & Seal Co. of Baltimore, 155 Md. 66, 141 Atl. 425 (1928).

[28] Republic Finance & Investment Co. v. Fenstermaker, supra note 22; Chicago Corporation v. Munds, supra note 16.

[29] Supra note 25.

concern. The opinion likewise rejected market value as an exclusive test. In the *Indiana case*[30] the court rejected both market value and asset value in liquidation, the following language being used: "The value of shares of stock as of any given time must, of course, be determined from the value of the assets of the corporation, tangible and intangible. This does not necessarily mean the amount that the assets would bring upon liquidation, unless the corporation is shown to have been in distress and liquidation inevitable. Stock market value is not necessarily a true criterion, since fluctuations are some times attributable to causes other than changes in the value of the shares, but it may be of some assistance in determining values." The position taken by the court in the *Indiana case* was that every fact brought forward which has a tendency to indicate value should be taken into consideration, such as asset value, market value, book value, good will or going concern value, earnings and general economic conditions.

It was contended in the principal case that where *anything* is given to common stockholders it constitutes a recognition as a matter of law that the common stock is worth something and that preferred stock should be paid in full in order to preserve its contract priority.[31] The only appraisal case in which such a question seems to have been passed upon by the courts is the *Indiana case*[32] just discussed. There the court held that "considerations of policy or good will may account for allocation of stocks to common stockholders in merging companies, notwithstanding an allocation of stock on the strict basis of value might require that it go to the preferred stockholders."

The fact that 95% of the common stock of International Securities Corporation and 80% of the common stock of American Founders was held or controlled by a single entity should also be considered in applying general principles and tests of value in the appraisal cases. It should be borne in mind that all increase in asset value in American Founders and all over 11% increase in asset value in International Securities Corporation would inure exclusively to the benefit of the common stock, except as it afforded a cushion for the preferred. Furthermore the large amount of common stock outstanding substantially represented control of the corporation, despite the voting power

[30] Republic Finance & Investment Co. v. Fenstermaker, supra note 22.
[31] See brief on behalf of stockholders, pp. 61-73.
[32] Supra note 22.

of the preferred through default in payment of dividends. The control of the common stock would seem to have the following significance:

1. "Something for the common stock." The control of this stock, treating the corporation as a going concern, had a very real value despite the fact that in the International Securities Corporation if a liquidation occurred there would be nothing left for the common stock. The right to control some $17,000,000 of assets with the potential benefit that might so be derived would quite certainly bring a real price on the market. It is a well-known fact that controlling interest is often purchased although if immediate liquidation occurred, nothing could be realized on the investment.

2. The right of the common stock to control carried with it a correlative element of risk so far as the preferred was concerned. Even assuming honest but unsatisfactory management by the common, whether through error in judgment or inability to foresee unpredictable trends of the market, there was a very real risk that the preferred might, without the ability to prevent it, find its asset position impaired. As has so often been said, it is, however, the right of the common stock acting in good faith to control the destiny of a corporation, even though the course followed may appear to be financial suicide.[32a]

3. Because the corporation was a going concern and the statute required that valuation be made as if the consolidation were not conceived, the standard of valuation of the interest of preferred stockholders should not have been liquidation value as such. Even if the assets had consisted entirely of cash, it would seem to be clear that the interest represented by a minority preferred stockholder in such case where the right to continue the business rested with someone else, with the inherent risk of loss which this entailed, would be something less than the present aliquot share of that cash.

In the final analysis, it is submitted that the part the courts should play in stock valuation cases is a negative one. Instructions to the appraisers should point out that no indication of value by itself can be the sole basis of a determination of fair value. If the Court of Appeals has laid down for the future the rule that asset value in liquidation is controlling, it seems to run contra to the better reasoned text writers and authorities. It should be remembered that the problem involved is above all an economic

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[32a] See Powers Foundry Co. v. Miller, 166 Md. 590, 171 Atl. 842 (1934).

one and that if definite standards are necessary "they can better be derived by consulting the business man, the banker, and the industrial engineer, than the jurist, legal scholar, or lawyer."[33]

Perhaps the most encouraging thing about the opinion of the Maryland Court is the following paragraph: "In reaching a decision, the appraisal of the Commissioners must be given great weight, first, by the Chancellor and now by this tribunal. The presumption is that their award is correct, and effect will be given to their determination unless it appear by clear and satisfactory evidence that the award was, by reason of some material and prejudicial error of law, in conduct or of fact, not the fair value of the stock, without regard to any depreciation or appreciation thereof in consequence of the merger or consolidation."[34]

It should be pointed out that the decision affirming the award can be justified on the record without accepting the principle that "asset value in liquidation" represents the minimum proper award in such cases. The commissioners may well have felt that the market in the stock had been too "thin" to establish any reliable market value.[35] Whether selling values of so-called "comparable stocks," strongly urged by the defendant corporation but not mentioned by the lower or appellate court, should have been employed as an active factor in determining value would seem to be a matter within the commissioners' discretion. They may well have felt that the comparisons with the other companies selected were not sufficiently close to require that weight be given to such evidence in reaching their determination.

Viewed in its long-range aspects, the decision will be unfortunate only if commissioners appointed in future cases regard the opinion as laying down an instruction that "asset value in liquidation" is a conclusive minimum. If

[33] Lattin, op. cit. supra note 6, p. 270.

[34] See the following Maryland cases dealing with the weight to be given the decisions on facts of lay tribunals: Bonaparte v. Mayor and City Council of Baltimore, et al., 131 Md. 80, 86, 101 Atl. 594 (1917); Schemmel v. Gatch & Sons Contracting & Bldg. Co., 164 Md. 671, 166 Atl. 39 (1933); West, et al., v. United Railways & Elec. Co. of Baltimore, 155 Md. 572, 582, 142 Atl. 870 (1928).

[35] Record, pp. 51-52. Testimony at this point indicated that only five or six quotations were made over a six months period. The last published statement of assets prior to notice of the consolidation, showed an asset value of only $46.17 per share of preferred, while the so-called market value immediately prior to the notice was $52 per share. Stockholders, therefore, made the argument that market value in this case was merely a reflection of the public's impression of the assets back of the stock, and for that reason not entitled to much weight in fixing the intrinsic or fair value.

an active market value is shown, the average prices at which sales are consummated, whether above or below asset value, cannot properly be ignored.

A rule definitely fixing either asset value or market value as the test to determine fair value clearly fails to recognize that value when applied to stocks is a combination of many elements none of which can be ignored. The ultimate result must be an analysis of all existing elements not as entities but as relationships. The closer a court approaches establishing a specific test the farther it will have strayed from establishing the correct general test.